OFFICE OF FAIR TRADING

Classified directory advertising services

Review of undertakings given
by BT to the Secretary of State
in July 1996

May 2001

OFT332

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Further advice from the Director General of Fair Trading to the Secretary of State of Trade and Industry.

1 SUMMARY OF FINDINGS AND RECOMMENDATIONS

Introduction

1.1 This is a report to the Secretary of State for Trade and Industry on the review by the Office of Fair Trading (OFT) of the undertakings given by British Telecommunications plc (BT) in respect of its Yellow Pages division (BTYP) on 23 July 1996 following the investigation and report by the MMC in 1995/6.

1.2 Under section 88(4) of the Fair Trading Act 1973 (FTA), the Director General has a duty to keep under review the carrying out and effectiveness of undertakings in addressing the adverse effects identified by the MMC in their public interest findings.

1.3 I therefore recommend that you direct me to seek BT's agreement to the amendment of the undertakings in line with the recommendations set out below.

Findings

1.4 We have concluded that the relevant market remains that for the supply of printed classified directory advertising services in the UK and that BTYP continues to have a dominant position in that market. Effective competition is absent from the market and effective competition from new entry is not likely in the foreseeable future. We have concluded that, due to the lack of competitive constraint in the market, the adverse effects identified by the MMC will continue to exist for the time being unless there is effective regulatory intervention by means of suitable undertakings. We have noted the growth of electronic classified directory advertising services in recent years; it remains to be seen how much they will in due course constrain market power in the provision of printed classified directory advertising services.

1.5 Despite the price cap since the 1996 report, BTYP has maintained exceptionally high levels of profitability. Its Return on Sales (ROS) has been persistently over 40%. The mean ROS for three groups of companies used for comparison is between 3% and 14% over a three year period.

Recommendations

1.6 I recommend that the price cap on BTYP be tightened significantly. In particular, I recommend that it be amended to bring BTYP's ROS towards that which could be expected in a competitive market. BTYP should be required to cut its rates by 15% on 1 Jan 2002 and then by RPI-4 on 1 January 2003, 2004 and 2005. Based on BTYP's forecasts, this will result in a ROS higher than [...]% but approaching that level by 2005. For a business such as BTYP that is a very high rate of profit.

1.7 I have considered BTYP's request for a more flexible price cap, but on balance do not recommend any change (with the exception of allowing more freedom on discounts). The fixed price cap is transparent, prevents anti-competitive conduct and protects all advertisers (and ultimately consumers) from excessive prices.

1.8 I recommend that BTYP be released from the undertakings concerning discount schemes and increases to published rates. On balance, the risk that these practices could be used with exclusionary or anti-competitive effect is sufficiently reduced by the retention of the fixed price cap together with my new powers under the Competition Act 1998.

1.9 The undertaking requiring BTYP to seek the Director General's approval to changes in business practice in relation to the range of advertisement sizes or features and the ordering of entries has not had any apparent pro-competitive effect. This undertaking is onerous and without much benefit to advertisers and ultimately consumers. It could be a disincentive to innovation and prevent BTYP from responding to customer demands. I recommend that BTYP be released from this undertaking too.

1.10 The undertaking concerning the calculation of new rates following rescoping of a directory has proved effective in preventing a circumvention of the price cap and I recommend that this undertaking should be retained.

1.11 I recommend that the undertaking that prevents BTYP from distributing, except on request, a copy of a directory outside its distribution area be amended for the few areas where BTYP receives a significant number of requests. Where the area affected accounts for less than 5% of the home directory circulation, I recommend that BTYP be allowed to make either a double delivery or deliver the directory from an adjoining area. Where the area affected accounts for 5% or more of the directory circulation, I recommend that BTYP be allowed to insert a card in each directory offering the recipients the opportunity to receive a second directory.

1.12 The publication of local directories is likely to continue to allow BTYP to target competitors directly. Save in areas where BTYP is the only provider of printed classified directories, the undertaking concerning the prohibition to publish local directories should remain.

1.13 I recommend that the undertaking concerning the release of accounts be amended such that BTYP is required to file its accounts no later than the date BT files its own accounts, whether or not it is incorporated. I recommend no change to the type of information BTYP should provide.

1.14 I recommend that undertakings concerning the publication and distribution of the rate card, good faith, the preparation and availability of accounts, and the provision of information required by the OFT for monitoring purposes remain unchanged.

2 BACKGROUND

2.1 In their report ‘Classified directory advertising services’, Cm 3171, published March 1996, the MMC concluded that a monopoly situation existed in favour of BT in the supply of printed classified directory advertising services in the UK and that:

a) the charging by BTYP of prices higher than would be the case if competition were effective was a step taken for the purposes of exploiting the monopoly situation; and

b) BTYP’s publication of local directories was a step taken by BTYP for the purpose of maintaining the monopoly situation and an action attributable to the existence of the monopoly situation (paragraph 2.100).

2.2 These practices were found to be against the public interest.

2.3 The MMC concluded that measures to encourage new entry or strengthen competition would not by themselves be effective in remedying the adverse effects and recommended price control comprising a price cap of RPI-2 (paragraph 2.116 (c)). The MMC also recommended (paragraph 2.116(d)) that BTYP be prohibited from publishing or distributing more than one classified directory covering or including all or part of any particular area. Both of these recommendations were incorporated into the undertakings given by BT.

2.4 The recommendation (paragraph 2.116(a)) that BT be required to establish BTYP as a separate subsidiary was rejected by the Secretary of State. Instead, BT was asked to give undertakings regarding the preparation and publication of financial information relating to BTYP.

2.5 In addition to formal recommendations on remedies, the MMC urged BTYP to give attention to a number of issues related to customer service and business practices such as rescoping of directory areas. BT gave undertakings on the provision of rate card information and changes in business practice. A copy of the undertakings signed by BT is attached at Annexe A.

3 THE REVIEW

3.1 My predecessor announced this review in May 2000 with the aim of establishing the appropriate level of regulation for the future.

3.2 We have consulted widely with BTYP, Thomson, other directory producers, electronic information service providers, and representatives of advertisers, such as trade associations. A consultation paper was published on 24 May 2000 and placed on the OFT's website. The closing date for initial responses to the consultation document was 17 July 2000. The narrative section of the consultation paper, including the summary of the MMC report, is provided as Annexe B. The detailed views of BTYP and other interested parties are set out at Annexe C.

BTYP's views

3.3 BTYP's view is that printed directories are part of a wider classified advertising market, including local newspapers, specialist classified publications and electronic directories. BTYP argues that price control is no longer necessary. It regards a price cap of more than RPI-0 as compromising its efforts to improve the quality of service, and argues for a more flexible price cap which relates to a basket of prices. BTYP does not think that it should have to seek the consent of the Director General to the withdrawal of a discount.

3.4 On non-price undertakings, BTYP asks for an amendment in relation to a few directory areas where it receives regular requests for a copy of the neighbouring area directory. For these areas BTYP wishes to include a card with each directory offering recipients the opportunity to receive a second directory.

Competitors' views

3.5 Competitors generally held the view that the relevant market is that for printed classified directories and that this market has changed little since the MMC inquiry. Only one competitor argued that non-printed directories are part of the same market, but still saw Yellow Pages as the undisputed leader, considered by advertisers as a "must have".

3.6 Competitors are in favour of the removal of the price cap. They see this as disadvantageous to their businesses and as discouraging potential new entry and innovation.

3.7 Rescoping is seen as a means of targeting competitors and leading to a loss of market share.

Trade Associations

3.8 We received responses from ten trade associations covering a large proportion of advertisers in classified directories. Generally, they were of the view that there is no effective alternative to advertising in Yellow Pages. There has been no significant new entry into the market for printed directories. Classified advertising by means of electronic services currently posed no substantial competitive threat to Yellow Pages.

4 ANALYSIS

4.1 This review has considered whether there is value in maintaining the undertakings in their current form or a modified form or whether they should be discontinued altogether. In considering this we have examined how the market has developed since the undertakings were given.

4.2 The MMC defined the relevant market to be the supply of printed classified directory advertising services in the United Kingdom excluding specialist directories. These services are described in more detail at Annexe D. BTYP and Thomson were estimated to have 84% and 14%, respectively, of this market (paragraph 2.7). The MMC considered that electronic classified advertising might well pose strong competition to printed directories in the longer term, but that the timing and extent of such developments were very uncertain. Telephone-based services were considered to be an alternative to printed classified directory advertising services, but the limited use made of these products and the fact that Talking Pages is owned by BTYP meant that whether they were included in the same market as printed classified directory advertising services was not important to the assessment of competition.

4.3 The MMC examined the extent to which other media, such as television and national, regional and local newspapers, competed with printed classified advertising directories. They concluded that the product characteristics (such as the aim of the advertising, the type of advertisement and the retention period of printed products) were not sufficiently similar that they could be included in the relevant market (paragraph 2.37).

4.4 We have re-examined the two dimensions of market definition: product and geographic. We looked at the scope for substitution on both the demand side and the supply side.

The relevant product market

4.5 The key issue is whether advertisers consider other media to be alternatives to printed directories. In particular, it is whether advertisements in other printed media, telephone-based services or electronic services are considered to be sufficiently substitutable for advertising in printed classified directories. The effectiveness of other media in reaching the target audience will depend on the attractiveness of these media to the target consumers (people who use the directories).

4.6 The essential characteristics of advertising in printed directories are that the directories are readily available to users and are comprehensive, they are targeted at a local area and widely distributed in that area, and they are standard references in that an advertisement may be repeatedly referred to throughout the duration of a directory (usually a year). These characteristics might make classified directory advertising to some degree complementary to other media.

4.7 BTYP's views on the relevant product market are summarised at paragraph 3.3 above and set out in greater detail at Annexe C.

4.8 The characteristics of the media and advertisers have not changed substantially since the time of the MMC review, which found the relevant market to be that for the supply of printed classified directory advertising services. In general, Trade Associations in responding to the consultation paper said that for their members there was no substitute to advertising in Yellow Pages. BTYP's own market research shows that value for money is the most important consideration for its advertisers and that Yellow Pages has been consistently regarded as offering greater value for money than local newspapers. There is also no evidence that prices of other media have become a greater constraint on BTYP's prices. In particular, BTYP has increased all its rates by the maximum allowed by the price cap except in a few instances. It has told us that it would raise prices in line with RPI if released from the price cap.

4.9 The turnover of telephone-based products is small relative to printed directories and they have been declining relative to printed directories.

4.10 BTYP's Talking Pages, a freephone classified directory advertising service, had a net revenue in 1999/2000 of about £15m compared with some £475m for Yellow Pages. In the four years to 1999/2000, the number of unique advertiser accounts in Talking Pages fell from [...] to [...]. Scoot also provides a telephone-based classified directory advertising service, with 1999 revenues of just below [...].

4.11 We have no evidence to suggest that users or advertisers would switch readily between printed and telephone-based directory services. Even if telephone-based products were in the same market as printed classified directories, they would not significantly dilute BTYP's market share.

4.12 A range of classified directories is available on the Internet, from comprehensive listings to those specialising in a particular service or range of services. BTYP, Thomson and Scoot all offer comprehensive classified directory advertising listings through the Internet, although for BTYP and

Thomson these will not necessarily have the same advertisers as their printed directories. BTYP said that AskAlex.co.uk and Fish4it.com offered comprehensive UK business listings also. As well as being available through their own web sites, some services are also offered in conjunction with other service providers: Thomson, for example, has an arrangement with Lycos, and BTYP with Excite.

4.13 BTYP also referred to specialist services such as Autotrader.co.uk, Smoothound.co.uk and e-street.com. These do not, however, provide advertising across a comprehensive range of goods and services and some are limited to only certain parts of the UK.

4.14 We recognise that, since the MMC investigation, there have been considerable technological advances in the capability of electronic media and that electronic classified directories are growing rapidly. They also offer certain advantages over printed directories. However, at present there is no good evidence that electronic classified directories are offering strong competition to printed directories, or that they are likely to do so in the immediate future.

4.15 The evidence is that few advertisers are so far purchasing classified directory advertising services in electronic format. For Yell, Thomweb and Scoot, the largest providers by revenue, Table 4.1 shows that their combined 1999 revenue was less than [...]% of that for printed directories.

TABLE 4.1 - REVENUES AND SHARES IN THE SUPPLY OF ELECTRONIC DIRECTORY ADVERTISING

	1996		1997		1998		1999	
	Sales (£k)	Share (%)	Sales (£k)	Share (%)	Sales (£k)	Share (%)	Sales (£k)	Share (%)
Yellow Pages [1]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Thomweb [2]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
Scoot [3]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]

[1] BTYP's financial year ends on 31 March of the following year
[2] Thomson's financial year ends on 31 December.
[3] Scoot's financial year ends on 30 September.

4.16 The number of users with access to the Internet is increasing. But while there continues to be a large number who do not have access to the Internet, we would expect advertisers who want the widest possible reach to the local population to continue advertising in printed directories. We conclude that advertisers do not yet see the Internet as a substitute for printed directories.

4.17 We recognise that not all consumers or advertisers will need to consider electronic products to be substitutes for printed directories for these products to be in the same relevant market. We also recognise that for advertisers the choice is not necessarily one of advertising either in a printed or in an electronic directory. An advertiser may be able to reallocate advertising expenditure between printed and electronic directories. However, the limited market penetration of electronic directories to date suggests that electronic products are unlikely to have a significant erosive effect on the demand for printed products in the foreseeable future or to bring competitive discipline to Yellow Pages. This view is consistent with BTYP's comments based on market research it had commissioned.

4.18 Finally, if effective competition from other forms of classified directory advertising services had emerged since the MMC inquiry, we would have expected prices to have fallen below the level required by the price cap. With insignificant exceptions they have not done so. BTYP told us that in the absence of the price cap it would have increased prices in line with RPI. It added that if the price cap were to be removed, this would be its intended practice for the future also.

4.19 For other printed or non-printed media to be in the same market as printed classified directories on the grounds of supply side substitution, suppliers of these other products would have to be able to switch resources quickly and easily to the supply of printed directories. This is not the case for the same reasons that barriers to entry are high in the market for printed classified advertising directories (see paragraph 4.27 below).

The relevant geographic market

4.20 The MMC did not discuss the relevant geographic market but concluded (in paragraph 2.4 of their report) that a monopoly situation existed in relation to the supply of classified directory advertising services in the UK.

4.21 Printed classified directories are essentially a local product for both advertisers and users, in the sense that they are published and distributed in discrete geographical areas. Directories for different geographic areas will not be substitutes for each other and, in principle, publishers could set rates for directories to reflect the local market conditions including the strength of local competition. These are all features of the supply of printed directories that might be consistent with a local market definition.

4.22 However, both BTYP and Thomson have a national presence and what competition there is between them would seem to be taking place at a national level. Both BTYP and Thomson have argued that the primary focus of competition is the offering of differentiated products. The positioning of their directories is the same across the UK, and prices are determined largely at a national level by a general relationship which relates advertising rates to directory circulation. Discount schemes are available nationally and other marketing efforts are not generally directed at particular areas.

4.23 In practice, whether the market is defined to be national or local is not critical to our analysis. The market structure is broadly the same at local and at national level, with BTYP clearly having a dominant position. For the purposes of this report, we have presented market share on the basis of a national market.

Conclusion on market definition

4.24 We conclude, as did the MMC, that the relevant market is the supply of printed classified directory advertising services in the UK.

Market Shares

4.25 There has been very little change in the competitive situation. BTYP still has a market share of around 83%, which is approximately the same as at the time when the MMC investigated. Although Thomson's financial performance has improved considerably since 1995 (see Annexe E), it has not succeeded in increasing its market share which remains at around 15% (and this share must be seen in the context of the restrictions on how BTYP competes locally). There has been no evidence to suggest that the share of other suppliers of printed classified advertising services has increased above 2%.

4.26 Table 4.2 below shows our estimate of BTYP's and Thomson's market shares over the period 1994 to 1999.

TABLE 4.2 - MARKET SHARES SINCE 1994

	1994		1995		1996	
	Sales (£m)	Share (%)	Sales (£m)	Share (%)	Sales (£m)	Share (%)
Yellow Pages [1]	344.4	84	380.3	84	402.3	83
Thomson [2]	57.1	14	64.1	14	70.5	15
Others[3]	8.2	2	9.1	2	9.6	2
Total	409.7	100	453.5	100	482.4	100

	1997		1998		1999	
	Sales (£m)	Share (%)	Sales (£m)	Share (%)	Sales (£m)	Share (%)
Yellow Pages	421.4	83	445.4	82	484.7	83
Thomson	78.2	15	84.7	16	86.5	15
Others	10.2	2	10.8	2	11.7	2
Total	509.8	100	540.9	100	582.9	100

[1] BTYP's financial year ends on 31 March of the following year

[2] Thomson's financial year ends on 31 December

[3] Estimated on the assumption that 'others' continue to have a 2% market share.

Note The figures are gross directory revenues, before waivers or other credits.

Barriers to entry

4.27 Barriers to entry remain very high. BTYP, and to a lesser extent Thomson, have established brand names with very wide recognition. In addition to this, the market is characterised by strong network effects. In particular, a directory will be more valuable to users if used by a larger number of advertisers and a directory will be more valuable to advertisers if widely consulted by users. Success, which in BTYP's case stemmed from the erstwhile monopoly position of BT, therefore breeds success. This makes it very difficult for a new entrant or a smaller player to challenge BTYP's position.

4.28 We therefore conclude that the relevant market remains that for the supply of printed classified directory advertising services in the UK and that BTYP continues to have a dominant position in this market.

Prices and Profitability

4.29 There is no evidence that Thomson is now a more effective constraint on BTYP's prices than at the time of the MMC inquiry. Save on a few occasions, BTYP has increased its prices by the maximum permitted by the price cap. The price cap, rather than competition from Thomson, has therefore limited price increases.

4.30 We have examined the relationship between the price cap and BTYP's profitability. In order to assess the effectiveness of the price cap we have examined BTYP's financial performance since 1990/91 to compare the position before and after the undertakings came into force.

4.31 The most commonly used measures of profitability for any company are Return on Sales (ROS) and Return on Capital Employed (ROCE). The MMC examined both BTYP's ROS and ROCE and found them to be high in comparison to other industries (see paragraphs 5.33 to 5.41).

4.32 The MMC found, however, that high ROSs and ROCEs were not untypical of companies in some sectors of the printing/publishing industry, but concluded (paragraph 2.43) that whereas "such high profitability may be justifiable for a company of exceptional performance in a competitive market, it raises questions in a company which is not subject to effective competition and which has steadily increased prices in real terms".

4.33 For regulated industries, such as the utilities, standard practice would be to assess a company's profitability by looking at ROCE (in relation to a company's capital asset base). If such an approach were adopted mechanically in the case at hand, it would point to a much greater tightening of the price control on BTYP than that proposed below. It is not, however, an approach that can be readily applied to businesses such as printed directories which have few tangible or physical assets in relation to turnover. Although BTYP has intangible assets, valuing these will always be subjective. A particular problem is that the market value of intangible assets will be determined by the expectations about the future revenue that assets are expected to generate, including any excessive profits resulting from the exploitation of a dominant position.

4.34 There are other approaches to the measurement and assessment of profitability. In the case of firms with mainly intangible assets, these tend to suffer, however, from the same problems of subjectivity and circularity in the valuation of assets.

4.35 In considering the profitability of BTYP we have therefore focused on ROS for the last ten years (see Table 4.3 below).

TABLE 4.3 - BTYP's FINANCIAL PERFORMANCE FROM 1990/1991 TO 1999/2000

	1990/ 91	1991/ 92	1992/ 93	1993/ 94	1994/ 95	1995/ 96	1996/ 97	1997/ 98	1998/ 99	1999/ 2000
Net sales (£m)	285.9	294.9	301.7	313.1	337.9	372.4	398.1	432.0	457.6	496.2
Direct costs (£m)	130.9	143.1	139.7	128.0	130.5	148.7	152.4	156.4	166.6	184.4
Gross profit (£m)	155.0	151.8	162.0	185.1	207.4	223.7	245.7	275.6	291.0	311.8
Overheads (£m)	54.0	54.8	56.1	60.4	69.6	71.3	79.7	99.1	98.4	106.5
Operating profit (£m)	101.0	97.0	105.9	124.7	137.8	152.4	166.0	176.5	192.6	205.3
Return on Sales (%)	35.3	32.9	35.1	39.8	40.8	40.9	41.7	40.9	42.1	41.4

Note 1 BTYP's financial year ends on 31 March.

Note 2 The figures for 1990/91 to 1994/5 are as shown in the MMC report. Both the MMC's figures and those for 1995/96 and later are for the UK directory business which includes Business Pages as well as Yellow Pages. BTYP told us that it could not separate out the profit attributable to the Yellow Pages directory business because important overheads (e.g. staff related costs) were allocated on an "as used" principle. The individual gross revenues for 1999/2000 were £484.7m for Yellow Pages and £16.5m for Business Pages. The figure of £496.2m represents net revenue after waivers.

4.36 We conclude from the above figures that BTYP has maintained levels of profitability that are somewhat higher than those observed by the MMC.

5 UNDERTAKINGS RELATING TO ADVERTISING RATES

5.1 Undertakings 5(1) to 5(5) all relate to the requirement on BTYP not to increase any price by more than RPI-2 starting from the base level of prices in 1996. They were obtained following the MMC's findings that BTYP's high prices could effectively be remedied only by direct price control. The MMC recommended a price cap of RPI-2 but stressed that they "would have proposed a stringent control on BTYP but for [their] concerns that such an approach may damage existing or future competition" (paragraph 1.9). In particular, the MMC expected and hoped that their recommendations would stimulate Thomson into sharpening its competitive challenge to BTYP.

5.2 We concluded at paragraphs 4.29 to 4.36 above that Thomson has not been an effective competitive restraint on BTYP's prices and profitability. Price control continues therefore to be the only effective way to ensure that prices are not higher than those which can be expected in a competitive market.

5.3 What is a reasonable level of profitability for BTYP is the key consideration in setting the price control. In setting the price cap, we considered whether we needed to take account of the effect on Thomson.

5.4 Both BTYP and Thomson are of the view that there is strong non-price competition between them. Thomson, in particular, said that its presence in the market had been a spur to innovation.

5.5 We were not persuaded, however, that the threat of losing business to Thomson, or the promise of attracting Thomson's advertisers, has been a crucial driver for the improvements BTYP has made in consumer satisfaction or for innovations such as the introduction of colour. These developments must in any event be judged against the background of advances in technology available to the printing industry. BTYP's business development effort has largely been aimed at promoting the use of printed directories by businesses which have not traditionally done so.

5.6 We have considered the means of assessing a reasonable ROS and what the comparators should be. As there is no single objective benchmark for determining a reasonable level of ROS, our approach has been to make comparisons with the ROS earned by other firms in taking a view on what might be a reasonable ROS for Yellow Pages.

5.7 In making such comparisons it is important to recognise that the ROS earned by other companies will be sensitive to their cost and capital structure (especially capital intensity), their degree of vertical integration, and to the level and type of risk to which they are exposed. We have therefore looked at the ROS earned by companies with similar activities to BTYP. These included media and publishing companies, and also communications, where some organisations are largely funded by advertising. We also looked at firms in these and other sectors with a low ratio of physical assets to turnover.

5.8 For our analysis we used Company Analysis, a database produced by Thomson Financial Publishing. Some results are summarised in Table 5.1 below and further detail is provided in Part I of Annexe F.

5.9 The average ROS over the three years was only 12% for all printing and publishing companies, 14% for communications companies and 3% for the 200 least capital intensive companies (excluding those earning negative returns).

5.10 Very few companies achieved a ROS above 25%. Only one printing and publishing company, Scottish Radio Holdings, achieved an average ROS over the three years of more than 25%, but it did not achieve a ROS of 25% or more in each year of the three years. Five communications companies achieved an average ROS of more than 25%. Two of these, however, National Grid plc and United Utilities, are primarily utility businesses which are relatively capital intensive which explains their ROS. The other three are more capital intensive than BTYP although two of them are not substantially so. Only three of these companies achieved a ROS greater than 25% in each of the three years and two of these were United Utilities and National Grid. The other was Granada Media. Even if one accepts the similarities between BTYP and this company it remains the case that only one company out of 54 has consistently achieved ROS in excess of 25%. None of the low capital intensive companies achieved an average ROS greater than 15%.

TABLE 5.1 - RESULTS OF THE COMPANY ANALYSIS

	Groups of companies		
Statistics	Printing & Publishing	Communications	Low assets: sales ratio
Percentage of observations with ROS above 25%	3.5%	9.6%	0%
Maximum ROS for:			
1st quintile	6%*	3%*	1%
2nd quintile	9%	11%	2%
3rd quintile	13%	18%	3%
4th quintile	16%	24%	5%
Average ROS across all observations			
All observations	2%	-69%	0.2%
Excluding negative ROS	12%	14%	3%
Number of companies achieving average ROS over the three years of more than 25%	1 (Out of 79)	5 (Out of 54)	0 (Out of 200)
No. of companies achieving > 25% in all three years	0†	3†	0

* Profitable Companies Only

† Granada Media plc /United Utilities plc/ National Grid Company plc

These figures show that a persistent ROS of greater than 25% would be a very high ROS for a company like BTYP.

5.11 BTYP argued that the appropriate benchmark should be the ROS earned by printed directory businesses in other countries. It provided us with a list of five European directory businesses, all of which published printed directories. Profitability figures were given for these companies, either as Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA), Earnings Before Interest and Tax (EBIT) or both (see Part II of Annexe F). Of the three EBITDA figures given, the lowest for 2000 was 29% with the highest being 34%. The EBIT figure for the latter company was 27%, with the only other two EBIT figures being 49% and 54%. BTYP's figures are BIT. Although one would expect to have a higher ROS under EBITDA than under EBIT, in BTYP's case there is little difference between the two.

5.12 However, it is not clear that international comparisons are appropriate in this case. Worldwide the supply of printed classified directory advertising services has similar characteristics to those observed in the UK including the dominant position of one player. In the absence of regulation of these businesses, there would be no reason to believe that the ROSs that they earn are reasonable. BTYP was not aware of any explicit price regulation in other countries.

5.13 In the light of the above, I conclude that it would be reasonable to impose a price cap on BTYP that would have the expected result of reducing its ROS in the supply of printed classified directory advertising services to one approaching […]% by 2005. This figure would still be very high in comparison with other companies.

Forecasts of BTYP's profitability

5.14 BTYP's forecasts in its Five Year Plan were based on the assumption of the price cap continuing at RPI-2 and were based on market research commissioned in July 2000. These projections are that if the current price cap were to remain, BTYP's profitability would remain close to […]%.

TABLE 5.2 - BTYP PROFITABILITY AT RPI-2

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Revenue (£m)	496.2	[…]	[…]	[…]	[…]	[…]
Op. Profit (£m)	205.3	[…]	[…]	[…]	[…]	[…]
ROS (%)	41.4	[…]	[…]	[…]	[…]	[…]

5.15 The Tables 5.3 to 5.5 below show BTYP's forecasts of revenue, operating costs and ROS on the assumption that prices are reduced by 15% on 1 April 2002 and then by either RPI-2, RPI-4 or RPI-6 on 1 April 2003 and on 1 April 2004.

TABLE 5.3 - BTYP PROFITABILITY FOR A 15% PRICE CUT FOLLOWED BY A CONTINUING RPI-2 FORMULA

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Revenue (£m)	496.2	[…]	[…]	[…]	[…]	[…]
Op. Profit (£m)	205.3	[…]	[…]	[…]	[…]	[…]
ROS (%)	41.4	[…]	[…]	[…]	[…]	[…]

TABLE 5.4 - BTYP PROFITABILITY FOR A 15% PRICE CUT FOLLOWED BY A CONTINUING RPI-4 FORMULA

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Revenue (£m)	496.2	[…]	[…]	[…]	[…]	[…]
Op. Profit (£m)	205.3	[…]	[…]	[…]	[…]	[…]
ROS (%)	41.4	[…]	[…]	[…]	[…]	[…]

TABLE 5.5 - BTYP PROFITABILITY FOR A 15% PRICE CUT FOLLOWED BY A CONTINUING RPI-6 FORMULA

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Revenue (£m)	496.2	[…]	[…]	[…]	[…]	[…]
Op. Profit (£m)	205.3	[…]	[…]	[…]	[…]	[…]
ROS (%)	41.4	[…]	[…]	[…]	[…]	[…]

Note 1: BTYP's forecasts are based on the assumption of RPI inflation throughout the period being 2%.

Note 2: Tables 5.2 to 5.5 show net revenues for the UK directory business which includes Business Pages as well as Yellow Pages. BTYP told us that it could not separate out the profit attributable to the Yellow Pages directory business because important overheads (e.g. staff related costs) were allocated on an "as used" principle. The individual gross revenues for 1999/2000 were £484.7m for Yellow Pages and £16.5m for Business Pages. The figure of £496.2 represents net revenue after waivers.

5.16 For the purpose of the calculations above, BTYP has assumed that demand would increase as prices fell, but that there is a limit to the extent that this would occur, and with sharp price cuts the additional volume of new business generated by a price cut would decline. With regard to costs, BTYP has considered in some detail how the major cost categories would increase with increases in demand. Generally these assumptions and others do not seem to be unreasonable in terms of the overall impact on profitability. However, there is no guarantee that the cost assumptions in these projections incorporate maximum efficiency on the part of BTYP. We have nevertheless used these forecasts as a basis for calibrating the appropriate level of the price cap.

5.17 For the purpose of the calculations above, BTYP took 1 April 2002 to be the date from which a new price cap would apply as the financial year starts in April and BTYP has already sold space for the financial year 2001/02 at the current rate card prices. To test the sensitivity of the forecasts to a change in the implementation date for a new formula to 1 January 2002 and subsequent years, we asked BTYP to provide us with a revised forecast showing the effect of a 15% price cut followed by RPI-6, as shown in Table 5.6 below.

TABLE 5.6 - BTYP PROFITABILITY FOR A 15% PRICE CUT FOLLOWED BY A CONTINUING RPI-6 FORMULA, FOR A NEW PRICE CAP STARTING ON 1 JANUARY 2002

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Revenue (£m)	496.2	[…]	[…]	[…]	[…]	[…]
Op. Profit (£m)	205.3	[…]	[…]	[…]	[…]	[…]
ROS (%)	41.4	[…]	[…]	[…]	[…]	[…]

5.18 Based on these projections, a price formula of a 15% price cut on 1 January 2002, followed by RPI-4 on 1 January, 2003, 2004 and 2005, would reduce BTYP's ROS from 41.4% in 1999/00 to approaching […]% by 2005. This represents a substantial reduction in prices and profitability compared with the position if the current RPI-2 were to remain (with no downward step adjustment), but a ROS of […]% remains very high in comparison with other companies.

5.19 Of those companies within our comparisons none achieved a ROS of […]% on a persistent basis. The mean rates of returns for the three groups of comparable companies over a three year period are between 3% and 14% (excluding those with negative rates). BTYP, on the other hand, has been able to maintain persistently high ROSs which lie significantly above those levels.

5.20 I have concluded that BTYP has been able to achieve consistently very high ROS only because of its market dominant position and the absence of any effective competition. There are good arguments for imposing a more stringent price cap on BTYP. However, the proposal of a 15% price cut on 1 January 2002 followed by RPI-4 in consecutive years achieves a significant fall in prices reasonably quickly and on balance seems right for the present price review. I will however continue to keep the market under review.

5.21 In BTYP's view, the price caps considered in tables 5.3 to 5.5 would adversely affect the interest of both its advertisers and users, through compromising the efforts it had made in recent years to improve the quality of service. BTYP was not saying that it would abandon its commitment to service quality, but an increase in demand for service together with a reduction in prices would noticeably reduce the margin available to provide that support. BTYP also believed that lower prices would undermine its incentives to invest.

5.22 In most markets it is the spur of competition that impels investment, and firms on average earn no more than a reasonable rate of return. In the case at hand, where competition is not an effective constraint, the price cap would impact on BTYP's ability to improve its quality of service only if it required BTYP to reduce prices to such an extent that it was unable to earn a reasonable return. This is not remotely demonstrated by BTYP's own projections.

Recommended Price Cap

5.23 In view of the consideration above, I recommend that BTYP be required to cut the advertising rates for all of its Yellow Pages directories published on or after 1 January 2002 by 15%, followed by RPI-4 for directories published on or after 1 January 2003, 2004 and 2005 respectively.

5.24 BTYP said that its current master rate card, dated January 2001, covers all directories to be published up to September 2002. BTYP should be required to reissue its current rate card with the new price cap being applied to any directory published on or after 1 January 2002. Sub-paragraphs 5(1) to 5(5) of the undertakings will need to be reworded to reflect the change in level of price cap and the date of its implementation.

5.25 On the basis of our assessment of the relevant market and the rate at which other services are likely to grow, particularly those available through the Internet, I recommend that this price cap be applied until 2005. Early review of the price cap may, however, be appropriate if there are significant changes in the market.

5.26 The current price cap applies to all prices such that no price can increase by more than the price cap.

5.27 BTYP argued that the result of the rigid form of the price cap has been to fossilise its price structure. Because of this it could no longer be sufficiently responsive to advertiser needs. If a price cap were retained, it would prefer a more flexible approach which would allow it to change its pricing structure within the overall price cap.

5.28 Price controls in the regulated industries typically operate on the basis of a tariff basket or revenue yield. The aim of setting a price cap in those industries is to bring prices and profitability into line with those that would be expected were competition more effective, and a price cap that applies to average prices may be sufficient to achieve this. However, in other regulated industries regulation has also had a role in determining charging structures.

5.29 BTYP put forward a proposal based on a price basket. Within it, there were options such as whether it would include some or all of the advertising rates, and whether the individual prices would be subject to a maximum price control.

5.30 BTYP's proposal was for four separate tariff baskets, for each of four advertisement sizes. Each would comprise prices for all directories, and the price for each directory would be weighted by the volume of sales. The weighted average price for each basket would be allowed to increase by the level of the price cap. BTYP also proposed that no individual price be allowed to increase by, say, more than RPI.

5.31 BTYP proposed that the tariff baskets should apply to the 15mm semi-display, and the quarter column, half page and full page display advertisement sizes. Together these represented about [...]% of BTYP's current Yellow Pages advertising by revenue and [...]% by volume.

5.32 Thomson's view is that such a regime would allow BTYP to engage in costless price discrimination as it would be able to recover price reductions in one area by raising prices in another, and BTYP could use this to target Thomson. Thomson also argued that a flexible pricing regime would increase BTYP's incentive to rescope directories. It was concerned that BTYP could recover a reduction in charges for some users by raising prices for others. It could selectively introduce price promotions to the detriment of competition.

5.33 To be recommended, any alternative would have to be effective in regulating BTYP's prices, should be easy to monitor, should not inadvertently provide BTYP with incentives to restructure prices in a way that would not be in the interests of advertisers, and should not facilitate anti-competitive behaviour by BTYP. In particular, it would be a concern if BTYP could target emerging competitors in a focused strategic way to bolster its market dominant position. There is also some risk that a basket of prices would permit BTYP to act anti-competitively and delay emerging competition from alternative technology and prolong thereby the network effect to the detriment of consumers. This would be contrary to the aim to enhance electronic business forms, including electronic advertising, where that is efficient.

5.34 The current form of the price cap has the advantage of transparency in that no price can increase by more than what is allowed by the RPI-X formula. This would be lost with a flexible price cap. The current form also ensures that all advertisers benefit from the reduction in prices and an equitable sharing of the benefits. Neither does the current price regime prevent entirely the restructuring of prices, although the result of that might be a reduction in average prices to below the level required by the price cap.

5.35 I recognise that price flexibility can have advantages. On the other hand it can open up possibilities of potentially anti-competitive or discriminatory behaviour, and could increase regulatory burden. On balance I recommend that a fixed price cap should be retained. One factor influencing this recommendation is that, although the proposed price cap is significantly tighter than the existing price cap, it still leaves prices substantially higher than estimates of cost-reflective levels.

5.36 Thomson argued that BTYP had been able to ameliorate the effects of the price cap by introducing enhanced advertising formats for which it charged premium rates.

5.37 BTYP told us that it had set premium rates for white knock-out and colour advertisements at a level such that the value of this advertising would be preserved. If it set rates at a small premium then the value of the enhanced format would be lost since most advertisers would opt for the enhanced formats and these advertisements would no longer stand out from the rest. It expected that the eventual take-up would be about [...]% of all advertisers. BTYP also stressed that the introduction of colour had involved considerable costs and commercial risk. Its printer, RR Donnelly, had invested some [...] in upgraded printing facilities [...].

5.38 We accept that as a result of introducing these formats BTYP has been able to charge premium rates for some advertisements. However, the vast majority of advertisers who continue to use standard advertising formats continue to be directly protected by the price cap. The prices for new formats are also constrained by the availability of the standard advertising formats at the regulated prices. Furthermore, the rates for the enhanced formats, once established, are governed in subsequent directory editions by the price cap.

5.39 In summary, therefore, I recommend that a fixed price cap be retained in the form set out in paragraphs 5.23 to 5.25 above.

6 DISCOUNT PRICES UNDERTAKINGS

Paragraph 5(6)

6.1 According to this undertaking, if BTYP includes a discount scheme in the rate card, it cannot subsequently withdraw the discount unless the scheme is a trial, or unless I have given my consent.

MMC findings

6.2 The MMC did not make an adverse public interest finding on BTYP's discount prices. However, it considered that the fact that BTYP did not offer discounts for multiple directory advertisers, advertising agencies, or for advertisers with several advertisements in one directory was symptomatic of BTYP's dominant position and its bargaining power even with the largest advertisers (see paragraph 2.90 of the MMC report). The MMC in its report reminded BTYP of its "responsibility to conduct its business, and in particular its dealings with customers and competitors, with scrupulous fairness" (paragraph 2.117) and referred to particular matters to which attention should be given, such as a published discount structure, related to the volume of advertising and reflecting the cost advantages to BTYP. The undertaking at paragraph 5(6) addresses fair dealings with competitors.

BTYP's current policy

6.3 BTYP has not introduced any volume-related discount structure, but it has introduced the First Steps scheme for businesses not currently advertising in Yellow Pages and the Step-Up scheme for existing advertisers wishing to upgrade their advertisements. Both offers are based on an introductory rate, for one or two years, below the standard rate card price of the advertisement size they are purchasing, after which they pay the full rate. Step-Up is a fully implemented scheme, but First Steps is a trial scheme.

6.4 BTYP said that its research showed that advertisers were receiving value for money from its current discount policies, but that it continually reviewed these schemes and may wish to adapt them in due course.

6.5 BTYP expressed a concern that while we may treat individual schemes as qualifying as a trial scheme, we may treat some discount schemes, if introduced on a wider basis, albeit expressly as a trial, as not qualifying, with the risk that BTYP would be required to maintain the prices at the discount level even though this may be of no benefit to it or to advertisers.

6.6 BTYP told us that the undertaking would deter it from introducing promotions or discounts on a more regular basis, out of concern that any scheme might be interpreted as being on a permanent, or semi-permanent, rather than on a trial basis. It said that its preference would be to delete the undertaking which would allow it to implement promotional schemes more widely.

Conclusions

6.7 We do not wish to deter BTYP from offering discounts which might benefit advertisers and ultimately consumers. The existing undertaking does not prevent discounts but it might deter them, and it potentially involves some regulatory burden. On the other hand there is a risk that discounts could be used with exclusionary or anti-competitive effect. This risk is however reduced by the retention of the fixed structure for the price cap, and there now exist the prohibitions in the Competition Act 1998. On balance, I therefore recommend removal of the undertaking relating to discount schemes.

7 DIRECTORY AREAS UNDERTAKINGS

Paragraphs 7(1) to 7(2) and 9(1) to 9(3) of the undertakings

7.1 Paragraph 7 concerns the calculation of advertising rates where BTYP alters the distribution area for a directory (what is called rescoping). This was designed to prevent a circumvention of the price cap.

7.2 Under paragraph 9(2), BTYP cannot distribute, or arrange the distribution of, a classified directory without charge outside the specified distribution area for that directory, except in response to a specific request from a customer. BTYP has asked for some relaxation of this undertaking as described below.

7.3 Under paragraph 9(3), the distribution areas cannot overlap except to the small extent that they did at the time of the MMC inquiry. This undertaking has the effect of preventing BTYP from publishing more than one directory in any area and, in particular, from publishing local directories.

Rescoping

7.4 BTYP has informed the OFT prior to any rescoping proposals. Save for Thomson, no complaints have been received by the OFT as to this practice. Thomson argued that rescoping was a means by which BTYP could circumvent the price cap.

7.5 In addition, Thomson considers that BTYP's current policy of rescoping could be seen as having the effects on the market which were identified by the MMC in connection with the publication of local directories, and that this was likely to reduce both customer and user choice, and to reduce the effectiveness of competition from Thomson by removing the primary point of differentiation between the two companies' directories.

7.6 Thomson told us that it differentiates itself from BTYP in one key respect, by the scope of its directories, which almost invariably have a smaller distribution area than Yellow Pages (BTYP currently has 78 directories while Thomson has 170). Although Thomson's cost per circulation figures are generally higher than BTYP's, the advertising rates are usually lower because of the smaller circulation. This appeals to advertisers who do not require the wider coverage offered by Yellow Pages.

7.7 Thomson said that BTYP's rescoping of the Gloucester directory into separate Gloucester and Swindon directories meant that the new editions more closely matched its own areas. It said that Swindon had been one of its best-penetrated directory areas and that any competitive advantage it had was now greatly diminished.

7.8 BTYP has embarked upon a wider programme of directory rescoping, the effect of which is generally in each case to split one directory area into two. In comparison with the historic rate of one or two per year, BTYP is planning to rescope directories in ten existing areas, generating a total of 20 new directories, between July 2001 and July 2002. In chronological order the areas are Oxford, Southend, Cardiff, Mersey, Reading, London East, Cumbria, Bedford, [...]. BTYP told us that as far as it was aware Thomson was not currently present in the areas covered by its Cumbria and [...] directories.

7.9 BTYP told us that the reason for its accelerated programme of directory rescopings was that it had now become confident of the consultation process and price setting formula which enabled it rapidly to implement rescopings that had been under consideration for some time. It said that by the time its planned rescopings were carried out, it would have largely completed its programme of rescoping all the Yellow Pages directories in the main geographical and urban areas outside London, including Northern Ireland, Merseyside, Manchester, Birmingham, Leeds/Bradford, Bristol/Bath, the East Midlands and areas along the M4 corridor.

7.10 After the current planned round of rescopings, BTYP has no existing plans to carry out rescopings anywhere in the UK outside London. It told us that geographical and demographic conditions made it extremely difficult to know how to proceed in the London area and could not foresee any rescoping taking place before [...].

7.11 There was no adverse finding by the MMC in respect of rescoping, and indeed they considered that rescoping of existing directories may be in the interest of existing advertisers (paragraph 2.115).

7.12 However, the MMC was concerned that rescoping had resulted in a significant increase in costs for advertisers wishing to advertise in more than one directory. Under paragraph 7 of the undertakings, the rates for each new rescoped directory must be based on the average of a range of existing directories of slightly larger and smaller circulation, which are subject to the price cap. Since absolute advertising rates tend to fall with decreasing circulation (even though the rates per thousand circulation increase), rates for rescoped directories will be lower than for the parent directory. For all succeeding editions the rates will again fall within the price cap. The effect of this is that new and existing advertisers in just one directory pay a lower absolute rate.

7.13 In addition, BTYP's current pricing policy is that new advertisers wishing to have equal coverage in both of the new directories, and existing advertisers wishing to retain the same coverage in both directories will pay no more than they would have done before the rescoping. Once BTYP has set the prices for these users, these prices will then be subject to the price cap.

7.14 There is no evidence that BTYP's policy in rescoping has been to target Thomson: the MMC's concern in the case of local directories. Although the programme has been accelerated, in practice, this is limited to 10 of BTYP's 78 directories of which two are in areas not covered by Thomson. Neither is there any evidence that BTYP has considered rescoping as a means of circumventing the price cap.

7.15 I therefore conclude that the undertaking on price after a change to directory areas should be retained. There is no need to introduce any additional regulatory controls on rescoping.

Directory Areas

7.16 The MMC concluded that the publication of local directories was likely to diminish the effectiveness of the competition to BTYP and deter new entry, thereby reducing choice and increasing prices of printed directories in the longer term (paragraph 2.98). The MMC therefore recommended that BTYP should be prevented from distributing or publishing more than one consumer classified directory covering or including all or part of any particular area.

Distribution outside directory areas

7.17 Paragraph 9(2) of the undertakings prevents BTYP from distributing directories outside of their specified distribution areas, such as into a neighbouring directory area, except in response to a specific request. BTYP told us that there were a few directories with small pockets at the perimeters of their distribution areas where it received regular requests from consumers for a copy of the neighbouring area directory, either instead of, or in addition to, the home directory. Because BTYP was prevented from distributing copies except on request, it had received significant numbers of complaints.

7.18 BTYP has provided a list of these areas, 11 in total, which are set out in Annexe G to this report and, apart from one area, Coalville in

Leicestershire, none of them represents more than 5.4% of the home directory area.

7.19 Coalville is an area which was transferred in a wider rescoping exercise in 1995 from the Leicester to the Derby directory. The area in question represents 13.2% of the home directory circulation, significantly larger than for the other ten areas. Although consumer research at the time of the rescoping indicated a general preference for the new scoping, BTYP has received a steady stream of complaints, arising from requests from consumers for a copy of the Leicester directory, either as well as or instead of the Derby directory.

7.20 BTYP has proposed a general policy for dealing with such situations. Where the area affected is less than 5% of the directory circulation it would like to have the option of making either a double delivery of directories or to change the home directory. Where between 5% and 15% of the area is affected BTYP would like to include a postcard with each directory offering recipients the opportunity continually to receive a second directory. BTYP expected that any case involving more than 15% of the circulation of the directory would be extremely unlikely to occur but, in the event that it did, BTYP asked us whether these could be considered on a case-by-case basis.

7.21 Thomson was concerned that in the 11 areas this would have the effect of making these directories less attractive to advertisers because some households would receive two directories. It also considered that the overlap of distribution could damage competitors. Thomson was further concerned that if BTYP were allowed to implement its preferred option for these 11 areas, it might establish a precedent making future requests difficult to turn down.

7.22 There is no evidence that BTYP's request regarding the 11 existing situations demonstrates any anti-competitive intent, or that it is intended to exclude Thomson. Given the small scale of the requested changes there is no reason to believe that the effect could be exclusionary. Consumers in any case have the option of requesting a second directory (although BTYP would normally make a charge of £5 to cover costs, it does not do so in boundary areas).

7.23 In view of the relatively small number of consumers affected (BTYP distributes about 124,000 directories in these areas each year, out of a total of nearly 30 million), and the likelihood that not all of them will take up their option, I recommend that you accept BTYP's proposals for these 11 cases. I also recommend that you accept its general policy for serving consumers in adjoining areas who perceive a benefit from having directories covering adjoining areas. I do not, however consider that my consent is necessary as the number of qualifying cases is expected to be low. Should any anti-competitive effects become apparent then my new stronger powers under the Competition Act 1998 will allow me to take action.

7.24 The guidelines for future cases should be set out in a new undertaking, and for monitoring purposes BTYP should be required to inform me of each case.

Local directories

7.25 We have considered whether, in the light of the conclusion regarding the price cap, BTYP should continue to be prohibited from publishing local directories. Thomson is also of the view that BTYP is using rescoping as an alternative to the publication of local directories – a practice which the MMC found to be against the public interest.

7.26 In examining BTYP's intentions as regards its local directories, the MMC (paragraph 2.78) reported BTYP as referring to the "need to reinforce our position at the expense of Thomson"; giving as one rationale for the strategy "to surround the competitor with other Yellow Pages products [which] may be preferable than competing in the current way". There was also a reference to "[competing] on product quality ... [with a] standard advertising rate ... slightly below Thomson"; and to the plan being "to publish slightly before Thomson". The MMC also referred (paragraph 2.98), among other points, to BTYP's local directories being supported by the subsidy of initial losses and by discounts to existing Yellow Pages advertisers.

7.27 While we have concluded that Thomson does not provide an effective competitive constraint on BTYP, we recognise that Thomson offers some benefits and choice to consumers and advertisers. Removal of the undertaking would, in our view, carry a risk of sending a signal to BTYP that it can introduce several products to target Thomson directly. Such an outcome would be undesirable, particularly bearing in mind BTYP's market dominance and its ability to carry out such a move with limited risk to loss of existing customers and an ability to cross-subsidise so that attractive initial rates could be offered to attract advertisers away from Thomson.

7.28 I am therefore of the view that BTYP should continue to undertake not to publish local directories in competition with an existing provider. I do, however, consider that to prevent BTYP from publishing local directories in areas where it does not face competition would be to the detriment of advertisers and consumers. I therefore recommend that paragraph 9(3) of the undertakings should be amended to permit BTYP to publish local directories as long as there is no other supplier of printed classified directories in the relevant area.

8 OTHER UNDERTAKINGS

Comprehensive rate card/rate card changes (paragraphs 2-4)

8.1 Paragraphs 2 and 3 of the undertakings require BTYP to publish a comprehensive ratecard, showing the advertising rates for all of its directories, including any promotional offers. We believe that this information provides transparency of BTYP's pricing to advertisers and to existing and potential competitors. The undertaking in these paragraphs should be retained. The date for the publication of the first Master Rate Card was 31 August 1996 and for the next set of undertakings should be agreed in discussion with BTYP.

8.2 Paragraph 4 of the undertakings prohibits changes to published rates applicable to a particular edition which would increase those rates without my consent. This undertaking appears to address a concern as to predatory behaviour by BTYP. In the light of the proposed tighter, fixed structure price cap and the existence of the prohibition in the Competition Act 1998 the undertaking is no longer necessary.

Changes in business practice (paragraph 6)

8.3 Pursuant to paragraph 6 of the undertakings BTYP is required to seek my consent before introducing any significant changes in its business practice regarding the range of advertisement sizes or features, and the ordering of entries within each classification. During the review period BTYP has, among other measures, introduced intermediate advertisement sizes such as the 3/8 column and the 3/8 page, and guides for inclusion in its directories such as London Local Guides and City Guides, and has developed the use of colour in its advertisements.

8.4 Although Thomson put it to us that some of these developments were introduced as a means of ameliorating the effects of the price cap (see Annexe C) BTYP could have introduced such changes without the price cap, and they may offer benefits to advertisers. In view of our conclusion that there is no effective competition within the relevant market, and to the extent that the undertaking may prevent BTYP from responding to demands from advertisers and customers, we consider that BTYP should be released from this undertaking.

Good faith (paragraph 8)

8.5 Paragraph 8(1) of the undertakings requires BTYP to have regard to the objective of the undertakings and to ensure that prices paid for advertisements in classified directories published by BTYP decline by at least RPI-2 each year. This value should be changed to reflect the new price regime.

8.6 Paragraph 8(2) states that "nothing in these undertakings shall require BT to do anything that would contravene the provisions of the Unsolicited Goods and Services Act 1971 as amended from time to time". This clarification should be retained.

Preparation and availability of accounts (paragraphs 10-12)

8.7 BT is required to publish in its annual accounts, and to make this information available on request, the turnover, operating profit and net assets of its classified directory advertising business.

8.8 BT announced on 13 April of last year that it intended to list BTYP and the following November that it intended to sell 25% of its directory businesses. If this goes ahead, or any alternative proposal such as a demerger, then BTYP will need to be established as a separate legal entity but may remain a subsidiary of BT. Assuming that BT will be obliged to publish accounting information on the incorporated BTYP in its Group accounts then BT's statutory disclosure requirements will replace elements of the undertakings, and will address some of the requirements set out by the MMC in Appendix 2.1 to their report (see Annexe H to this report). BTYP has confirmed that as a new corporate entity it will comply with paragraphs 2 to 4 of Appendix 2.1 to the MMC report as it will be subject to the Companies Act 1985 and to general accounting principles.

8.9 Whereas the undertakings require BT to produce separate figures for the Yellow Pages printed directories, BT would include much less information in its Group accounts. In addition, BTYP has indicated to us that as a corporate entity it would not automatically provide this information in its statutory accounts but would instead include its segmental note figures for its UK printed directory business, which includes Business Pages as well as Yellow Pages. The gross revenue in 1999/00 for Yellow Pages was £484.7m, and £16.5m for Business Pages, so the total figure is only slightly higher than the Yellow Pages revenue. However, the current undertakings require BT to provide information for its classified directory Business, excluding Business Pages. BTYP has indicated that if necessary it would, as a corporate entity, include a footnote to the relevant figures indicating the Yellow Pages contribution to both turnover and operating profit. We believe it is important that BT/BTYP continue to make this information available and accordingly recommend that both BT and BTYP be required to continue to provide financial and accounting information for its classified directory business in such form as will enable me to monitor compliance with and effectiveness of the undertakings.

8.10 I consider that these requirements, plus a continued undertaking to provide information on the turnover and operating profit of the classified directory business, will meet the purpose of the undertakings which was principally to ensure that BT's dealings with BTYP are transparent. Knowledge by potential market entrants that BTYP did not gain significant advantages from being part of BT was hoped also to provide a modest stimulus to competition. Thomson told us that the undertaking requiring BTYP to make financial information available had not proved effective to stimulate market entry. We do not believe, however, that the provision of any further information would have made any real difference.

8.11 Thomson complained that since BTYP did not release the information until a considerable time after the end of the financial year it was "stale" by the time competitors saw it, and also that information was not provided for specific directory areas. The MMC's original recommendation (Annexe H, paragraph 3) was that "[t]he subsidiary be required to file its accounts no later than the date BT files its own accounts, whether or not it is incorporated as a plc." To the extent that statutory requirements do not address this point we recommend that an undertaking to that effect should be required from both BT and BTYP.

8.12 We have considered whether this information should be made available for specific directory areas but concluded that such information would be unlikely to make competition more likely and that its provision would place a disproportionate burden on BTYP. I do not recommend that such an undertaking be required.

8.13 Thomson also made a number of suggestions as to how the accounts might become more informative and useful. We have not been convinced that these would either stimulate market entry or increase consumer benefit. I do not recommend that the undertakings should request the provision of any information in addition to that recommended above at paragraphs 8.9 and 8.10.

Director's consent (paragraph 13)

8.14 This is a requirement on me in relation to the giving of consent where this is sought by BT in connection with any of these undertakings. This provision should remain.

Information (paragraph 14)

8.15 BTYP is required to provide to me its Master Rate Card and any other information which we may reasonably require for the purpose of monitoring of the undertakings, and this undertaking should remain unchanged.

ANNEXES

A THE UNDERTAKINGS GIVEN BY BT

Monopolies and Mergers Commission Report
Classified Directory Advertising Services

UNDERTAKINGS BY BRITISH TELECOMMUNICATIONS PLC

British Telecommunications plc ("BT") hereby gives the following undertakings relating to the publication and distribution of printed consumer classified advertising directories to the Secretary of State for Trade and Industry under section 88(2) of the Fair Trading Act 1973 ("the Act") to take action requisite for the purpose of remedying or preventing the adverse effects specified in the report of the Monopolies and Mergers Commission on classified directory advertising services (Cm 3171, March 1996 – "the Report").

Interpretation

1. In these undertakings:

"the Act" means the Fair Trading Act 1973;

"Classified directory" means a printed directory which:

(a) contains advertisements published pursuant to engagements to that effect; and

(b) shows suppliers of goods and services, classified by reference to the goods or services supplied; and

(c) is distributed wholly or mainly direct to consumers (within the meaning of section 137 (2) of the Act);

"the Director" means the Director General of Fair Trading;

"Edition" means any edition of a classified directory published or to be published by BT;

"the Master Rate Card" means the rate card from time to time published by BT in accordance with clause 2 (1) below; and

"RPI" means the general index of retail prices published from time to time by the Office for National Statistics.

Comprehensive rate card

2. (1) BT shall publish a rate card for all the Editions that it intends to publish between the dates set out in that rate card: in it there shall be set out all the charges on payment of which BT is prepared to display advertisements in such Editions, including all discount schemes with, in the case of trial schemes, the termination date.

(2) BT shall make no charge for the inclusion of an advertisement in any Edition other than the charge specified in respect of that category of advertisement and that Edition in the Master Rate Card from time to time current.

(3) The Master Rate Card shall be made available, free of charge, by BT to anyone who requests it, within 5 working days of receipt of the request provided that:

(a) BT shall not be obliged to make more than one copy of any edition of the Master Rate Card available to any applicant; and

(b) BT shall satisfy this requirement by making copies of the Master Rate Card available exclusively through its Yellow Pages Division or any successor to the Yellow Pages Division.

(4) BT shall publish the first Master Rate Card by 31 August 1996.

3. BT shall be entitled to publish and distribute extracts from the Master Rate Card provided that:

(a) the rates set forth in such extracts conform with the corresponding rates set forth in the Master Rate Card; and

(b) each such extract contains a clear reference to the fact that any person is entitled to obtain a copy of the Master Rate Card on the terms set forth in clause 2 (3).

Rate card changes

4. When BT have published a Master Rate Card specifying a rate applicable to a particular Edition, they shall not publish (in any subsequent Master Rate Card or elsewhere) a higher rate applicable to that Edition (for the category of advertisement in question) unless the Director first gives his consent.

Rates

5. (1) The rates in any Master Rate Card shall meet the requirements set out in paragraphs (2) and (3) below.

(2) No price in any Master Rate Card relating to any Edition that is included in BT's July 1995 Rate Card shall be higher than the lesser of:

(a) the price for that Edition and category of advertisement shown in the July 1995 Rate Card; and

(b) the price arrived at by making the adjustment set out in paragraph (4) below.

(3) No price in any Master Rate Card relating to any future Edition that is not included in BT's July 1995 Rate Card shall be higher than the price arrived at by making the adjustment set out in paragraph (4) below.

(4) The adjustment referred to in paragraphs (2) and (3) above is to be made by multiplying the price for the immediately preceding Edition of that classified directory (for the category of advertisement in question) by the fraction:

$$\frac{\Delta\ \text{RPI} - 2}{100}$$

where Δ RPI is the RPI number for the latest month for which statistics were available before the publication of that Master Rate Card, expressed as a percentage of the RPI number for the same month in the preceding year.

(5) BT shall be entitled to round any price calculated pursuant to this clause to the nearest whole pound.

(6) If BT includes a discount scheme in a rate card the scheme shall not subsequently be withdrawn unless:

(a) the scheme is a trial scheme, expressed in the rate card to have effect only until a specified date; or

(b) the Director consents.

Changes in business practice

6. BT shall not significantly change its business practice in relation to any of the following matters without the prior consent of the Director (such consent not to be withheld unless the Director considers that the change would conflict with attainment of the objective set out in clause 8 below):

   (a) the range of advertisement sizes or features offered to potential advertisers; or

   (b) the ordering of entries.

7. (1) If BT alters the distribution area (within the meaning of clause 9) of a classified directory, no rate for any advertisement in the first Edition of any of the Classified Directories affected by the change shall exceed the average (subject to the rules in paragraph (2) below) of the latest published rates for the five Editions with immediately larger Guaranteed Minimum Circulation ("GMC") than the rescoped Directory and five Editions with immediately smaller GMC.

   (2) In calculating the average under paragraph (1) above, there shall be disregarded (unless the Director otherwise consents):

   (a) the rate for the Central London directory; and

   (b) any rate greater than:

      (i) £2.75 per 1000 GMC for a quarter column; or

      (ii) the equivalent, pro rata, rate for a page, or other sub-division of a page,

   the limit, in either case, being adjusted by reference to the RPI-2 formula set out in clause 5(4) above.

Good Faith

8. (1) BT shall have regard, in securing compliance with clauses 1 to 7 above, to the objective of these clauses, which is to ensure that, on the basis of a like-for-like comparison prices paid for advertisements in Classified Directories published by BT decline, relative to the RPI, by at least 2% each year.

(2) Nothing in these Undertakings shall require BT to do anything that would contravene the provisions of the Unsolicited Goods and Services Act 1971 as amended from time to time.

Directory areas

9. (1) BT shall ensure that a map showing the area in which each classified directory is to be distributed (the directory's "distribution area") is printed in each Edition.

(2) BT shall not distribute, or arrange for the distribution of, a classified directory without charge outside its distribution area, except in response to a specific request from a customer.

(3) BT shall ensure that distribution areas do not overlap, except to the extent shown on page 44 of the Report (a copy of which page is annexed).

Preparation of account for classified directory business

10. BT shall prepare, in respect of its classified directory business, accounts in respect of each financial year, ending 31st March, which:

(a) meet the requirements of Schedule 4 to the Companies Act 1985;

(b) comply with those UK accounting standards which relate to unincorporated entities; and

(c) include proper charges in respect of transactions between the classified directory business and other divisions of BT.

Availability of accounts

11. BT shall ensure that a copy of the account prepared in compliance with clause 10 above is:

(a) sent, each year, to the Director within nine months of the end of the accounting year, together with a report from BT's auditors as to whether the accounts show a true and fair view of BT's classified directory business; and

(b) made available, free of charge, to anyone who requests a copy, within 5 working days of receipt of the request, if the request is made after the Director's copy of the accounts has been sent to him.

BT annual accounts

12. BT shall publish in its annual accounts segmental information for its classified directory business, comprising turnover, operating profit and net assets, and shall conspicuously specify in the annual accounts the procedure for obtaining on request and free of charge the accounts specified in clause 10 above.

Director's consent

13. In relation to any matter where BT seeks the Director's consent pursuant to these Undertakings, such consent shall not be unreasonably withheld or delayed and it shall be presumed that the Director has granted his unconditional consent to the application unless he notifies BT within 20 working days after receipt of the application that he has serious doubts about whether such consent can be granted.

Information

14. BT shall provide to the Director:

    (a) a copy of the Master Rate Card when it is published together with a version in electronic form suitable for loading onto a computer; and

    (b) such other information as the Director may reasonably require for the purpose of ascertaining that these undertakings are being or have been carried out, including in particular extracts from the Master Rate Card and information about the profitability of particular Editions.

Dr Alan Rudge 23/07/1996
.. Date.....................................
Deputy Chief Executive

Colin R Green
..
Company Secretary & Chief Legal Advisor

For and on behalf of British Telecommunications plc

B OFT CONSULTATION PAPER

Classified directory Advertising Services: Review of Undertakings given by BT to the Secretary of State

Background: the MMC inquiry and subsequent undertakings

Following the publication of the MMC's report in March 1996 on classified directory Advertising Services, British Telecommunications plc (BT) gave undertakings, to the Secretary of State for Trade and Industry under section 88 (2) of the Fair Trading Act 1973 (the Act), to take action for the purpose of remedying or preventing the adverse effects specified in the MMC's report. These were signed on 23 July 1996.

The undertakings were given by BT in respect of its classified directory advertising business, BT Yellow Pages (BTYP). As a matter of convenience, the paper will refer throughout to BTYP, except where it is necessary to refer to BT specifically. Where a reference is made to "Yellow Pages", this relates specifically to BTYP's printed directories.

The undertakings have the following main provisions:

a) the publication of a rate card covering all the intended editions of Yellow Pages and setting out BTYP's charges for displaying advertisements, including any discount schemes;

b) a price cap of RPI-2 on advertising rates;

c) a requirement on BTYP to obtain the consent of the Director General of Fair Trading (the DGFT) for significant changes in business practice affecting advertisement sizes or features offered to potential advertisers, or the ordering of entries;

d) except for permitted areas of overlap, a prohibition on BTYP publishing and distributing more than one classified directory for each distribution area;

e) a requirement that if BTYP published new directories as a result of altering distribution areas (for example by changing boundaries or splitting distribution areas) it must not, when calculating rates for the new directories, exceed prices which are determined by a price formula; and

f) an obligation on BT to prepare accounts in relation to its classified directory business and publish separate financial information in relation to this business in its annual accounts.

The MMC had suggested a review period of five years or less to review the provisions set out at (b) and (d) above. The Director General has a duty under section 88(4) of the Act to keep under review the carrying out of undertakings. This is a general review, but at this stage the Director General is concerned in particular to have an understanding of the effects of the price cap, and also to see if the undertakings have remedied the issues they were designed to address.

Following the review, the Director General will make a recommendation to the Secretary of State, based on his findings. This may be that the undertakings are no longer necessary and that BTYP may be released from them, or that the undertakings be varied or superseded.

Scope and purpose of the review

This paper identifies the issues and information which the Director General will consider in assessing the need for future regulation of BTYP's conduct and, in particular, the competition which BTYP faces. He requests comments and data from interested parties relating to any aspect of this paper. **Interested parties should respond to this paper by Monday 17 July if they wish their views to be considered by the Director General during the review**.

The Director General is seeking information which will enable him to assess:

- the carrying out and the effectiveness of the undertakings; and
- whether there has been any change of circumstances, for example in the structure of the relevant market and BTYP's position within it

As a result of the review, the Director General will consider whether the existing undertakings continue to be appropriate or whether, in the light of changes in circumstances, the existing undertakings should be varied or superseded, including whether BTYP should be released from them. If this is the case, or if it appears that any undertaking has not been, or is not being, fulfilled he will make appropriate recommendations to the Secretary of State.

The first part of the assessment will examine the effectiveness of the undertakings in addressing the adverse effects identified by the MMC. The Director General is interested to know for example whether changes in BTYP's policies, or rescoping of directory areas, has led to advertisers paying more for advertisements than would be the case without such changes. Since the undertakings were given, BTYP has introduced or proposed directory rescopings of the Gloucester, Southend-on-Sea and Oxford directories, and in each case one directory was split into two.

While BTYP's advertising rates are governed by a price formula, the Director General would like to know whether any changes in BTYP's business practices, such as the introduction of colour advertising (at this stage on a trial basis) and the use of intermediate advertisement sizes such as the 3/8 column, has been seen as a way of ameliorating the effects of the price cap without providing any clear benefits, or whether advertisers feel that the changes have been generally beneficial.

Another important question is whether the requirement of BT to make available BTYP's key financial figures details has succeeded in applying a modest stimulus to competition, as a result of allaying concerns among existing or potential competitors that BTYP gained significant advantages from its relationship with BT.

The second part of the assessment will look at whether there is a continuing need for undertakings and, if so, whether they should be varied or perhaps lifted. To carry out this the Director General will need information to enable him to define the relevant economic market or markets in which BTYP operates, and whether the market definition used by the MMC is still appropriate. In particular he will be seeking information about the products and services with which Yellow Pages directories compete, including whether competition from advertising in electronic and other media has now become sufficiently well-established that it can be included in the relevant market. The Director General will also assess whether the market shares, either as a result of competition between suppliers of printed directories, or a change in the definition of the relevant market, have changed.

In general, a wider relevant market will include a greater range of products which consumers regard as substitutes for each other. In a competitive market there should be less need for regulation, since the presence of a sufficient number of competitors should place constraints on the extent to which any undertaking can act anti-competitively. The Director General is keen to ensure that competition is fostered within markets, and where competition is emerging but is not yet fully established it may be necessary to protect and encourage fledgling competition.

A review of any market will be assisted by the provision of current and verifiable information. The Director General will consider any comments received, but will accord more weight to arguments supported by robust, verifiable, and objective data. He therefore encourages respondents to provide supporting data with their responses. If significant volumes of numerical data are to be provided it would be helpful if this could also be provided electronically, for example on Excel spreadsheets.

Annex 1[1] contains questions which the Director General would specifically like respondents to answer. Except where specifically indicated, BTYP is asked to address all the questions, and some questions are intended to be answered by BTYP only. For directory providers other than BTYP, and any advertiser, trade association or representative body, or any interested party, you are asked to address those questions which are relevant to your business. However, if you wish to comment in response to other questions you should feel free to do so.

In due course, the Director General may wish to put information provided by other parties to BTYP for its response. He is bound by comprehensive statutory restrictions on disclosure of information, which limit the circumstances in which information provided to him can be disclosed to others. However, one of the circumstances in which disclosure is allowed is if it assists the Director General to carry out any of his various statutory functions. This means that not only may the Director General put information provided to him, in the course of this review, to BTYP for its comments, but it is also possible that he may wish to use this information in connection with other investigations or inquiries.

Nevertheless, if any person supplies information that he or she would prefer to be kept confidential to the Director General, that information must be contained in a separate annex and/or disc marked "confidential information" and an explanation given why it is preferred that the information be kept confidential. If the Director General proposes to disclose any information to any person in connection with this review (apart from another Government Department or any consultants specially engaged by him to assist in the review) he reserves the right to disclose that information if necessary. However, he shall give the person who provided the information (1) written notice of his proposed action and (2) a reasonable opportunity to make representations to him, in both cases if it is reasonably practicable for him to do so". If you have any questions on this matter please contact the OFT.

ADDRESS FOR RESPONSES

Six copies of all responses, together with any computer discs, should be delivered by Monday 17 July 2000 to:

[ ]

[1] Not included in this report

The Monopolies and Mergers Commission report

On 1 March 1995 the Director General of Fair Trading (DGFT) asked the MMC to investigate and report on the supply in the UK of classified directory advertising services. The main directories covered by the reference were Yellow Pages (published by BTYP) and Thomson Local. Concerns that led to the reference included the very high rates of return of BTYP, a division of British Telecommunications plc (BT), and its scope to act anti-competitively by virtue of its strong position in the market, combined with high entry barriers.

Market definition

The reference to the MMC related to the provision of classified directory advertising services. These services (known as the “reference services”) were defined as being the undertaking and performance of engagements to publish advertisements in directories which show suppliers of goods and services classified by reference to the goods or services supplied, and are delivered wholly or mainly to consumers. BTYP was estimated to supply 84% of the reference services and Thomson 14%. No other supplier had as much as 1%.

The MMC, in assessing the extent of competition, included in the relevant market the smaller classified directories where they were delivered direct to households and covered a broad range of goods and services, but excluded specialised directories which were confined to a few classes of goods or services. They also looked at advertising in electronic and other media and considered that this may well pose strong competition to printed directories in the longer term. They concluded, however, that because the timing and extent of such developments was uncertain and depended on wider domestic use of computer technology they could not at the time be regarded as being within the relevant market. Whereas Talking Pages did provide a direct alternative to printed classified directories, it was still limited in scale and was in any case owned by BTYP, and did not affect the MMC’s assessment of competition.

The MMC examined the extent to which other media, such as television and national, regional and local newspapers, competed with the reference services, but considered that the product characteristics (such as the aims of the advertising, the type of advertisement and the retention period of printed products) were not sufficiently similar that they could be included in the relevant market. The MMC did not find any objective evidence that the pricing policy of BTYP, or the prices of the reference services in general, were constrained by the price of other media to a significant degree. The MMC concluded that the relevant market coincided almost entirely with the reference services.

BTYP’s position in the relevant market

The MMC found that BTYP had a very large and stable share of the relevant market. They also found that it consistently achieved high profit levels with a return on capital over the previous five years ranging between 118 and 145%. The MMC considered that BTYP enjoyed a number of advantages, including a “first-mover” advantage and high barriers to entry making new entry on a significant scale improbable. Although the MMC recognised that Thomson was an established and profitable competitor, they were unable to regard it as a sufficiently effective competitor to constrain the prices charged by BTYP. In conclusion, the MMC found that BTYP was dominant in the relevant market and that its conduct was not constrained by any sufficiently effective competition or by the possibility of potential entry.

MMC conclusions on the public interest

The MMC made the following conclusions:

a) The charging by BTYP of prices higher than would be the case if competition were effective is a step taken by BT for the purpose of exploiting the monopoly situation and may be expected to operate against the public interest, with the particular adverse effect of higher prices being paid by advertisers than would otherwise be the case.

b) BTYP’s publication of local directories is a step taken by BT for targeting competitors and maintaining the monopoly situation. This may be expected to operate against the public interest, by reducing the effectiveness of competition to BTYP, and thereby reducing choice and increasing prices of the reference services in the longer term.

Summary of recommendations

The MMC recommended in its report that:

a) BT should be required to establish BTYP as a separate subsidiary of BT, and that the subsidiary should be subject to certain reporting and other requirements as specified in Appendix 2.1 of the MMC report.

b) BT should undertake that all arrangements between itself and BTYP for the use by BTYP of BT’s facilities or services should be on an arm’s length basis, and (where appropriate) in the public domain and accessible to other suppliers on the same terms.

c) As regards directories to be published in September 1996 or later, BTYP should be prohibited from making any charge to an advertiser higher than is arrived at by applying a formula based on changes in the Retail Price Index less two percentage points (an RPI-2 formula). Detailed recommendations are set out in Appendix 2.2 of the MMC report.

d) BTYP should be prohibited from publishing or distributing more than one consumer classified advertising directory covering or including all or part of any particular area.

The MMC felt that these recommendations would go some way to addressing concerns brought to light by this enquiry. Apart from (a) which was viewed at the time as not being a necessary step, the recommendations were accepted by the Secretary of State and incorporated into the undertakings.

The MMC also made informal recommendations relating to BTYP's internal disciplines. In particular these covered:

- appraising the scope for introducing a published, cost-related discount structure;
- reinforcing its complaints handling procedures;
- adhering to a policy of accepting advertisements from competitors
- making every effort to ensure the integrity of its product; and
- revising its policy towards rescoping its directories to reduce adverse impact on certain advertisers.

OFFICE OF FAIR TRADING
24 May 2000

C VIEWS OF BTYP AND OTHER PARTIES

BTYP

Background

C.1 BTYP told us that in 1999/2000 around 1.8 million businesses had a free entry in Yellow Pages. Of these, some 380,000 businesses paid for additional advertising in Yellow Pages.

C.2 Between 1995/96 and 1999/2000 BTYP's revenue per column millimetre sold had declined in nominal terms from [...] to [...], a decline in real terms of 13%, which demonstrated that the objective of the MMC that prices paid by advertisers decline in real terms had been achieved. At the same time, it had introduced new styles of advertising, including colour, for which it had charged premium rates, and as these were introduced across all directories BTYP was likely to benefit from higher future revenues (although the initial financial investment has been significant). It had also developed a number of pricing options, particularly price discount offers.

C.3 BTYP said that there were significant differences between the way its profits were currently obtained compared with the period prior to the MMC inquiry. While the MMC found that its profits were driven by rate increases, they were now driven by quality improvements, customer focused discount schemes, product innovations and efficiency improvements.

C.4 Even though, prior to the MMC inquiry, rates had risen by similar levels or slightly below that for a number of years, BTYP explained that as prices had fallen in real terms between 1995 and 1999 it had increased its customer base from [...] unique accounts to [...]. Customer retention levels had increased from [...]% to [...]%, and BTYP had attracted over [...] new advertisements and [...] new customers. Bad Debt provisions had been reduced from [...]% to [...]%, waiver provisions from [...]% to [...]% and automation and improved processes meant that virtually the same number of people were selling and processing approximately [...]% more advertisements.

C.5 Since 1996 BTYP's complaints procedures had been totally revised. The provision of more detailed information when dealing with complaints had enabled even fairer and more reasoned decisions to be made. BTYP distributed nearly 30 million directories each year but received few complaints from users. Of the […] complaints handled in 1999, 95% had resulted in a mutually acceptable settlement. The average time to settle complaints had been reduced from 23 days in 1996 to just seven in 1999, with 50% of complaints being resolved on the same day. As a result of BTYP's investment in customer service, the overall level of complaints had declined substantially since the MMC inquiry, including a near 75% reduction in the already low number of errors that may render an advertisement useless.

The relevant market

C.6 The aim of advertising by BTYP and classified directory advertising suppliers (this also applied to other forms of advertising) was to bring the directories to the attention of consumers, while at the same time demonstrating to advertisers that they were doing so.

Competition with other printed directories within the relevant market

C.7 BTYP was not surprised that a new national printed directory had not entered the market as a consequence of the greater transparency of its financial performance. UK classified directory profitability had been known for many years and there had been few obvious requests for BTYP's accounts from potential new entrants. Any potential market entrant would undertake market research that would indicate BTYP provided a product highly valued by both advertisers and users.

Non-price competition with other printed directories

C.8 The key to BTYP's success was its understanding of customer requirements, the creation of advertising programmes to meet requirements and the excellent delivery of those products and services. It examined how others had interpreted and delivered customer requirements, looking at a wide range of competitive products and strategies in the context of international markets, traditional competitors such as local press, Kingston and Thomson, and new media.

C.9 […]

C.10 BTYP also pointed to its regular market research in which its performance was compared with that of Thomson. In the user and consumer satisfaction surveys BTYP compared its performance with that of other media, against a range of price and non-price attributes identified by respondents as being important. In its Yellow Pages and Thomson Advertisers Study, BTYP sought to understand in more detail the attitudes of these businesses to directory advertising and the Thomson and Yellow Pages products.

Competition with other media

C.11 BTYP maintained that it operated in a highly competitive market that included local newspapers, Thomson, specialist classified publications and Internet companies.

C.12 At the time of the MMC inquiry BTYP measured its market share under two definitions: the Classified Advertising market, which included directories, regional press (excluding property and recruitment), national press, business and consumer magazines; and the Local Advertising market, which included directories, regional press, classified advertising and radio. In its main submission in response to the consultation paper, BTYP adhered to this definition, and provided its estimate of its own market shares on the basis of both of these wider markets. For the Classified Advertising market it said that its share was 13.8% in 1999/2000, and 16.5% of the Local Advertising market, compared with figures of 14.9% and 17.6% respectively for 1994/95.

C.13 BTYP carried out its own market research on a range of matters, and in its most recent survey of media effectiveness it asked directory advertisers to rate various forms of classified advertising. Yellow Pages printed directories came top with a score of [...]. BTYP had not carried out any surveys of responses to advertisements according to whether the advertisement was seen in a printed directory or on the Internet: such analysis was difficult to do, and BTYP was not able to provide any evidence of the relative use of Yellow Pages compared with Yell.com (referred to in the MMC report under its former name, Electronic Yellow Pages) or other electronic directory products.

Competition with electronic media

C.14 BTYP had effectively replicated its classified directory products on the Internet, either directly or in association with Internet Service Providers (ISP) such as BTInternet and MSN as well as Search Engines such as Excite or Ask Jeeves. Some other services providers also offered similar products containing comprehensive UK business classified listings. There was also an increasing number of products offering specialised services such as hotel and restaurant guides.

C.15 BTYP believed that some services did compete with printed directories. While several offered classified advertising it was for a limited range of services such as hotels and restaurants, weddings and car sales, or only in a limited part of the UK. Four – Scoot.com, Thomweb (part of Thomson), AskAlex.co.uk and Fish4it.com – did offer comprehensive UK business listings.

C.16 The main focus in the classified advertising market had been the significant growth in new companies providing classified directory information on the Internet, such as Yahoo, AltaVista, Scoot and many others. This had been driven by the ease with which businesses and consumers used the Internet through PCs, WAP phones, digital TVs and other devices.

C.17 Some of the key entrants to the market for Internet directories posed a direct competitive threat not just to BTYP's own electronic products, but more importantly to its printed directories. In BTYP's view electronic directory products were developing the same essential characteristics of classification and localisation as printed directories and should therefore be regarded as being in the same market.

C.18 BTYP commented, however, that electronic products would not have a significant erosive effect on the demand for printed products in the short-term future. Although there were many indicators that people would increasingly use electronic channels to access information, there was no evidence that usage of printed directories would decline in absolute terms.

C.19 According to figures provided by BTYP (source: Fletcher Research) the penetration of PCs in the home with Internet access in the UK would reach about 13 million adults in 2000, and some 18 million in 2003. The penetration of Internet enabled PCs at work would reach around 7 million and 10 million adults respectively.

C.20 BTYP provided extracts from research carried out in the US (Source: Forrester Research Inc. August 1999) on the extent to which advertising on the Internet would be funded at the expense of traditional media. Out of six media (TV, radio, press, direct mail, magazines and yellow pages), at one end yellow pages and radio were forecast to lose about [...]% of potential growth between 1999 and 2004, compared with newspapers losing about [...]%.

Impact of the price cap

Effects of the price cap during the review period

C.21 In BTYP's opinion there was little doubt that the price cap, coupled with the other undertakings, had slowed down and lessened BTYP's ability to develop and innovate its products. It had nonetheless introduced a number of innovative products and services.

C.22 BTYP said that since the introduction of the price cap advertisers now expected and demanded static prices in real terms, year on year, for their Yellow Pages advertising. This was, in part, borne out by the market research commissioned in July 2000 and also supported by the increasing awareness by advertisers of other classified advertising opportunities available to them, particularly on the Internet. It was particularly important to note that a consequence of attracting increased advertisers had meant inevitably that such advertisers tended to be much more discretionary in their Yellow Pages advertising, and therefore considerably more sensitive to price increases than longer-established advertisers. Such advertisers tended to be "marginal" in that they could continually move in and out of advertising in Yellow Pages. Moreover, the recent introduction of First Steps indicated that new marketing initiatives were vital to continually attract additional advertisers. BTYP believed that advertisers' price expectations were such that it would potentially suffer significant reductions in the number of advertisers if prices increased much above the rates experienced over the past few years. For example, in 1999/00, its churn rate (the proportion of advertisers not renewing their advertising each year) for new advertisers was over [...]%, and BTYP believed that annual price increases above RPI would increase this level of churn. Its modelling showed that if it increased its prices by [...]% above RPI, projected profits would be lower by around £5m per annum compared to its current business plan projections.

Effects of a continuing price cap

C.23 In the absence of a price cap, BTYP's pricing strategy would be to maintain its "headline" price increases at around RPI. It added that historic data implied that the price cap had contributed towards both reducing its overall churn rates and increasing its total number of advertisers. BTYP said it would not jeopardise such important business achievements by increasing overall rates above RPI in the future. Since 1994/95 the number of advertisers across all Yellow Pages directories had increased by around [...], and one of its key business objectives was to continue this trend.

BTYP profitability projections

C.24 BTYP's existing forecasts, and those that it used as the basis of its own internal projections, were based on the assumption of the price cap continuing at RPI-2. In any case its own prices were set and known to advertisers until mid-2002. Its profitability projections were based on market research commissioned in July 2000, with the RPI-2 scenario being derived from its current business plan.

C.25 BTYP did not have a formalised elasticity model. [...]

C.26 [...]

C.27 [...]

C.28 Advertising volume growth, brought about as a result of a tighter price cap, would have an impact on BTYP's direct costs, and there would also be an associated rise in overhead costs, mainly in sales and customer service staff. This would cause a [...] shortfall in its profit projections for the Classified Directory Business (CDB), and it would feel obliged to find ways to make this good. This shortfall would have to be addressed as a corporate issue and not just a CDB problem. Some part of it would no doubt be recovered from the CDB business but most would be recovered from other parts of BTYP's activities, possibly at the expense of other investment plans. Overall, it would be forced to redirect its expenditure in ways that were sub-optimal compared to its business plans, with a consequential adverse effect on overall profitability.

Flexible price cap

C.29 Over the past four years BTYP's price setting behaviour had been constrained by a very detailed line by line price formula, which had impeded its ability to respond in a flexible and innovative manner to rapidly occurring market changes. The price cap had had the effect of totally undermining any incentive it had to review its overall pricing structures. It could not experiment fully with innovative new products and with promotional pricing offerings. Apart from incentives to first-time and upgrading advertisers, it had been unable to introduce short-term promotional offers because of the requirement in the undertaking that (subject to the Director General's consent) any discount schemes be effectively permanent. If a price cap were retained, BTYP would prefer a more flexible approach, so that it could adjust prices to suit market needs.

C.30 Its main proposal was for a flexible price cap in which the average weighted price of each of a selection of advertisement sizes would not be raised by more than that permitted by the price cap, while the prices of individual advertisement sizes could be varied up or down to suit BTYP's marketing intentions.

C.31 BTYP maintained that it did not, and would not, in the event of a flexible price cap, price discriminate [...] when rescoping. The priority in directory rescoping was to generate a directory of optimal relevance to users and which delivered greater value to advertisers. In short, the regulatory risk associated with such behaviour was considerably greater than any possible commercial gain.

C.32 BTYP believed there was no reason why any potential anti-competitive pricing behaviour by Yellow Pages could not be dealt with effectively by the Competition Act 1998. The advance publication of rate cards would provide ample opportunity for the Director General to be able to consider fully its current and future pricing policy well before it published a directory, since its prices were already set until mid-2002.

C.33 In the setting of future prices BTYP argued that they would always act in a way to avoid any reasonable suggestion that it was price-discriminating against one of its competitors, but the flexible price basket would allow some limited variance in price by directory.

C.34 Furthermore, BTYP pointed out that the prospect of the Director General's next review would act as a substantial discipline upon BTYP's behaviour. Assuming that this would take place in three to five years' time, BTYP would not have had the opportunity to recoup any profits sacrificed by this kind of pricing strategy, nor would Thomson have suffered irremediable damage of the kind that it seemed to fear.

Price promotions

C.35 As well as a more flexible price cap, BTYP wished to have greater flexibility for promotional pricing, for example in its [...] directory area where take-up of advertising was below national average levels. BTYP said it currently prevented by the undertakings from withdrawing discount schemes except, according to paragraph 5(6)(b) of the undertakings, with the Director General's consent.

C.36 While BTYP had generally priced up to the price cap, or nearly so, in all cases for the prices on its rate card, it had introduced two particular offers, called First Steps and Step-Up, respectively, for businesses not already advertising in Yellow Pages which may wish to do so, and for existing advertisers wishing to upgrade their advertisements. Both offers were based on an introductory rate, for one or two years, below the standard rate card price of the advertisement size they are purchasing, after which advertisers would pay the full rate. While Step-Up was a fully implemented scheme, First Steps was a trial scheme, expressed in the rate card as having effect only until a specified date, permitted by paragraph 5(6)(a) of the undertakings.

C.37 BTYP was concerned that, while the OFT may treat individual schemes as qualifying as a trial scheme, it may treat some discount schemes, if introduced on a wider basis, albeit expressly as a trial, as not qualifying. There was a risk BTYP would be required to maintain the prices at the discount level, even though this may be of no benefit to it or to advertisers.

Directory Rescoping

C.38 BTYP commented that the MMC had agreed that rescoping was a valid and useful business policy that produced benefits to users and advertisers. Its fundamental approach had not altered since the MMC report, but it had made a number of improvements, particularly with regard to pricing and its overall consultation process.

C.39 There were extremely good and rational reasons for rescoping. Historically, Yellow Pages directory boundaries were based on GPO telephone areas but, over time, as substantial social and demographic changes took place across the UK, there had been a continuing need to reflect these changes in the coverage areas of its directories and therefore to update the boundaries. In the late 1970s, a review of Yellow Pages' directory boundaries commenced which had continued ever since.

C.40 BTYP's policy on rescoping was to identify those directories where the product offering to users and advertisers could be improved by rescoping. The objectives of a rescoped directory were to better reflect the key towns within the directory coverage area, to take account of changes in consumer shopping habits, to provide users with a greater choice of local products and services and to offer advertisers a more targeted market.

C.41 It carried out extensive market research and public consultation involving both advertisers and users, and if the public consultation did not return a majority in favour then the changes would not be implemented. Whereas previously advertisers wishing to retain the same coverage after a directory rescoping would have to pay more, BTYP had introduced a composite rate pricing structure which meant that they would not have to pay more than their original rate. Although this was not required by the undertakings it satisfied many of the concerns expressed by advertisers to the MMC. Since the MMC inquiry, BTYP's policy had been that existing and new advertisers who wished to be in both rescoped directories would pay no more than if the directory had not been rescoped.

C.42 Not all existing advertisers continued to advertise in both rescoped directories. BTYP said that in the […] rescoped directories, on average only around […] of all existing advertisers continue to advertise in both directories. In fact, only […]% of pre-rescoped customers advertised in both the […] rescoped directories and about […]% advertised in both the […] rescoped directories. BTYP's review of market research indicates that, in a re-scoped area, the percentage of new advertisers coming to Yellow Pages at the expense of […] was in line with the national average.

C.43 BTYP currently had 78 directories throughout the UK. In comparison with the historic rate of one or two per year, BTYP was planning to rescope and publish directories in ten existing areas, generating a total of 20 new directories, between now and July 2002. In chronological order the areas were Oxford, Southend, Cardiff, Mersey, Reading, London East, Cumbria, Bedford, […]. BTYP told us that as far as it was aware Thomson was not currently present in the whole of the areas covered by its Cumbria and […] directories.

C.44 BTYP told us that the reason for its accelerated programme of directory rescopings was that it had now become confident of the consultation process and price setting formula which enabled it to rapidly implement rescopings that had been under consideration for some time. By the time its planned rescopings were carried out, it would have largely completed its programme of rescoping all the Yellow Pages directories in the main geographical and urban areas outside London. After the current planned round of rescopings, BTYP had no existing plans to carry out rescopings anywhere in the UK outside London. It was considering what to do about the London area, but geographical and demographic conditions made it extremely difficult to know how to proceed. Although it would like eventually to consider rescoping, it could not foresee this happening before […].

Enhanced advertising formats

C.45 Since 1996, BTYP had introduced a number of product developments to its Yellow Pages directories, including additional advertisement sizes, colour in advertisements (such as spot colour), London Guides and City Guides, and was planning to introduce the wider use of colour in the foreseeable future. For advertisements including colour, price premiums were typically around 150% of the prices for the standard advertisements, with a current take-up rate of some […]% of advertisements.

C.46 BTYP charged varying levels of premium, from 40% over the standard rate for White Knock-out (the printing of white on yellow paper onto which further colours, or black, are printed), to about 75% for full process colour. It expected that the eventual take-up of such advertising would be about […]% of all advertisers.

C.47 Such innovations were not a cost-free development, and BTYP told us that there was an element of commercial risk since its printer, RR Donnelley, had had to invest some […] in upgraded printing facilities, […].

Directory areas

C.48 BTYP said it was prevented by paragraph 9(2) of the undertakings from distributing directories outside of their specified distribution areas, such as into a neighbouring directory area, except in response to a specific request. There were a few directories with small pockets at the perimeters of their distribution areas where it received regular requests, as well as a significant number of complaints from consumers for a copy of the neighbouring area directory, either instead of or in addition to the home directory.

C.49 It said that of these areas, 11 in total, only one, Coalville in Leicestershire, represented more than 5.4% of the circulation of the home directory area. Coalville was transferred in a wider rescoping exercise in 1995 from the Leicester to the Derby directory. The area in question represents 13.2% of the home directory circulation, significantly larger than for the other ten areas. Although consumer research at the time of the rescoping indicated a general preference for the new scoping, BTYP had received a steady stream of complaints, arising from requests from consumers for a copy of the Leicester directory, either as well as or instead of the Derby directory. Its preferred solution was to include a card with each directory offering recipients the opportunity to continually receive a second directory.

C.50 Customers in any case had the option of requesting a second directory. The effect of BTYP implementing its preferred solution would be that of the 124,000 or so delivery points in these areas (of a UK total of nearly 30 million), some 7,000 would be transferred to a different directory area, 27,000 would receive two directories, and the 90,000 customers in the remaining areas would have the option of receiving another directory in addition to the home directory.

COMPETITORS

THOMSON

Background

C.51 Since 1995, Thomson had achieved increased efficiencies within its business and had introduced numerous innovations to its product range as well as investing in the business in general. In particular, it had been able to increase its printed directory revenues by some 10.8% in 1997 and 8.4% in 1998. During the same period, it also increased its revenues through the increased success of its business information group, which derived revenue of […] in 1996 and revenues of […] in 1999 and increased its revenues from internet advertising services from […] in 1998 to […] in 1999.

C.52 Thomson had also striven to reduce its costs since 1995, reducing “uncollectables” (including, credits, write-offs etc.) from […]% in 1996 to […]% in 1999. This reduction was attributable in particular to improved debt collection procedures which had reduced debtors, and improved customer service which had reduced the number of credits issued. Direct costs had reduced considerably as a proportion of revenues over the review period as the business identified and implemented efficiencies across the board. It had also enhanced its efficiency through reorganisation of its sales force. It had been able to increase its revenues per sales person from […] in 1996 and to […] in 1999 while at the same time reducing its direct selling costs as a percentage of revenue from […]% to […]%.

C.53 As a result of its initiatives, Thomson had been able to grow its earnings before interest, tax, depreciation and amortization “EBITDA” from […] in 1996 ([…]% of revenue) to […] in 1999 ([…]% of revenue).

The relevant market

C.54 Thomson considered that in the period since the Secretary of State accepted undertakings from BT, the market for printed classified directories had changed little. Thomson had continued to provide competition to BTYP, but there had been no significant new entrants to the paper-based classified directory sector and there was little prospect of such entry. This was consistent with the MMC's analysis and conclusions.

Competition with other printed directories

C.55 Thomson had been able to increase its market share in the period immediately after the acceptance of the undertakings from a share of [...]% in 1994 to [...]% in 1998, but it had already fallen back to [...]% in 1999. Thomson submitted that BTYP's decision to continue its aggressive "copy-cat" tactics rather than develop its own differentiated product innovations could have been a cause for the decline of Thomson's market share and was detrimental to long term competition and innovation and hence contrary to the interests of advertisers and consumers alike.

C.56 In respect of the MMC's findings, Thomson considered that the application of a price control to BTYP would inhibit competition and innovation, and that, since only BTYP could use the "Yellow Pages" trade mark, Thomson and new entrants would be at a substantial competitive disadvantage to BTYP.

Non-price competition with other printed directories

C.57 Thomson said that it had continued to offer vigorous non-price competition since 1996, and that the level of competition had grown with the development of new and innovative products, and it had also introduced directories in new areas. Its activities, and BTYP's response to them could be considered under three headings: directory innovations, directory scoping; and new products and services.

C.58 Thomson said that it had been consistently innovative, and that this had acted as a competitive spur to BTYP. Thomson said that BTYP had followed its lead in the introduction of Spot Red, White Knock-Out and full colour advertisements, and in the addition of special information sections, for example the local guides and the trade association guides. Thomson Directories also had unique functional features such as the A-Z business listings and tabbed section dividers.

C.59 It complained that BTYP, however, instead of differentiating itself by its own innovation had copied that of Thomson. For example, BTYP introduced White Knock-Out, then full colour classified advertising after Thomson. BTYP charged varying levels of premium, from some 40% over the standard rate for White Knock-Out (the printing of white on yellow paper onto which further colours, or black, are printed), to about 75% for full colour. Other initiatives referred to by Thomson were the use of pricing initiatives for new advertisers and for existing ones who wished to upgrade their presence. Thomson argued that the enhanced charges introduced by BTYP for these formats had enabled it to get round the effect of the price cap by a significant margin. Furthermore, without the competition provided by Thomson it was unlikely that BTYP would have undertaken these innovations.

C.60 Thomson maintained that the primary point of competition between it and BTYP was differentiation in the scope of the directories and argued that since 1996 BTYP had commenced a programme of rescoping its directories to match more closely the scope of its own and that this programme appeared to be accelerating. It told us that there was no "natural" scope for the directories, and the economically rational scope for a directory could only be determined when a provider had taken a decision on how to position itself in the market.

C.61 While Thomson recognised that the OFT might not presently be in a position to recommend that BTYP should relinquish its rights to the "Yellow Pages" trade mark, it considered that BTYP's continued ownership of the trade mark entrenched its dominant position in the core market for printed classified directories. Thomson considered that, for as long as BTYP continued to refuse to license others to use this trade mark, it would continue to enjoy a significant competitive advantage, which would necessitate the regulation of its conduct to prevent it from exploiting that advantage improperly.

Competition with other media

C.62 More significant developments had occurred in other related product sectors, in particular in the development of Internet services offering on-line access to classified directory databases. Thomson and BTYP also offered classified directory advertising services through the Internet, although they were separate from the printed directories and would not necessarily have the same advertisers. Thomson had been at the forefront of the development of on-line access to classified directories, with its proprietary service now named Thomweb. Its business finder on-line directory was also distributed on other Internet sites. It had continued to innovate by introducing premium advertising packages, enhanced functionality such as mapping services and "real call", which allowed a user to make a request on-line for a business to call back.

C.63 BTYP and Scoot were engaged in ventures to exploit their business finder databases through other Internet players, for example Freeserve which provided a business finder service in conjunction with Scoot. As well as being available through their own web sites, the on-line classified directory services were also available in conjunction with other service providers: Thomson's online business finder, for example, was available on the Lycos service as well as on its own Thomweb site. BTYP's database was available through its own web-site and through Excite.

C.64 Thomson considered that these services did not compete directly with printed directory advertising services: in particular, on-line services had not attained any substantial level of penetration of the population at large, and they continued to generate relatively low levels of revenue. It said it should be noted, however, that as yet the availability of Internet access to domestic users was relatively limited and Internet access itself was slow and inconvenient. The availability of access to the Internet was particularly low among lower income households, so that advertising on an Internet-based directory service was not an attractive option for companies wishing to promote their services to large sectors of the population in their homes.

C.65 By contrast with Internet services, telephonic services such as BTYP's "Talking Pages" service and Scoot's telephone service were available to the majority of consumers in their own homes, but did not present the same volume and range of information to consumers as a printed classified directory.

C.66 In the light of these factors, Thomson considered that the provision of advertising services in printed classified directories continued to comprise a separate market, and the availability of opportunities to advertise in other media did not impose an effective competitive constraint on BTYP as the dominant supplier of printed classified directories.

Impact of the price cap

C.67 In Thomson's opinion, the price control undertaking had served little useful purpose: although it had prevented BTYP from raising its prices to advertisers across the board by as much as it otherwise might have done, the formula was too crude to be an effective control on BTYP's prices for new product offerings such as colour advertising. Thomson argued that there were two principal means by which BTYP had been able to mitigate the effects of the price cap: by introducing enhanced advertising formats for which it charged premium rates; and by rescoping its directories.

C.68 However, Thomson believed that it would be a mistake for the OFT to seek to introduce a more sophisticated form of price control, designed to cover new product offerings as well as existing ones: there would be a serious risk that, if it were to do so, it might have the effect of stifling innovation. In particular, such a price control might deter Thomson from continuing to innovate for fear that, if BTYP were to copy its successful innovations, and were to offer them at the price-controlled price, that would force Thomson to reduce its own prices to a level which would be insufficient to remunerate it for its costs and for the risk associated with such innovations.

C.69 Thomson favoured the removal of the price cap, arguing that it was not an appropriate way of regulating the market. It believed that there were other, more effective ways of achieving this end, such as governing BTYP's behaviour with regard to directory rescoping. Thomson said that since BTYP had told its customers that it was limiting price increases, it had itself been constrained in its ability to raise prices, since [...]% of its customers were also customers of BTYP. Although Thomson's rates were not capped, Thomson told us that its customers would be resistant to a rate rise by Thomson only.

Flexible price cap

C.70 Thomson viewed a flexible price cap as being even less welcome than the current rigid one: it viewed a flexible price cap as a means by which BTYP could selectively introduce price promotions to the detriment of competitors. It had no fundamental objection to any BTYP price promotion outside of a price formula: this was the nature of competition.

C.71 We put BTYP's proposals for a flexible price cap to Thomson for its comments. Principally it argued that such a regime would allow BTYP to engage in costless price discrimination. Thomson considered that BTYP could target it with price reductions in selected directory areas while recovering any revenue losses by increasing prices in other directory areas, to an extent limited by the specific formulation of the price cap.

Directory rescoping

C.72 Thomson told us that it differentiated itself from BTYP in one key respect – by the scope of its directories – which almost invariably had a smaller distribution area than Yellow Pages (BTYP currently had 78 directories while Thomson, with a smaller UK geographical and demographic coverage had, in 2000, 170). Although Thomson's cost per circulation figures were generally higher than BTYP's, the advertising rates were usually lower because of the smaller circulation, and this appealed to advertisers who did not require the wider coverage offered by Yellow Pages. [...].

C.73 Even though BTYP might have honoured the letter of the undertaking imposed as a result of the 1996 MMC report which effectively prohibited the publication of local directories, Thomson said BYTP had recommenced a programme of selectively rescoping of its directories to mirror Thomson's local directories, with a view to targeting it. In an effectively competitive market, Thomson would expect to see competitors copying its most successful products, but the situation was quite different here, and with BTYP as the dominant supplier there was little prospect of new market entry. Thomson's presence in the market was essential to provide a spur to innovation, and consumers would be seriously damaged if BTYP were to be allowed to use selective rescoping as a weapon to drive Thomson out of the market. Thomson said that the MMC had noted that the offering by BTYP of directories which were scoped similarly to Thomson's could be expected, in the longer term, to reduce both choice and competition.

C.74 Thomson put forward two arguments regarding the linkage between the price cap and rescoping, and how this might influence BTYP's behaviour. Thomson's concern was that since it saw BTYP's rescoping activity as having the effect of targeting its own directories, this would be exacerbated by any additional incentives for BTYP to rescope.

C.75 First, Thomson maintained that the existence of a price cap would encourage BTYP to rescope since it could increase its overall rates per thousand circulation, and it argued that BTYP could do this by means of increasing the rates by more than permitted by the price cap while adhering to the letter of the undertakings.

C.76 The second argument was that the presence of a flexible price cap would increase BTYP's incentive to rescope, compared with a more rigid one such as currently applies. Thomson's concern was that BTYP could recover a reduction in charges for some users by raising prices for others. By rescoping, Thomson maintained that BTYP could manipulate the relative volumes of advertising in different directories such that average controlled prices could rise by more than the level intended under the price cap.

C.77 Thomson told us there was a clear link between BTYP's practice of rescoping, and its (pre 1996) practice of introducing local directories which copied the scope of Thomson's directories: both practices could clearly be deployed to copy Thomson's products, and to undercut Thomson's prices.

C.78 Thomson considered that the MMC's conclusion on the publication of local directories, at paragraph 2.100 (b), and their account of the steps being taken by BTYP, were wide enough to allow BTYP now to be required to give an undertaking which covered rescoping as well as the publication of additional local directories. Thomson went on to argue that BTYP's current policy of rescoping could be seen as having the effects on the market which were identified by the MMC in connection with the publication of local directories, and that this was likely to reduce both customer and user choice, and to reduce the effectiveness of competition from Thomson by removing the primary point of differentiation between the two companies' directories.

C.79 BTYP's rescoping of the Gloucester directory into separate Gloucester and Swindon directories meant that the new editions more closely matched its own areas. [...].

C.80 Thomson argued that BTYP rescopings had the effect of targeting Thomson directory areas. [...]. It put forward two arguments that the matter of rescoping should be looked at as part of the review: first, that rescoping raised issues similar to those raised in the context of the publication of BTYP local directories at the time of the MMC inquiry; [...] and therefore the matter of the level of the price cap could not be looked at in isolation from rescoping.

SCOOT.COM PLC

C.81 Scoot.com plc (Scoot), a classified directory publisher which supplied telephone-based and electronic services, told us that Yellow Pages remained the bedrock of the classified directory advertising market, and an entry in it was perceived as a “must have” by advertisers. As a brand name, it was on its own in terms of market strength and position, and also acted as a feeder to BTYP’s non-printed classified directory services. In the present state of the market, from the standpoint of the advertiser, the printed and non-printed classified directory market remained one large market.

C.82 However, the development and eventual emancipation of the non-printed directory market as a separate market depended crucially on two things: the reliability of the technology and the development of value-added services. Moreover, the development of a truly competitive market in such services depended to a large extent on BT not being able automatically to transfer its dominance in the printed market into the non-printed market.

C.83 Developments in the classified directory market since 1996 were in the non-printed rather than printed directories. Nevertheless, despite the advantages that improving technology could offer consumers, natural conservatism and the general convenience of a printed directory meant that Yellow Pages were still the bedrock of the classified market. Scoot considered that the printed Yellow Pages directory was likely to be relied upon more than BTYP’s equivalent Internet-based Yell service.

C.84 One of the key benefits of printed classified advertising directories as compared with classified advertising in newspapers or magazines was the perception by the customer that the list was comprehensive. In this respect, although most printed classified directories offered a free-line entry, Yellow Pages had a clear advantage over competitors as many businesses would regard an entry in Yellow Pages as essential.

C.85 Scoot said there appeared to be little scope for new entrants in the printed classified directory market, and was unaware of any new entrant in the printed sector. In the electronic sector new entrants include Virginbiz.net, Ask Alex, Fish4, Ineed.com and Citypages. Services such as Ask Jeeves, although not strictly a classified directory service, used portals to achieve a similar result and might represent an alternative direction in which the electronic directory market was moving. There were also many general search engines, and local area directories, but these appeared to be distinguishable from the classified directory market as typified by Yellow Pages and, although they might compete to some extent, appeared not to be in the same market as comprehensive directories.

C.86 It was likely that the printed and non-printed markets would move further apart, as the range of options in the non-printed classified directories become more sophisticated. However, the growth of television and Internet had only a limited effect on printed matter such as newspapers, magazines and books. Scoot did not consider then that Yellow Pages' core market would be particularly affected by the changes in the electronic directory market. On this basis Yellow Pages would remain the first option for most advertisers for the next three to five years.

TELEPAGES

C.87 At the time of the MMC inquiry, Telepages (now called Telepages local directories Limited) published 22 local classified directories for free distribution mainly in central southern England, with a 1994 turnover of just over £1 million. Telepages now operates on a franchise basis, publishing 17 directories with each one covering an area of some 15 to 20 miles radius, with an average circulation of around 60,000. It told us that following BTYP's rescoping of its Gloucester and Swindon directory into two separate directories, it had lost about 10% of its advertisers in its own areas which were also covered by the rescoped Yellow Pages directories.

COATES PUBLICATIONS (COATES)

C.88 Coates publishes the Pink Pages classified directory, distributed to some 85,000 households and businesses for four telephone dialling codes in East Anglia. It told us that the BTYP price cap may have helped advertisers' advertising budgets but it had not helped BTYP's competitors whose rates must be set (and limited) by reference to the market leader's rates. Competition for BTYP was only likely to come from Thomson, or a new entrant to the market backed by substantial funding and experience. Other than that, it knew of no particular barrier to a new market entrant. It did not know of any potential competitors to BTYP which had entered the market, but believed that the price cap had held down advertising rates and would discourage any potential competitor to BTYP from entering the business classified directory market.

C.89 Coates believed that the price cap was too severe and should be eliminated. There was sufficient competition in the wider advertising market, particularly from the Internet both now and in the future, to ensure that advertisers were charged a fair price for the different forms of advertising.

C.90 BTYP remained the undisputed market leader and covered the whole country. Thomson was seen as less important and did not cover all of the country. In the few areas where the Pink Local Directory was published, advertisers ranked it on a par with Yellow Pages.

C.91 Anecdotal evidence about complaints concerning BTYP by advertisers had significantly reduced in recent years. Although its sample was very small and was not representative, it did seem that there had been a definite improvement in BTYP's levels of service.

TRADE ASSOCIATIONS

The Institute of Plumbing (IOP)

C.92 The IOP, the UK's professional body for plumbers and others in the plumbing industry, agreed an Advertising Screening Programme with BTYP covering the vetting of all advertisements of plumbing engineering services for misuse of its logo. It said that there had been a reduction in complaints arising from such misuse. It was complimentary about BTYP's quality achievements, and general communication with its members.

The Driving Instructors Association (DIA)

C.93 DIA represents the interests of driving instructors in the United Kingdom. It told us that its members considered Yellow Pages and Thomson Directories as matched competitors, but the introduction of Thomson Local had confused advertisers. While aware of competition for the directories in the electronic market it had not become involved.

C.94 It believed, from its members' viewpoint as advertisers, that Yellow Pages was marginally better than Thomson Directories or Thomson Local due to its better coverage and distinctive brand.

C.95 It told us it was aware that increasing use of personal computers, mobile phones and other such products would cause a decline in the use of printed directories, but believed that for ease and speed the printed directories would be here for many years yet.

The Association of Building Engineers (ABE)

C.96 ABE is a professional body representing the interests of engineers in the construction industry. While satisfied that Yellow Pages continued to provide a consistent vehicle for members' use, it considered that recently there had been competition from such publications as the "Thomson

Local". Members supported the use of either directory by individual choice, and had also promoted themselves via the Internet.

C.97 It told us the construction industry operated on a recommendation/repeat work basis with the directories having greater play for specialist/emergency services. Individual companies worked on a business cycle and at times of expansion would use all opportunities available to advertise. No preference for any particular medium was apparent.

C.98 The greater flexibility sought by clients was being supported by modern technology and the need in for immediate response reinforced the need for information to be available in electronic format, which would involve a significant move away from printed information services.

The Association of British Travel Agents Ltd (ABTA)

C.99 ABTA is the trade body that represents the interests of travel agents in the United Kingdom. It considered that BTYP still had a monopoly in the classified directory advertising sector, and it seemed proper that the undertakings should continue to stand.

The British Association of Leisure Parks, Piers & Attractions (BALPPA)

C.100 BALPPA represents the interests of major leisure attractions in the United Kingdom, and has a diverse membership, including Blackpool Pleasure Beach, Alton Towers, Whipsnade Wild Animal Park and Drayton Manor. It considered that other trade directories, including "Thomson Local", trade magazines, the BT phone book, local papers and the Internet had all competed to some extent with Yellow Pages. It believed that WAP phones, phone services such as Scoot, and the Internet, generally would have an influence on the relative usage of printed or electronic directories.

The British Association of Removers (BAR)

C.101 BAR is the trade body that represents the interests of the removal industry in the United Kingdom. It told us that most members thought Yellow Pages advertising was necessary, and in most areas significantly superior to Thomson Local. In its experience the Yellow Pages brand name carried substantial weight and authority and BAR accepted that most potential customers would use Yellow Pages. However, there was now evidence that customers were beginning to use the Internet to search for removal companies.

C.102 BAR told us that Yellow Pages was an important source of "recognition advertising" for obtaining business. Removal vehicles were effectively large mobile advertising hoardings, making potential customers subliminally aware of the company, resulting in them making the connection in Yellow Pages. BAR thought it very important to display a badge of authority and recognition on the printed page.

C.103 While BAR thought that increased use of the Internet to search for suppliers in general was expected, among removers it was unlikely to supersede the printed page in the near future.

The Electrical Contractors' Association (ECA)

C.104 ECA represents the interests of the electrical contracting industry in the United Kingdom. It told us that Yellow Pages was the principal source directory for homeowners seeking building and associated contractors. However, it was very concerned that Yellow Pages did not provide any qualification or guarantee of competence and accountability of those represented. Thomson Directories did act as a competitor to Yellow Pages, but was not seen to be as comprehensive.

C.105 It pointed out that the Government was seeking to introduce a "Quality Mark" scheme for construction services and that, in the long term, this could provide an alternative to Yellow Pages for the construction sector.

C.106 ECA also said there that were a number of web directories trying to get established. Qualification requirements for inclusion were not transparent or authoritative, and none of these services had yet reached a general level of awareness amongst the general public. There were also a number of businesses setting up approved supplier networks on the Internet, but it would be some time before they gained recognition.

C.107 ECA considered that the public interest would best be served if each industry sector had a trade body which developed and maintained a qualification system for its sector, to improve the quality of the service provided by the directories to the general public.

The Automotive Distribution Federation (ADF)

C.108 ADF, whose members include motor distributors and factors in the United Kingdom, had no reports of Yellow Pages circumventing the price cap undertaking: rather the opposite in terms of preferential pricing for the ADF group scheme.

C.109 It had received reports from members of inflexibility of Yellow Pages on the classification of businesses within its directories which, given the spread of the target audience, forced members to advertise in more than one classification.

C.110 The ADF said that members made no significant use of alternative printed directories. However, many had their own web sites, and it assumed that the effectiveness of these and of different search engines would seriously impact upon the printed directories.

C.111 It said customers consulted printed directories in a time of need, unlike the advertising found in magazines or newspapers. While the latter could provide a link to a directory entry, advertising in a directory indicated permanence in the market that would not be apparent from classified advertising in a periodical.

C.112 Yellow Pages was the only directory mentioned by members, but the ADF was aware of a growing number of e-commerce sites operating within the sector. None, however, yet had a market leader role.

C.113 The ADF had received only one complaint from its members regarding a complaint about BTYP, which related to the timeliness of corrective action in advertisements. An error in production could not be corrected until the next directory reprint, although an improvement in Yellow Pages' proof reading arrangements had recently been noted.

C.114 […]

C.115 […]

C.116 […]

C.117 […]

C.118 […]

C.119 […]

OTHER ORGANISATIONS

The Directory and Database Publishers Association (DPA)

C.120 The DPA represents all of the major providers of classified directories in the UK, notably BTYP, Thomson and Kingston Information Services. It was unaware of any significant new entry into the market for printed directories, and considered that the new entrants in the provision of electronic services currently posed no competitive threat. On printed material alone, some of its members believed that the relevant market was as narrow as classified directories alone, while others thought that the market could be broadened to include controlled circulation local newspapers as they competed for suppliers' advertising budgets. Although the DPA expected that electronic services would form a significant part of the market they had not yet done so, and early use was weighted toward the business to business sector.

C.121 On a separate matter, the DPA told us that when it had contacted BTYP, on behalf of advertisers who had complained to the association, it had got a quick response. There had been only four written complaints since 1996, and the most recent of these was in 1998.

Referenceline.com (Referenceline)

C.122 Referenceline, a company helping consumers to find suppliers by publishing recommendations and testimonials on its web site, told us that directories played a much broader role in overall competition within the UK than was recognised in the MMC investigation, notably in the market for home improvements and maintenance. They permitted a culture of unsubstantiated claims ("approved", "guaranteed" etc) by companies that were actively encouraged to adopt bogus names, such as O.O.O.Aaaaardvaark in order to get to the front of a classification.

C.123 It believed that BTYP and Thomson should be encouraged to compete with each other to meet the real needs of advertisers and consumers, and that this would generate some exciting and genuinely novel competition.

C.124 Both directory publishers should be required to offer an economy display advertisement, such as a quarter column, at a highly affordable, regulated, price (set annually in terms of cost per thousand circulation). The objective would be to draw a much larger number of firms into the directory, thus increasing competition for consumers. This would create a natural downward pressure on the desirability and pricing of larger advertisements. The price could be even lower, if advertisers were allowed to submit their text by post or email, avoiding the need for expensive sales visits.

C.125 It felt that both publishers should be required to include prominent information and "government health warning" sections for consumers, with the objective of supporting reputable firms and consumers, advising consumers on what to look for and what questions to ask. The costs should be met in full by BTYP and Thomson and funded by advertisers and sponsors.

C.126 It considered that price caps were generally too hard to police in this industry, given the wide range of “new” advertisements that could be discontinued or introduced.

D DESCRIPTION OF CLASSIFIED DIRECTORY ADVERTISING SERVICES

D.1 Classified directory advertising services are the undertaking and performance of engagements to publish advertisements in directories which show suppliers of goods and services classified by reference to the goods or services supplied, and which are distributed wholly or mainly to consumers free of charge.

D.2 The main supplier of the reference services in the UK is BT through its Yellow Pages trading division (BTYP), which publishes Yellow Pages directories. The only other major supplier is Thomson which publishes the Thomson Local directories. Kingston Communications (Hull) plc publishes the Hull & District Yellow Pages which is similar to Yellow Pages in Kingston's area of supply.

D.3 The precise origin of the term 'Yellow Pages' is unclear. We understand that the first separate classified directory printed on yellow paper was published in Detroit, USA by the Michigan State Telephone Company in 1906. In 1920 the classified headings were standardised by Yellow Pages publishers across the USA. The American Telephone and Telegraph Company launched its successful Walking Fingers logo in 1963.

D.4 In the UK, the General Post Office (GPO) first published Yellow Pages classified sections in 1966, which were incorporated into the main alphabetical directories published by the GPO. The term had, however, been used by the Hull telephone company before then, and the GPO had itself previously produced classified sections in its phone books but had not branded them as Yellow Pages. As the Yellow Pages sections became larger the GPO began publishing them as separate volumes. Until 1980, when its contract expired, the advertising space in them was sold by Thomson Yellow Pages Ltd which had been appointed as the agent for this purpose by the GPO. Although Thomson tendered for the replacement contract for the whole Yellow Pages area, it was offered only Scotland, and elected instead to produce its own directories in competition with Yellow Pages. A partnership for this purpose was formed in July 1980, owned equally by the Dun & Bradstreet Corporation and the Thomson Corporation, under the name Thomson Directories Ltd. Thomson then launched its own series of classified directories in 1981.

D.5 BTYP currently publishes 78 Yellow Pages classified directories which, between them, cover the whole of the UK (excluding the area in and around Hull). Thomson currently publishes 170 directories – The Thomson Locals. Each of these generally covers a much smaller area, usually about 200 to 450 square kilometres, than BTYP's main directories. Thomson's directories do not cover the whole of the UK, but include the main centres of population (including most of southern England, the Midlands, the North-West, West and South Yorkshire, the North-East and the Glasgow, Edinburgh and Aberdeen areas); they cover about 85% of all UK households and businesses.

D.6 There are a number, perhaps 150 or more, of other suppliers of classified directory advertising services, but all are very small and generally serve only local markets.

E THE FINANCIAL PERFORMANCE OF THOMSON

The table below shows Thomson's financial performance since 1990. The figures are based on the Group revenues, since it was unable to separate the costs of its printed directory business from those of its other revenue streams.

THOMSON'S FINANCIAL PERFORMANCE FROM 1990 TO 1999

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
Net sales (£m)	39.6	43.9	45.8	47.4	51.4	58.8	65.5	73.7	81.6	85.6
Direct costs (£m)	21.6	28.4	27.6	27.5	30.3	35.5	38.4	41.3	40.8	41.7
Gross profit (£m)	18.0	15.5	18.2	19.9	21.1	23.3	27.1	32.3	40.8	44.0
Overheads (£m)	13.7	14.7	15.6	13.9	15.3	17.9	21.4	25.1	25.6	23.3
Operating profit (£m)	4.3	0.8	2.6	6.0	5.8	5.4	5.7	7.2	15.2	20.7
Return on Sales (%)	10.8	1.9	5.6	12.7	11.3	9.2	8.7	9.8	18.6	24.2

Note 1 Thomson's financial year ends on 31 December

Note 2 Figures up to and including 1994 are as reported in the MMC report

Note 3 The figures for 1995 to 1999, except those for Return on Sales, are as provided by Thomson

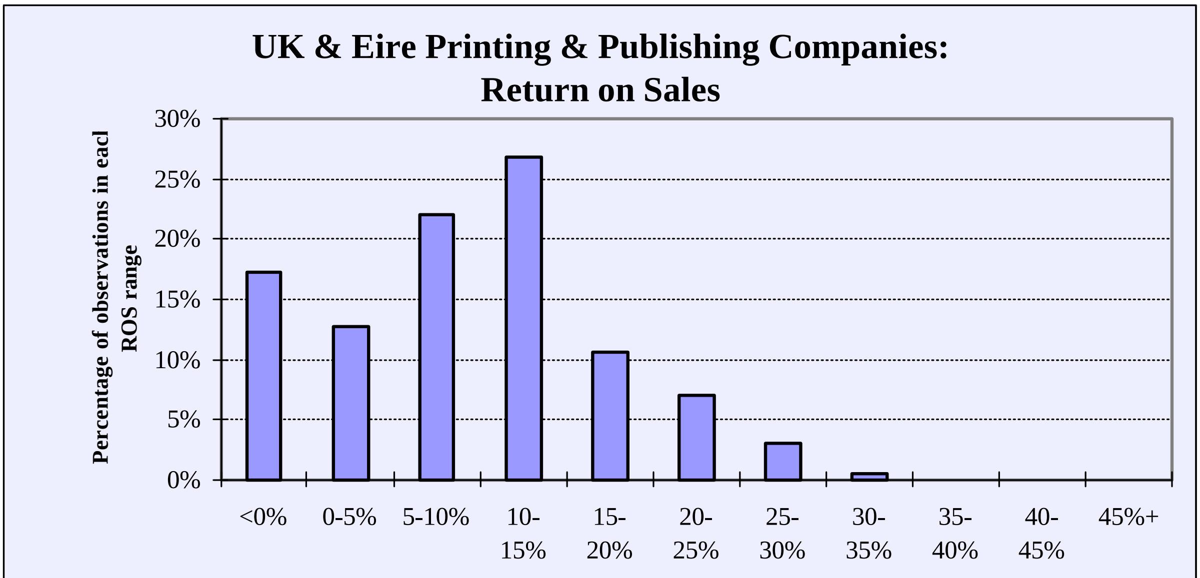
F COMPARATIVE RETURN ON SALES

Part I: UK and Eire

F.1 The data in the following tables are derived from the Company Analysis database. This is a database of all listed UK and Irish companies and a number of the larger unlisted companies, contributing a total of more than 4000 companies. We sought to identify those companies which may face similar risks as BTYP and which require relatively low investment in assets as compared to those in related sectors.

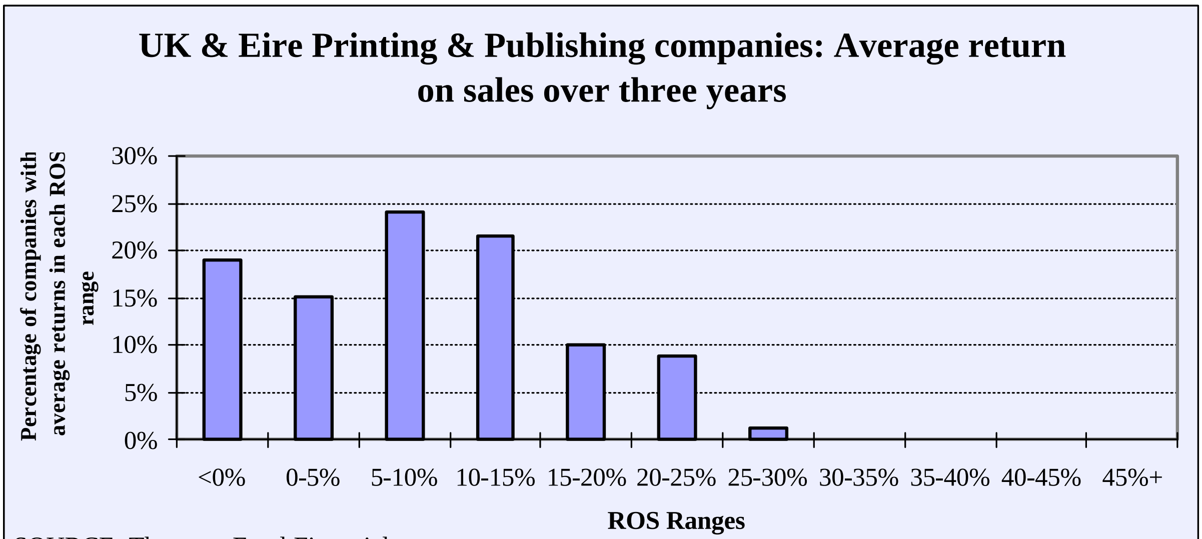
F.2 The three comparative groups we have considered are those classified as Printing and Publishing, those classified as Communications, and the 200 companies with the highest sales to gross assets ratios i.e. those that are least capital intensive. Printing and publishing companies were selected as the supply of classified directories is a printing and publishing activity. Communications companies, in particular, those funded by the sale of space on airtime to advertisers may face similar risks. We recognised, however, that not all companies in these groups would be directly comparable to BTYP, for this reason we looked at a number of comparators. In all cases we restricted our search to UK & Eire.

F.3 There were 79 companies in this population and we obtained information for the last three years, where available, giving a total of 227 data points or observations. The distribution of ROS for each of these observations was as shown below:



SOURCE: Thomson Extel Financials

F.4 The distribution of the average ROS achieved by each company over the last three years was as shown below:



SOURCE: Thomson Extel Financials

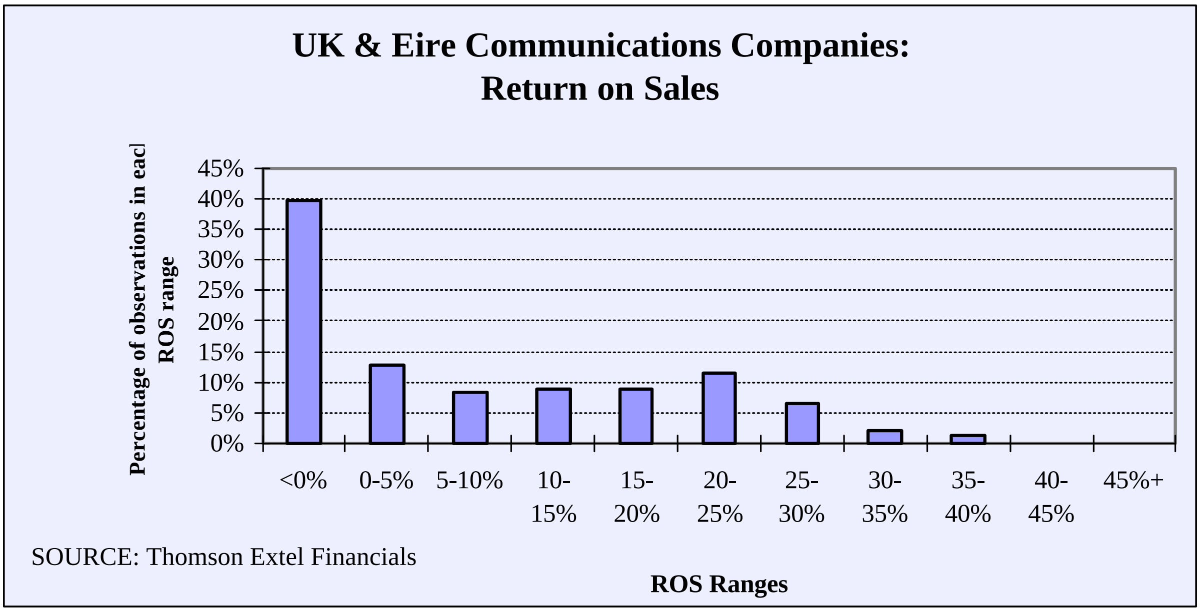
F.5 These charts and the table below show that only one company, Scottish Radio Holdings plc, achieved an average ROS over the three years of more than 25% and only six companies achieved a ROS greater than 25% in at least one year. All these companies, with the exception of Thomson Intermedia plc, were, however, more capital intensive (measured by the ratio of capital employed to sales) than BTYP and might therefore be expected to earn a higher ROS.

Name	**Sector**	**Year to**	**ROS**	**Capital employed*/ sales (3 year average)**
AdVal Group plc	Misc publishing	31 Mar 98	30%	0.36
Durlacher Corporation plc	Stockbroker	30 Jun 00	28%	0.48
Johnston Press plc	Newspapers	31 Dec 99	27%	1.52
		31 Dec 98	26%	
Scottish Radio Holdings plc	Radio broadcasting	30 Sep 99	26%	1.07
		30 Sep 98	27%	
Stockcube plc	Research in investment / commodity markets	31 Dec 98	28%	1.16
Thomson Intermedia plc	Provision of media monitoring services (via internet)	31 Jan 00	31%	Negative average capital employed

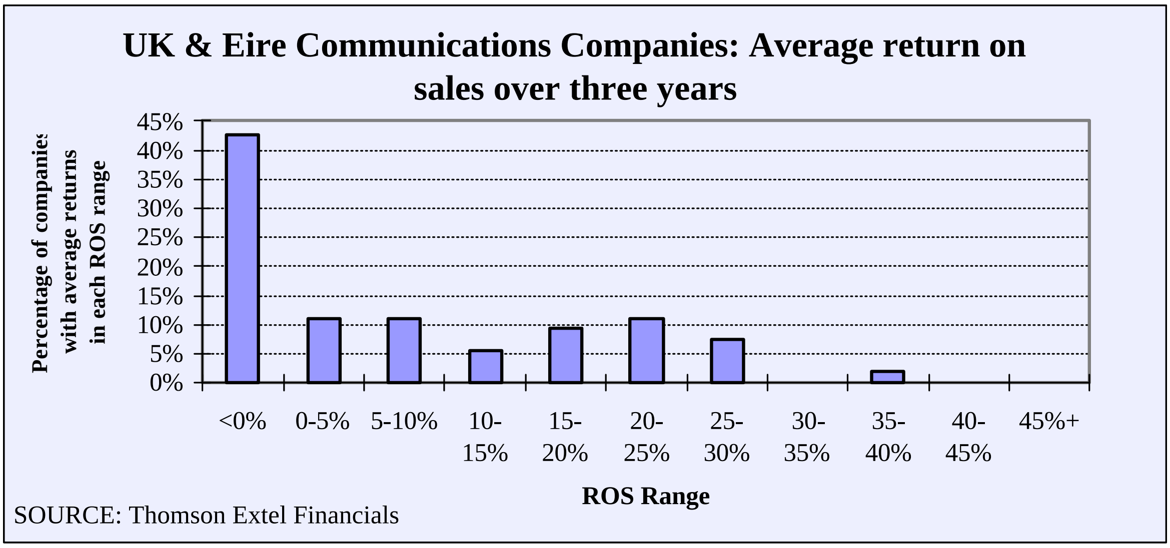
*BTYP's ratio of capital employed to sales for the financial years 1996/7 to 1999/00 was between 0.29 and 0.32

Communications

F.6 There were 54 companies in this population and again we obtained information for the most recent three years, where available, giving a total of 156 data points or observations. With a large number of Internet companies and other relatively new companies this population had many loss making companies. The distribution of the ROS for each of these observations was as shown below.



F.7 The distribution of the average ROS achieved by each company over the last three years was as shown below:



F.8 These charts and the table below (which shows all the companies achieving a ROS of 25% or more in any of the three years) show that five companies achieved an average ROS over the last three years of more than 25%. These were Capital Radio plc, Granada Media plc (the television production business), Scottish Radio Holdings plc, United Utilities plc, and National Grid Company plc. A further two companies, Ulster Television plc and Vodafone plc, achieved a ROS above 25% in at least one year.

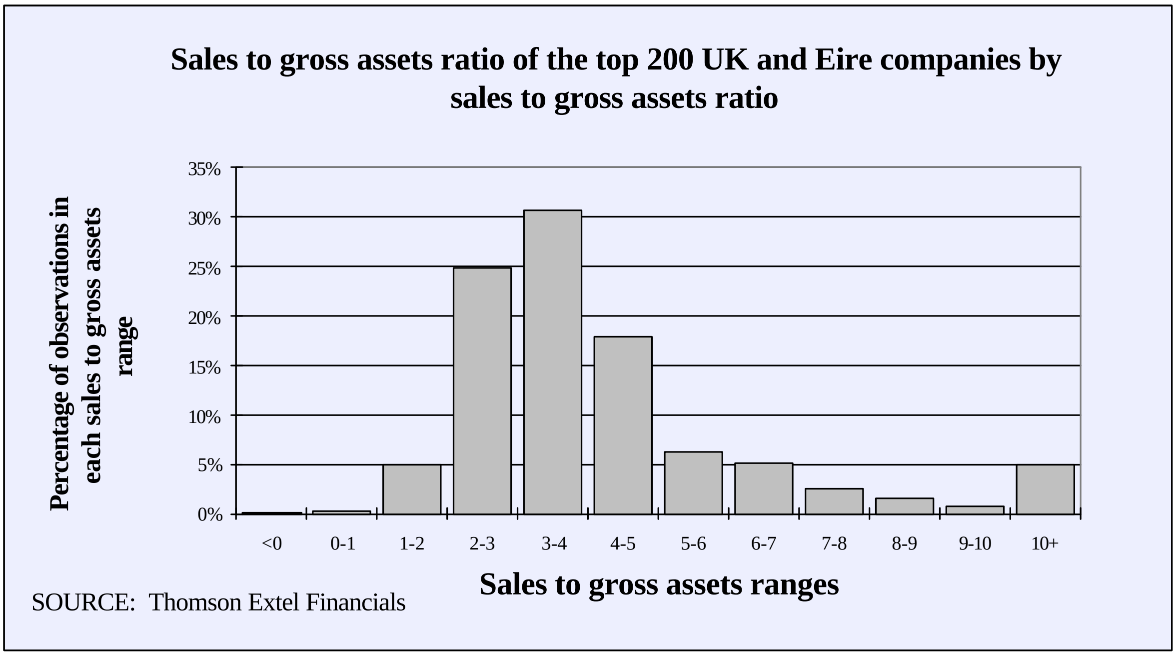
F.9 While United Utilities plc and National Grid Company plc have some communications interests, they are primarily utility businesses. The table shows that these companies are relatively capital intensive which explains their high ROS. The other companies are also shown to be more capital intensive than BTYP, although Capital Radio plc, Granada Media plc and Ulster Television plc are not greatly so.

Name	**Sector**	**Year to**	**ROS**	**Capital employed*/ sales (3 year average)**
Capital Radio plc	Local radio broadcaster	30 Sep 97	29%	0.40
Granada Media plc	Content creator and broadcaster	25 Sep 99	25%	0.40
		26 Sep 98	25%	
		27 Sep 97	27%	
National Grid Company plc	Electricity supply	31 Mar 00	35%	2.00
		31 Mar 99	38%	
		31 Mar 98	34%	
Scottish Radio plc Holdings	Radio broadcasting	30 Sep 99	26%	1.07
		30 Sep 98	27%	
Ulster Television plc	Operation of Channel 3 licence for Northern Ireland	31 Dec 99	31%	0.39
United Utilities plc	Operation of electricity distribution, water and waste water assets	31 Mar 00	29%	2.24
		31 Mar 99	30%	
		31 Mar 98	27%	
Vodafone Group plc	Mobile telecommunications and products	31 Mar 99	25%	1.53
		31 Mar 98	26%	

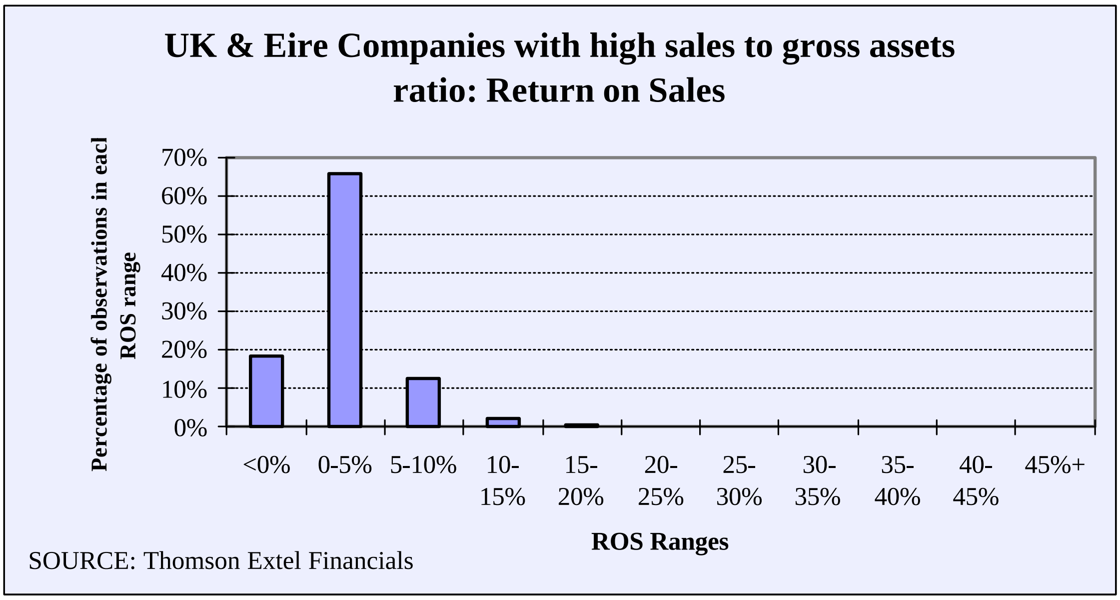
Other potentially relevant companies with high sales in relation to gross assets

F.10 Finally, we identified the 200 least capital intensive UK and Irish companies as measured by the ratio of sales to gross assets. These comprised companies from various sectors including asset management and other financial services companies, advertising agencies, recruitment consultancies and travel companies. Comparison with these companies is considered to be relevant insofar as BTYP is also a company with a high ratio of sales to gross assets.

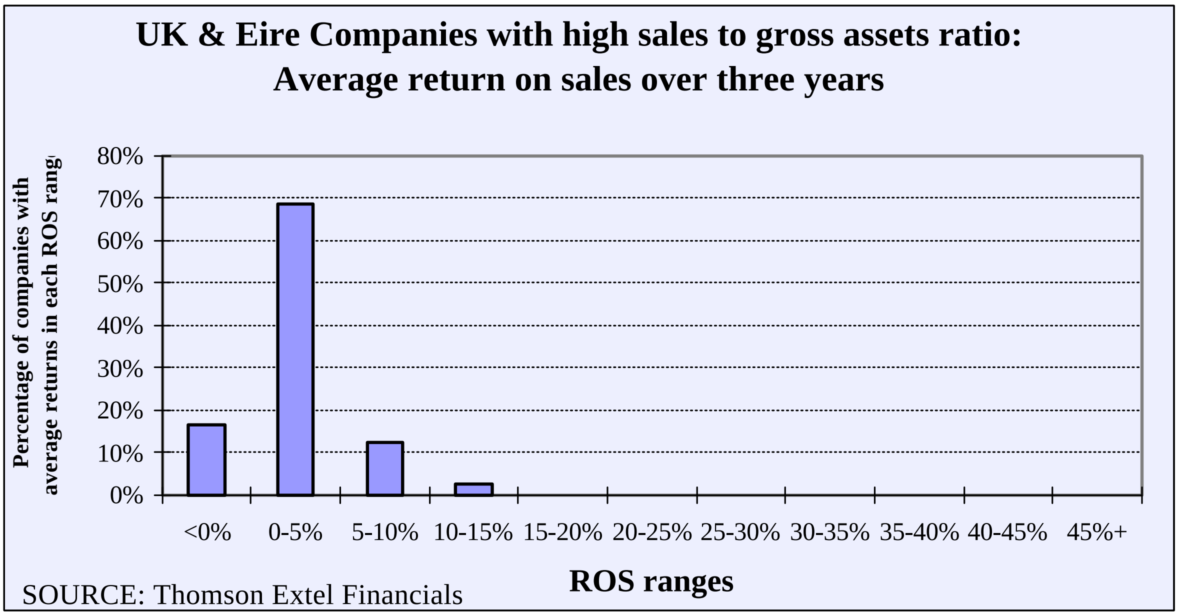
F.11 These 200 companies are the 5% least capital intensive of the companies in the database. The chart below shows the distribution of the 591 observations for these companies according to the ratio of sales to gross assets (the higher the figure the less capital intensive). BTYP would be in the 2-3 range.



F.12 The charts below show that very few of these low capital intensity companies achieved a ROS above 15% and no company achieved an average ROS over the three years of more than 15%.



F.13 The distribution of the average ROS achieved by each company over the last three years was as shown below:



Part II: International comparisons

F.14 The following figures of printed directory businesses in Europe have been provided by BTYP. They were extracted by N M Rothschild and Sons from brokers' forecasts.

	EBITDA margin 2000	EBIT margin 2000
VNU (Netherlands)– paper directories	n/a	**54%**
SEAT (Italy) –paper directories	n/a	**49%**
TPI (Spain) – paper directories	**34%**	**27%**
Wanadoo (France) – paper directories	**32%**	n/a
Eniro (Sweden)	**29%**	n/a

G BTYP REQUESTS FOR CONSIDERATION

Complaint Area	Home Book Delivery	Desired Book Delivery	Postcodes	No. of Delivery Points	% of Min Circ (Homebook)	Change Home Book (2)	Delivery Overlap (2)	Card plus standard delivery (2)(3)
Tean	Derby	Stoke	ST10 4	2,771	1.2%	1	-	-
Coulsdon	Gatwick	London South	CR5 1 & 3	6,941	3.7%	-	2	1
Chorleywood/ Rickmansworth	London NW	Watford	WD3 1,2,3,4,5 & 6	17,343	3.4%	-	1	2
Ripley	Chesterfield	Derby	DE5 3,8, & 9	9,636	4.6%	-	1	2
Barnes	London NW	London SW	SW13 8 & 9	4,145	0.8%	1	-	-
Edenbridge	Gatwick	Tunbridge Wells	TN8 5, 6 & 7	5,359	2.8%	-	2	1
Uttoxeter	Derby	Stoke	ST14 5, 7 & 8	8,595	3.7%	-	2	1
Gerrards Cross (1)	Reading	Oxford	SL9, 0, 7, 8 & 9	8,693	2.5%	-	-	1
Newton Aycliffe	Sunderland	Middlesbrough	DL5 4, 5,6 & 7	12,701	4.4%	-	2	1
Ilkeston	Nottingham	Derby	DE7 4, 5, 8 & 9	17,582	5.4%	-	-	1
Coalville	Derby	Leicester	DE12 7, LE65 1 & 2, LE67 1, 2, 3, 4, 5, 6, & 8	30,300	13.2%	-	-	1

Note 1: To be reviewed after the rescoping consultation in August 2000

Note 2: Preferred option, with 1 being the most preferred

Note 3: A postcard would be delivered to all households in the affected area offering the option to continually receive a second directory

H APPENDIX 2.1 OF THE MMC REPORT

APPENDIX 2.1
(referred to in paragraphs 2.112 and 2.116)

Reporting and disclosure requirements applicable to the BT subsidiary into which BTYP's business is hived off

1. We have proposed in paragraph 2.112 that BTYP's business should be hived off into a subsidiary of BT separate from BTYP's[1] other activities.

2. This subsidiary would be subject to the disclosure requirement of the Companies Act 1985 and to the accounting principles established by the Accounting Standard Board and its predecessor bodies. We see no need for it to be subject to the Stock Exchange requirements imposed on listed companies.

3. The subsidiary should be required to file its accounts no later than the date BT files its own accounts, whether or not it is incorporated as a plc.

4. Irrespective of any exemptions that might be available to it under the relevant accounting pronouncement or the Companies Act 1985, the subsidiary should be required:

   (a) to publish a cash flow statement;

   (b) to publish an unconsolidated profit and loss account;

   (c) to disclose details of all transactions with its parent company; and

   (d) to provide the segmental information required by SSAP 25 for plcs.

[1] It is assumed that this is intended to refer to BT not BTYP.