

FEDERAL TRADE COMMISSION
BUREAU OF ECONOMICS

GROCERY STORY ANTITRUST:
HISTORICAL RETROSPECTIVE
AND CURRENT DEVELOPMENTS

Thursday, May 24, 2007

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FTC Conference Center
Conference Rooms B & C
601 New Jersey Avenue, N.W.
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P R O C E E D I N G S

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3 MR. SALINGER: Good morning. I'm Michael
4 Salinger. I'm the director of the Bureau of Economics
5 here at the Federal Trade Commission.

6 I have to begin with some security
7 announcements. So item No. 1, please do not use cell
8 phones in this room. I'm told it's not just a courtesy
9 issue, but that it's also a security issue. So you can
10 have your phones on vibrate, but if you need to talk on
11 the phone, please go out into the hallway.

12 Second, if you leave the building, you're going
13 to -- okay. I'll just speak louder. If you need to
14 leave the building, you're going to have to come back
15 through security. So you might want to consider that
16 when you step outside.

17 And then finally, in the unlikely event that
18 alarms, fire alarms go off, then we are to go across the
19 street. There'll be lots of people who know precisely
20 where you're going to go, so just follow the apparently
21 knowledgeable people.

22 So with the security stuff out of the way, I
23 would like to welcome everyone and thank you for coming
24 to this conference. We are going to be talking about
25 merger review in the grocery store industry. But the

1 idea behind this conference is much bigger than grocery
2 store antitrust, important as that might be. We're
3 holding this conference to ask the big picture question
4 of whether merger analysis asks the right questions. We
5 cannot answer that in the abstract. We can only do so by
6 looking at evidence.

7 The Bureau of Economics tries to assess merger
8 review in a variety of ways. One important way is to do
9 retrospective analysis on individual mergers. Bureau of
10 Economics staff have been particularly active in
11 reviewing consummated mergers in the hospital and oil and
12 gas industries. The Bureau's retrospective on the merger
13 between the Evanston, Northwestern, and Highland Park
14 hospitals arguably played a key role in the Commission's
15 judgment that there is reason to believe that the merger
16 may have reduced competition.

17 In oil and gas, just yesterday I testified
18 before the Joint Economic Committee of Congress about
19 whether consolidation in the industry caused the price
20 increases we have recently seen. I was able to testify
21 that consolidation has not caused the recent price
22 increases, in part based on three oil merger
23 retrospectives performed by Bureau of Economics staff.

24 Another way in which we assess past performance
25 is to publish data about it. Bureau economists Malcolm

1 Coate and Shawn Ulrick published their statistical
2 results about the factors that assist in predicting FTC
3 actions. Of course, that analysis cannot say whether
4 merger enforcement is appropriate or inappropriate. But
5 establishing what in fact gives rise to merger
6 enforcement as opposed to reading what we say about what
7 gives rise to merger enforcement is an important step.

8 Today's conference represents a different
9 approach to assessing merger enforcement. By looking at
10 an entire industry in which there is a long history of
11 merger and merger review, we can try to put FTC
12 enforcement into a perspective that is broader than the
13 review of a single merger.

14 The design of today's conference has three
15 major pieces. The first session is the 50,000-foot
16 perspective. Paul Ellickson, a professor at the Fuqua
17 School of Business at Duke and someone who's done
18 substantial research on the grocery store industry, is
19 going to talk about his data analysis of how the grocery
20 store industry in the United States has changed over time
21 and what role mergers seem to have played in that change.
22 That will give us some historical perspective.

23 Another way to get some perspective on the
24 industry is to compare the grocery store industry in the
25 United States to the industry in other countries. We're

1 privileged today to have Benoit Durand from the U.K.
2 Competition Commission and David Parker from Frontier
3 Economics to discuss the grocery store sector in the U.K.

4 So that's part one. Then part two, after we
5 get the 50,000-foot overview under our belts: The second
6 session will dig into the trenches. We're going to
7 explore what goes on in the trenches from both sides. We
8 have two attorneys with extensive experience representing
9 grocery store clients before the FTC. Deborah Feinstein
10 from Arnold & Porter will make a presentation on behalf
11 of Kroger. And then we also have Chris MacAvoy from
12 Howrey talking about what he believes several of his
13 clients were trying to accomplish with their deals.

14 After Debbie and Chris present the grocer's
15 perspective, Jim Fishkin, who had extensive experience
16 with grocery store mergers when he worked at the FTC,
17 will talk about the general approach the FTC took to
18 reviewing deals when he was here.

19 The decision on the part of a company to
20 undertake a merger, and the decision by the FTC about
21 whether to take any action against it, both entail
22 forecasting what effects the merger will have. To
23 comment on the contrast between those forecasts, we have
24 one of my eminent predecessors as bureau director, Dave
25 Scheffman, to see whether there's any -- or to comment on

1 whether there's any connect between the two.

2 The afternoon will be devoted to recent
3 academic research on the grocery store industry. We will
4 have two sessions, each covering topics central to
5 antitrust enforcement in the industry. The first will be
6 on pricing strategies, with papers by David Bell and Jon
7 Seaton, and the second will be on industry dynamics, with
8 papers by Tom Holmes and Arie Beresteanu.

9 These will set up a discussion in the
10 concluding panel that will both revisit the topic from
11 the morning panel of whether merger review is
12 appropriately focused and then comment on whether modern
13 research provides insights that can improve merger
14 review.

15 That panel includes a distinguished group of
16 antitrust scholars and practitioners. Giving them full
17 introductions will take more time than I have for these
18 comments. But just briefly, we've have Tim Brennan, a
19 former holder of the MacDonald Chair at the Canadian
20 Competition Commission; Joe Simons, a former director of
21 the Bureau of Competition here at the FTC; and Dennis
22 Carlton, the deputy assistant attorney general for
23 economics in the Antitrust Division.

24 Now, I said the conference is organized into
25 three main pieces. But really, it's four. At lunch,

1 we're very fortunate to have Bill Kovacic, one of the
2 current FTC commissioners, giving the keynote address.
3 Bill has been a vocal proponent of how important it is
4 for antitrust agencies to devote substantial effort to
5 asking the question of whether they're doing things
6 right. Without that encouragement, I doubt that today's
7 conference would have happened.

8 Before we get on with the conference, I would
9 also like to thank Chairman Majoras and her office, most
10 notably Brian Kuzman, for their support and encouragement
11 for this conference. I'd also like to thank my fellow
12 bureau director, Jeff Schmidt, both for supporting the
13 general idea of holding the conference and for helping me
14 contact people in the grocery store industry to solicit
15 their participation.

16 Finally, I owe a huge debt of thanks to Chris
17 Adams, who fleshed out this conference. I've been
18 pushing to do this conference for nearly two years now,
19 and it was really his hard work that made it happen.

20 So again, thank you all for coming, and I hope
21 you find it to be a stimulating and productive day. And
22 with that, if we can have the panelists from the first
23 session come up.

24 Our first speaker is Paul Ellickson. As I
25 mentioned, he's an assistant professor of economics at --

1 ooh, I got you wrong in the beginning.

2 MR. ELLICKSON: Yes. I'm in the econ
3 department.

4 MR. SALINGER: You're in the econ department.

5 MR. ELLICKSON: I used to be in the business
6 school. I decided I didn't like money that much.

7 (Laughter.)

8 MR. SALINGER: He's an assistant professor of
9 economics at Duke. He received his PhD in economics from
10 MIT in 2000. He previously taught at Rochester. And his
11 research interests are industrial organization of applied
12 micro-econometrics and marketing. And he's done a lot of
13 work on the retail industry.

14 MR. ELLICKSON: So do I have slides up here?

15 Okay. Thank you for having me out. I am Paul
16 Ellickson from Duke. And I'm going to talk about the
17 evolution of the supermarket industry and a little bit
18 about mergers, the roles of mergers and acquisitions,
19 although I'll leave a lot of that detail to people who
20 know it better than I.

21 So to just give you a quick highlight of what
22 I'm going to talk about, I'm going to try to walk you
23 through the major eras in the grocery/supermarket
24 industry in the past hundred years. And the executive
25 summary of that is that there are basically four things

1 that you want to have in mind.

2 First, a hundred years ago was the chain store
3 revolution, more or less, led by A&P, which was in every
4 respect the Wal-Mart of its time. Then in the '30s you
5 got the introduction of the supermarket format, which
6 changed the scale, the store-level scale of the industry
7 quite a lot and had a lasting impact.

8 Then the next big innovation was actually not
9 for another 50 years, but was the explosion of products
10 that happened in the 1980s and the introduction of
11 sophisticated information technology at the back end in
12 the growth of super-stores.

13 And then the last important development that's
14 happened has been the entry of Wal-Mart into the
15 supermarket industry and the grocery industry, the
16 proliferation of supercenters. And the last thing I want
17 to mention is a recent phenomenon, which is the growth of
18 what people are calling extreme value stores, which are,
19 at one end, companies like Save-A-Lot and Aldi that are
20 the dollar stores of the supermarket industry, and at the
21 other end firms like Whole Food and Wild Oats. And these
22 are a couple of the fastest-growing segments of the
23 market. So that's kind of the broad points that I'm
24 going to hit through here.

25 So just to walk you through the history, circa

1 1890, a hundred years ago, people had to go -- if they
2 wanted groceries, they pretty much had to go every day.
3 They had to walk there. And they had to go to a lot of
4 different types of specialty stores. Right? So you'd go
5 to the fishmonger for your fish. You'd go to the
6 meatcutter for your meat and the produce guy for your
7 produce.

8 You had tons, like 500,000, of these types of
9 stores spread all over the place. They were tiny. They
10 were run in a pretty haphazard manner. Pretty much no
11 accounting was being done in a lot of those places.

12 And one of the things that was very costly for
13 them was that the early grocery stores before A&P would
14 deliver stuff to you. You could call them up and they
15 would bring it to you. And they also sold a lot of stuff
16 on credit, which really added to the cost for those guys.

17 And so what happened around the 1910s or
18 starting a little bit earlier than that was the Hartford
19 brothers at A&P completely changed the game. They came
20 in and said, look, I'm going to pull a page out of Henry
21 Ford's book, and I'm going to introduce standardization
22 and scale to this industry, and I'm going to build a
23 giant network of stores.

24 I'm going to apply scientific management
25 principles. I'm going to take logistics serious. I'm

1 going to take site selection serious. And I'm going to
2 introduce a new type of a format, which was called the
3 economy format, which was cash and carry. So they got
4 rid of -- the first big innovations they did were to get
5 rid of the delivery and the credit, which was very nice
6 for them.

7 And so to give you an idea of what kind of
8 revenue these guys were doing, the per-store revenue of a
9 typical A&P in the 1920s was something like \$40,000 a
10 year, which is like \$500,000 a year now, so a small
11 convenience store. That's kind of what you picture that
12 object as being.

13 A&P also integrated into both distribution and
14 mfg. So they operated their own warehouses, their own
15 distribution networks, and they also produced a lot of
16 their own products. So private labels in some sense were
17 their game back then. And of course, they were relying
18 on introducing volume to the industry. So volume and
19 "low margins," where low margins is relative, obviously,
20 to what the margins are now.

21 So what were the big advantages of the chain
22 stores and why did they grow so rapidly? So you'll see
23 on the next slide that these guys just exploded. A&P
24 went from a few hundred stores in 1900 to 13,000 stores
25 in the late '30s. And the other names that you see up

1 there are names that we recognize today.

2 So Kroger really ramped up their number of
3 stores. American Stores, which was in existence until
4 just a few years ago. Safeway, of course, still a top
5 three firm. And First National has since disappeared.
6 But you can see that these things were growing really
7 rapidly.

8 And so why was it? Well, again, fewer
9 services, and basically price. Right? These guys were
10 20 percent cheaper than the existing "independent
11 grocer." And why were they so much cheaper? Well, they
12 offered fewer services, so they didn't deliver. They
13 didn't have these trading stamp things that people were
14 emphasizing back then. They didn't sell on credit; it
15 was cash and carry.

16 They took site selection very seriously; they
17 had people standing on street corners counting the number
18 of people that would come by. And they also did -- when
19 you see Tom Holmes later talk about the rollout of Wal-
20 Mart, the rollout of A&P was actually quite a bit
21 different because they were rolling out stores at a
22 similarly breakneck pace, but they were also rolling them
23 back all the time.

24 So they built like 3,000 stores over the course
25 of a few years and shut down like half of them because

1 they were trial and error, trying to figure out which
2 places worked and which places didn't. And their scale
3 is what would allow them to do that.

4 Obviously, their scale allowed them to
5 specialize things, take accounting seriously -- that's
6 another angle in which they were able to undercut people.
7 They focused a lot on logistics and distribution. So
8 again, very Wal-Mart-esque activities, just a hundred
9 years ago.

10 Integrating into manufacturing allowed them to
11 control their quality of product relative to a lot of
12 their complaints. And of course, they took inventory
13 management and stocking very seriously as well, managing
14 their stocks of goods and their turnover.

15 And I think one of the things that I emphasize,
16 that helps offering my thinking about what is going on
17 with big chains, is that what the big advantage is is
18 something about coordination, something about getting the
19 individual stores to do what the big machine in central
20 wants it to do. And I think that's what was driving
21 their advantages back then. I think that's what's
22 driving the advantages of the big chains now.

23 Other people obviously would emphasize buying
24 power, but I think if you go back and you read stuff by
25 Morris Adelman, who did a lot of work in A&P during the

1 times that they were being litigated, he would make the
2 case that maybe buying power was something like
3 15 percent of their advantage. That wasn't really what
4 was driving it, was squeezing manufacturers. It was more
5 kind of efficiencies all over the map from all sorts of
6 angles.

7 So you can see that this happened. These guys
8 rolled out stores like crazy. They sucked up an amazing
9 amount of share of the industry. So they went from a C5
10 of like 4 percent of firm concentration ratio to having a
11 quarter of total grocery sales. And of course, they
12 attracted, not unlike Wal-Mart, a lot of unwanted
13 attention.

14 So the Robinson-Pattman Act was more or less a
15 shot across the bow of A&P in particular. And Wright
16 Pattman was clearly a guy with real populist
17 sensibilities because the other thing he championed was
18 something called the chain store death tax, which was
19 supposed to do something like charge 75 percent tax on
20 the revenues of the firms. So he was just adamant about
21 putting A&P out of business.

22 And of course, that was coming from the little
23 guy, the little guy saying, oh, he's come to town and
24 killing me off. You've got to help me out. That sounds
25 familiar today; there's other people making similar

1 claims.

2 And it's a little bit hard to know how board
3 all the attention that they got was in terms of
4 performance, like A&P crashed and burned in the '60s and
5 '70s, but it probably didn't have that much to do with
6 antitrust activities. It was just poor management on the
7 part of the firm.

8 So something that was happening contemporaneous
9 to the chain store revolution was big demographic changes
10 in the United States. So at the same time this diffusion
11 was going on, you were also getting big structural
12 changes like urbanization; like people moving to the
13 cities; incomes going way up; incomes coming down, of
14 course, in the Great Depression; refrigerators being
15 introduced into the home, but also into the
16 establishments selling stuff. And of course, the
17 automobile was diffusing a lot in this period as well.

18 So what did that mean? It meant people didn't
19 have to go to the store every day, and they didn't have
20 to walk there. And so it changed the technology right
21 under the feet of A&P. They built this beautiful network
22 of tiny little stores, and all of a sudden they were out
23 of date within a ten-year period business. Now all of a
24 sudden it really made sense to build your store farther
25 away and bigger and allow people to go there less often,

1 and move the scale from the warehouse to the individual
2 store itself.

3 And another thing that helped that along was
4 the rise in mass media, radio in particular and national
5 brands. So there was a shift away from the private label
6 vertical integration style to national brands.

7 So the supermarket was a product of these types
8 of changes that were going on contemporaneously. And
9 this is a King Kullen, which was started by the guy that
10 basically gets credit for creating the supermarket
11 industry, Michael Kullen.

12 Various people will lay claim to this; the
13 Piggly Wiggly guy will lay some claims, and there's a
14 bunch of things that look like supermarkets out on the
15 West Coast. But by and large, Michael Kullen is the guy
16 that gets the credit for inventing the supermarket in
17 1933. He was a Kroger employee. And he came to them and
18 he said, I got this great idea.

19 I'm going to build stores that are ten times
20 the size of our typical store. I'm going to stock
21 national brands. I'm going to price aggressively. He
22 was kind of a megalomaniac, so he said all this stuff and
23 kind of exaggerated terms.

24 But I'm going to advertise like crazy, and
25 we're just going to kill the competition, and this is the

1 wave of the future. And the guys at Kroger said, no,
2 thanks. We like what we're doing already. And so he
3 took off and built his own store. And of course, that
4 wiped out the old model within 20 years or so.

5 The thing that's interesting to realize is that
6 the thing that I'm calling a supermarket circa 1933 is
7 not something you'd really recognize as a supermarket
8 today. It's really more like a club store or like a club
9 store crossed with a dollar store. So they were called
10 cheapies because they were cheap in terms of price, but
11 also cheap in terms of how they looked, the ambiance.

12 So they'd be located in old abandoned
13 warehouses or factories, surprisingly, in old abandoned
14 warehouse and factory districts, so not in a suburb.
15 They had very primitive wood shelving, and of course they
16 emphasized self-service, is the other big introduction
17 that they put in, was if you went into an A&P or a Kroger
18 in that time, you would be helped by a clerk, who would
19 have been suggesting some stuff to you and trying to
20 upsell you on various things.

21 And these guys just said, look. You're going
22 to go around and pick out your own stuff. A few years
23 later, some smart guy is going to come along and invent
24 the shopping cart, and make that a little bit easier on
25 you. But that was one of their big innovations as well.

1 And they were cheap. They were like 13 percent cheaper
2 than the chain stores, which themselves had been 13
3 percent cheaper than the little independent grocer back
4 then.

5 So that's giving you an idea these things were
6 really not like what you think about as like a Kroger or
7 a Safeway today. They were really more like kind of
8 Dollar General crossed with a club store, but in a really
9 bad area.

10 And they also sold a lot more than just
11 groceries. So King Kullen sold tires and vacuum
12 cleaners. Big Bear, which is another one of these big
13 guys back then, was a lot more like a Wal-Mart
14 Supercenter. Only 34 percent of their business -- or,
15 sorry, 56 percent of their business was coming from
16 groceries. Today Wal-Mart probably gets 40 percent of
17 their business from groceries.

18 And these guys did a lot more business than the
19 typical chain store, like ten to twenty times as much.
20 So in their first year in operation, King Kullen made
21 about a million dollars a store, which is about \$14
22 million a store today, which puts them right at the mean
23 in terms of the typical grocery store now.

24 Big Bear, on the other hand, made 3.8 million,
25 which puts them square in the middle of Wal-Mart

1 territory today in terms of sales. So these guys were
2 doing a very similar model of what you have today, but on
3 a bit of a smaller scale in terms of number of products.

4 So the supermarket took a little while to take
5 off, partly because World War II got in the way, and we
6 get price controls and labor problems and everything that
7 happens when you have a war. But after the war, they
8 took off like crazy. So they went from 386 supermarkets
9 to something like 5500 by 1948. Doubled again by '54.

10 By '63, they're up at 21,000, and by the '70s,
11 you've got about the same number of supermarkets that you
12 have today. This is 25,000 or so. If you're inflating
13 the cutoff with inflation for what it takes to be called
14 a supermarket, which in the '70s was about a million
15 dollars a year -- now it's probably like four or five
16 million, if you use that rule -- then you'd end up with
17 about 25,000 supermarkets today.

18 And you'd get about the same share of
19 groceries. So they ramped up their share of groceries
20 pretty much steadily until they hit the steady state
21 here, about 75 percent, which is the same basic ballpark
22 as it is today.

23 So what happened after the war? You got a
24 period of steady growth. You got suburbanization. You
25 got small chains; really, the power shifted to the little

1 guy because now the store was kind of like a warehouse
2 itself. So it was really the smaller guys that led the
3 way in terms of building supermarkets that -- you know,
4 the Michael Kullens of the world. But even A&P started
5 converting to supermarkets by the '30s, and A&P was even
6 a bit faster than Kroger and Safeway, firms a little bit
7 slower to pick up on that. But they did.

8 Sometimes they rolled out a second line, which
9 was typical of this industry. So Kroger initially opened
10 things called Pay n' Takits back then, as opposed to
11 Krogers when they were making supermarkets. And the
12 other thing that happened is that it changed from being a
13 cheapie to being what we would recognize as a supermarket
14 today.

15 So now we're building in the suburbs. Now
16 we're building them in shopping centers. Now we've got
17 delis and bakeries in them. And now they look, circa
18 1950, like something if you're at least over 30 you would
19 recognize fondly from your childhood as being something
20 quite recognizable. So this is a Safeway in 1955 or '58
21 in Lodi, California. And these black and whites are some
22 of their flagship stores from the '50s.

23 So then what happened in terms of postwar
24 growth, so you've got rising incomes and the growth of
25 suburbs. You've got a steady supply of new locations

1 opening up out West, and so forth, and building new
2 stores. A lot of little chains are building stores and
3 becoming bigger chains, mostly led by regional chains.
4 But the big guys were coming on as well.

5 And then there was actually a lot of
6 acquisition as markets got saturated, kind of got over-
7 stored. A lot of the little guys turned to doing
8 acquisitions in order to be able to amass stores,
9 increase their storing outright. So you got a lot of
10 merger activity in the '50s and early '60s, and you can
11 see some of that happening here.

12 One interesting thing is that it wasn't
13 everybody that was doing this. It was the Winn Dixies
14 and the Grand Unions, and the American Stores and the
15 Krogers were smaller chains at that point unless -- A&P
16 didn't merge much at all or use acquisition much at all,
17 and neither did Safeway.

18 So like I said, merger was basically a tool for
19 mid-sized chains to grow. It started in the '60s. And
20 it attracted attention, so the FTC kind of put the kibosh
21 on these guys by saying, look. Any firm that's got \$500
22 million or more of assets, we're going to look very
23 closely at you if you try to acquire anything but very
24 small stores.

25 And they took action against National Tea and

1 Kroger in the '60s. The key case here was probably DOJ
2 v. Vons in '66 in L.A. Vons was a No. 3 firm. Shop &
3 Bag or Bag & Shop, or something that I forget the name
4 of, was the No. 6 firm. They wanted to merge, and the
5 DOJ said, no dice. That would be too much concentration
6 there.

7 And I think late in the '60s was when the first
8 food distribution merger guidelines were established as
9 well. And that pretty much put the brakes on a lot of
10 acquisition activity in the '60s and '70s.

11 So the next big thing to happen was recession
12 and saturation kind of hitting together, and supermarkets
13 looking for a new way or losing money for the first time.
14 And it was at this point that you got some of the
15 explosion in formats that you see today. So all the big
16 interesting formats that are arising today, a lot of them
17 got their start in this period.

18 So club stores maybe started in the '70s and
19 '80s. Limited assortment stores, which are again these
20 Dollar General type stores that cater to people that are
21 below the Wal-Mart demographic, so people for whom Wal-
22 Mart is sort of expensive, mainly because they carry
23 national brands. These guys tend to carry private label
24 stuff, cheap stuff.

25 And of course, being the '70s, at the other end

1 of the spectrum you also got natural food stuff starting
2 up as well. And you might keep your eyes on those
3 because those guys are going to come back later. But
4 this is really where this movement started as well.

5 This is also the heyday of the small to medium-
6 sized chain. So if you look at what chains look like in
7 this period, the national Safeways, Krogers, and A&Ps
8 were sort of treading water or losing share from the '40s
9 even though the '80s, whereas local chains, like single
10 MSA chains, were growing a lot, and sectional and
11 regional chains were growing a lot. So this was the era
12 of the 20- to 40-store chain having a lot of impact.

13 And so then the next big thing to happen was
14 the information age. So in the '70s, you got this
15 explosion in format. But probably the most important and
16 significant thing that happened there was the
17 introduction of the UPC code and scanning registers.

18 So the first bar code was installed in '74 in a
19 Marsh supermarket in Troy, Ohio. And by '86, 50 percent
20 of the stores had them. And this was big because this
21 gave retailers, first of all, a lot more power. It gave
22 them access to the same information about product
23 movement that the manufacturers had. It gave something
24 to trade with firms like IRI and Nielsen in order to give
25 access to more data and more data analysis.

1 And so you got the beginning of test marketing
2 and consumer panels, which of course eventually laid the
3 groundwork for product proliferation, lots of additional
4 products coming out, and also gave people the beginnings
5 of what they would need to take logistics into the next
6 stage, computerize it and stuff.

7 So what happened, from '74 to '90 you got a
8 tripling of the number of products carried per store,
9 both because things were coming out in different sizes
10 and people were adding different stuff to the store, et
11 cetera, et cetera. Store size was growing steadily
12 throughout this entire period at a thousand square feet a
13 year. So you can see there's going to be some pressure
14 on these guys to figure out a way to manage all this
15 stuff.

16 And so there was a greater need for
17 coordination, a great need for more advanced back end
18 stuff, so electronic data interchange and best in time
19 delivery and this type of stuff. That was beginning to
20 be a pressure in the '80s.

21 You also got the supercenter and the extended
22 format in order to be able to pack all this stuff in. So
23 if you look at what's happening to store formats from the
24 '80s through the '90s, you see the conventional
25 supermarket, the one I showed you the picture of, dying

1 out and these extended formats, like superstores and food
2 and drug combos, coming up. So Wal-Mart would be like a
3 hypermarket, and that didn't really take off until after
4 this period. And you also got your warehouse and limited
5 assortment stuff happening as a result of the recession
6 and so forth.

7 So here's what was happening to square footage.
8 And that's pretty much a constant upwards trend, pretty
9 much going back even to the introduction of the
10 supermarket format. It would have been about 3,000 or
11 6,000 square feet. That's probably pretty much a linear
12 trend. And products per store, you got something closer
13 to something much more exponential due to computerization
14 and test marketing and all this type of stuff that is
15 happening at that point.

16 So what was the next big thing? The next big
17 thing that happened in the '90s, of course, was the entry
18 of Wal-Mart. And so Wal-Mart has been rolling out
19 supercenters at a breakneck pace since 1988. Tom Holmes
20 will tell us a lot more about that. They also triggered
21 a wave of mega-mergers right around 2000. So you got
22 Kroger buying Fred Meyer, and you got Albertsons buying
23 American Stores, and you got, very recently, Supervalu
24 buying Albertsons, and a bunch of other mergers, and the
25 other guys like this, basically triggered, as far as I

1 can tell, by the fear of Wal-Mart steadily encroaching on
2 the grocery business.

3 There was also a wave of merger in the '80s
4 that I've got less of an understanding of what those were
5 about. Some of that was just about downsizing and
6 getting rid of the bad stores.

7 So Wal-Mart has certainly quickly shot up the
8 ranks. But I think its impact is overstated a lot. And
9 part of the reason is because -- so the data that
10 everybody uses to say, okay, what share of the
11 supermarket industry does Wal-Mart have, is the
12 progressive grocer trade dimensions A.C. Nielsen data,
13 which I use a lot in my own research.

14 And they seem to have made a decision around
15 2000 or 2001 when I think Wal-Mart stopped cooperating
16 with A.C. Nielsen to start reporting Wal-Mart sales as
17 total/total sales, sales in groceries and the rest of the
18 stuff, the bikes and the shotguns and the polyester
19 shirts.

20 And so by that token, they're getting credit
21 basically for everything they're selling. And that's
22 getting plopped into the supermarket business. And so if
23 you take their numbers seriously, it looks like Wal-Mart
24 controls almost 23 percent of the supermarket. And
25 that's just not right. That's just flat-out incorrect.

1 More like 9 percent.

2 And that's still a lot. But where am I getting
3 this claim? Well, first of all, they don't have much of
4 a presence in the major cities, so the top eight cities
5 are essentially nothing. The next two cities, you get a
6 couple Texas cities where they quote unquote have 30
7 percent of the market.

8 Only 62 percent of their supercenters are in
9 MSAs; 48 percent of them are sitting in -- or, sorry, 38
10 percent -- are sitting in non-MSAs, so more rural areas.
11 And I would bet you -- and this is something I'm looking
12 into, but I would bet you that even a lot of these stores
13 are peripheral. They're not central city.

14 Their market share, however you want to
15 calculate it, is twice as big in small markets as it is
16 in large markets. They've also got a pretty big threat
17 coming from these limited assortment guys because their
18 business model is aimed at lower income people. And at
19 least in the cities, Aldi and Save-A-Lot really are
20 giving those guys a better deal because they're
21 undercutting Wal-Mart by offering private label stuff.

22 Why do I think I'm not making crazy claims
23 here? Well, look at the stock price. Wal-Mart stock
24 price is flat in the past five years. Kroger, Safeway,
25 and even Supervalu are actually doing quite well. A

1 couple of them are even outperforming the S&P 500.

2 Of course, given my economic department salary,
3 I don't want to bet against Wal-Mart with my money. You
4 can do it with yours. But again, just to back up these
5 claims, so you look at the number of stores that are in
6 MSAs for Wal-Mart versus the other major firms, and Wal-
7 Mart is at 62 percent and most everybody else is above
8 80.

9 I mean, obviously I'd be scared if I was a more
10 rural chain like Lowes or Winn Dixie. I'd be pretty
11 scared. Or Food Lion, maybe. But I'm not so scared if
12 I'm one of the major firms or if I'm a firm like Wegmans.
13 To Wal-Mart, I say, bring it on. You're not doing
14 anything that hasn't been done in this industry for a
15 long time. It's a mature industry.

16 So here's the market share information on these
17 guys. Like I said, they're basically a nonentity in the
18 top eight markets, and after that you see some pretty big
19 share. But I think these numbers are doubled. They're
20 inflated by 50 percent. If you deflate them down to like
21 40 percent, you say they're doing 40 percent of the
22 reported stuff in the trade dimension data, then Wal-Mart
23 looks like what you think they should have been able to
24 do.

25 So when I was writing my thesis ten years ago

1 and I was thinking about Wal-Mart, I was saying, you know
2 what these guys are going to do? They're going to come
3 in and they're going to kill off the fringe. They're
4 going to kill off all these little stores that are out in
5 between MSAs and so forth. And as far as I can tell,
6 that's pretty close to what they're actually doing.

7 And there's a lot of money to be made there.
8 That's a nice business to be in. But it's not city
9 money. And I don't think they have a shot at getting
10 into the cities, personally.

11 So another interesting trend, just to cap this
12 off because I'm almost out of time, is the other big
13 thing that's happened in the past ten years is like the
14 growth of what people are calling the extreme value
15 segment. So look at the rapid growth in Aldi and
16 Save-A-Lot. Save-A-Lot is actually owned by Supervalu,
17 but they do a lot of franchising.

18 So on the bottom end, think about the middle 70
19 of the grocery business being the stuff that's fought
20 over by the Safeways and the Krogers and the Wal-Marts of
21 the world. The outer ends of this thing that is the
22 fringe is now being carved up by these super low-end
23 guys, who are eating up that market and really catering
24 as well to minority groups and to the Hispanic
25 population. That's what's happening here.

1 And on the top end, you've got people coming in
2 and serving the people that are sort of too rich for the
3 typical store. So this should be interesting to watch
4 develop. I don't know what's going to happen with this,
5 but that's an interesting trend.

6 So I'm out of time, but the last thing I want
7 to leave you with is this quote that I pulled from a
8 paper. And it says, essentially, that you've got all
9 these choices in the cities, and it looks like the
10 industry is tending to return to discount operations at
11 low margin, one-stop shopping centers. But even now, the
12 quality supermarkets are continuing to prosper and grow.

13 This could have been written last week. It was
14 actually written in 1972. And if you go back to 1950,
15 you'd see something similar to this as well. So one of
16 the things that's interesting about the supermarket
17 industry is that it is a developed and relatively simple
18 business, and the things that you'd emphasize about it 40
19 years ago are the same types of things that you would
20 conclude today.

21 So anyway, that's my 50,000 foot perspective on
22 the historic evolution. Hopefully that sets the stage a
23 bit for people to talk in more detail.

24 MR. SALINGER: Great. Thank you very much.
25 That was terrific.

1 (Applause.)

2 MR. SALINGER: Well, to give us some
3 international perspective, we have Andrew Taylor
4 initially. He's the inquiry director at the U.K.
5 Competition Commission, where he directs inquiries into
6 merger transactions as well as the effectiveness of
7 competition in markets more generally.

8 Currently he's leading the Competition
9 Commission's investigation into the U.K. groceries
10 industry. Prior to joining the Competition Commission in
11 2005, Andrew was a consultant in the utilities sector,
12 primarily water, and previously worked for the Australian
13 government. So Andrew.

14 MR. TAYLOR: Thank you. Well, good morning.
15 Thanks very much for having me here to talk to you today.
16 Benoit is also working with me on this inquiry back in
17 London, along with a number of other people. But if
18 you've got any difficult questions, I'll get Benoit to
19 answer them later.

20 What we are doing is a market investigation
21 into the groceries industry in the U.K. And before I
22 tell you a little bit more about it, I just thought it
23 would be useful to give you just a before sense of what a
24 market investigation is for us.

25 It's a general investigation by the Competition

1 Commission. We're asked to carry these out by the Office
2 of Fair Trading, the other competition authority in the
3 U.K. We have the power to order remedies. So these
4 could be structural or behavioral remedies.

5 So if you want to put it in the context of the
6 grocery industry, we could, for example, require them to
7 divest stores, for example. So that kind of gives you a
8 sense of what we can do with these inquiries.

9 So having heard the first presentation, which
10 is all about mergers and so on, and perhaps this isn't as
11 relevant to your thinking about merger control, but it
12 probably is a little bit interesting in terms of just
13 giving you a sense of where we've been in the U.K. in
14 terms of grocery retailing investigations in recent years
15 and where we are at the moment.

16 So this investigation, the current one, started
17 in May last year. We've published some initial thinking
18 in January this year, and we've got some provisional
19 findings due in September, with a final report early next
20 year.

21 We've got quite a history of investigating the
22 grocery retail business in the U.K. The CC held another
23 market investigation back in 1999/2000, and since then
24 we've also had a couple of merger inquiries. So in 2003,
25 the U.K.'s fourth largest grocery retailer, Safeway, was

1 being bid for by the three largest U.K. grocery
2 retailers. That's Tesco, Sainsbury's, and Asda. Asda
3 which is owned by Wal-Mart, and one other, Morrisons.
4 And as a result of that inquiry, Morrisons was allowed to
5 acquire Safeway and other three were prohibited from
6 making that acquisition.

7 And then in 2005, we had another look at
8 supermarkets. As a function of that 2003 transaction,
9 Morrisons acquired the Safeway chain and it started
10 divesting all the small stores, and it developed really
11 into one of the larger stores.

12 And so in one of the transactions, it decided
13 to sell 112 stores off to Somerfield. And that
14 transaction was referred to us to have a look at as well.
15 And so we allowed most of that to happen, but we
16 prohibited a few of those store acquisitions.

17 So we've got quite a lot of history in the
18 sense of looking at the industry, a little bit different
19 from having precedent in the sense that when we make
20 decisions, they're administrative decisions and they
21 don't have precedent value for us. But, in a sense,
22 obviously they give us some guidance when we come to a
23 new inquiry and we want to look at the industry again.

24 So what I thought I'd do is quickly just take
25 you through a few of the issues for this current inquiry,

1 and then refer you on to some further reading or further
2 documents that you might want to take a look at.

3 So here's a market definition. The approach
4 that we've taken in the U.K. is in past cases, it has
5 been to find what's known as two markets. It's the two
6 markets approach. We've got a separate market for one-
7 stop shopping, which is defined as stores -- or has been
8 defined as stores larger than 1400 square meters, which
9 is around 15,000 square feet.

10 And at the time, they were considered
11 sufficiently large for shoppers to carry out a single
12 weekly shop. I guess the Commission in previous
13 inquiries had looked a shopping behavior and how people
14 went about doing their shopping, and based this on a view
15 that most people did a single weekly shop.

16 And then they did secondary and top-up shopping
17 during the week, but they did a single weekly shop. That
18 was their most important shop. And in order to service
19 that, you needed a store that was sufficiently large, and
20 they drew a threshold of 1400 square meters.

21 So they defined the market in terms of store
22 size, and they also defined it in terms of, if you look,
23 fascia. And this gets back to the point that Paul was
24 making earlier about the conversational supermarkets and
25 the high end and the low end people, where the approach

1 taken in the U.K. was to list those conversational
2 supermarkets and say, yes, these are the people competing
3 in the product market.

4 But the hard discounters, the people like Aldi
5 and Lidl and Netto, they're not competing with the
6 conventional supermarkets, and neither are the people at
7 the top end, like Marks & Spencer.

8 So that was kind of the history that we
9 inherited when we started this inquiry last year. So
10 we're still looking at market definition, and David
11 Parker, who's going to talk next, will I'm sure tell you
12 why the market as a whole is bigger than we perhaps think
13 it is at the moment.

14 But we have published some more thinking just
15 yesterday which said, well, this 1400 square meter
16 threshold which has historically been in place in the
17 U.K., we're not really sure how significant that is any
18 more. We're not sure whether there's any real magic
19 about that number in terms of stores above it and stores
20 below it.

21 We still think that, in a sense, large stores
22 constrain each other more than small stores constrain
23 large stores. But we don't think that you can really
24 draw a line, a hard line, in there around store size.

25 And part of that, we think, is probably -- or

1 in terms of the dollar analysis we've done, part of that,
2 I think, is being driven by changes in shopping habits.
3 Certainly we've seen a decline in the popularity of the
4 one-stop weekly shop in the past -- even within the last
5 ten years.

6 The number of households who are conducting
7 one-stop shops has fallen, and people are doing more
8 frequent shopping and small basket sizes. And we're
9 being told that a lot of that is being driven by
10 popularity of chilled food and ready meal type products.

11 We've also looked at the competitor set again.
12 But the analysis that we've conducted to date is still
13 showing that the hard discounters, the Aldis and so on of
14 this world, are not really providing that much
15 competition to the conventional supermarkets.

16 On the geographic market, just before I move
17 on, we've in the past generally viewed the market as
18 quite local, and saying that the catchment area for a
19 supermarket is around ten to fifteen minutes of that
20 supermarket. And that continues to be our view at the
21 moment.

22 So one of the big issues that we are really
23 looking at in this inquiry is the extent of local
24 concentration in the supermarkets. In the U.K. we have
25 four big chains and perhaps another 16 or so other chains

1 with a national presence of some sort or another, and
2 then lots and lots of, of course, independent convenience
3 stores and so on.

4 And this was identified as a concern back in
5 2000 as well. But since 2000, what we've seen is Tesco
6 and Sainsbury's in particular have acquired large numbers
7 of convenience stores.

8 And so what you're seeing is the rise of what's
9 known in the media in the United Kingdom as the "Tesco
10 town," towns like Cambridge or Inverness where there are
11 huge numbers of Tesco stores. Some of them are large,
12 and many of them are small, and that's a function of
13 having acquired a number of convenience store chains.

14 So that's, I guess, if you like, some of the
15 noise surrounding our inquiry, and one of the things that
16 we've been asked to take a look at and to see whether
17 that really is a cause for concern or not.

18 And then it was interesting to hear Paul talk
19 about the complaints of convenience store owners here in
20 the U.S. Certainly that's a large part of the noise
21 surrounding our inquiry as well. We have the Association
22 of Convenience Stores, which represents the 50,000 or so
23 convenience store operators in the U.K., and they're very
24 concerned about the future of their business and say that
25 they're basically being pushed out of business due to

1 unfair competition.

2 So we're very much interested in barriers to
3 entry into local markets. If we think there's a
4 concentration problem, are there barriers to entry? And
5 so a big aspect of what we're looking at is focused
6 around planning, the planning system in the U.K. We have
7 very much, I think, a type of controlled system of
8 development.

9 If you want to open up a store, you must get
10 the permission of the local authorities. The local
11 authorities will have a development plan in place, which
12 will define where you can cite supermarkets and other
13 commercial developments. And within those plans that
14 each local authority develops, there is an overarching
15 policy that the government sets which is called the "town
16 center first" policy.

17 And that came into place in the early 1990s.
18 And that really means that if you want to open up a
19 supermarket in the center of town, that's pretty easy.
20 It's pretty easy, but it's difficult to get the land. So
21 they tend to open up small stores. If you want to open
22 up an out-of-center or out-of-town development, it's much
23 more difficult.

24 And they have what's known as the need test at
25 the moment. The government announced it was going to

1 abolish it just a few days ago, partly based on an intent
2 to replace it with something similar, I think. And the
3 need test effectively says -- or allows the local
4 authority to come to a view on whether there's sufficient
5 retail floor space in the area or not. If they don't
6 think there is, well, then they'll let you build a
7 supermarket. If they think there's enough, well, I'm
8 afraid you can't.

9 So that's something that we're looking at, how
10 important these planning requirements have been in terms
11 of restricting that entry, and how is that interplaying
12 with local concentration of supermarkets.

13 The other thing that's been brought to our
14 attention and we've been asked to look at is what's
15 commonly called land banks. And these are the
16 substantial land holdings owned by a number of
17 supermarket chains, and whether they really just
18 represent a pipeline of future store development or
19 whether some of those land holdings are really strategic
20 holdings which are being held as a means of blocking
21 entries by competitors into local markets. So we're
22 taking a look at that as well.

23 And we get a lot of complaints about
24 manipulation of the planning system, too, objecting to a
25 competitor's planning applications, bullying of local

1 authorities. This is all very high profile in the U.K.
2 and all things that we are being asked to take a look at.

3 The scope of inquiry is pretty wide. We're
4 also looking at upstream issues. Back in 2000, there
5 were concerns being expressed about the treatment of
6 suppliers, and this led to a code of practice being
7 introduced for grocery and retailers.

8 And it covers all sorts of things, like
9 retrospective discounts, financing of promotions, those
10 types of activities. It doesn't actually prohibit any of
11 them, or only maybe one or two, but it asks the
12 supermarkets to be reasonable in their application of
13 them.

14 Since 2000, we don't think it's really changed
15 at all in terms of supermarkets' behavior. And we are
16 being -- and we need to come to a view whether we think
17 that's a problem or not. So we have to look at that code
18 of practice again and decide what we want to do about it.

19 And then there's another item, which is
20 concerns by the smaller store operators about a waterbed
21 effect, where it's saying, well, suppliers are having to
22 charge very low prices to the big retailers, and to make
23 that up, they're having to charge much higher prices to
24 the smaller retailers. That's putting us out of
25 business, it's unfair, and we want something done about

1 it.

2 Well, first we have to decide whether there's
3 any real legs to that argument. If the suppliers -- why
4 wouldn't the suppliers be price maximizing towards the
5 smaller retailers anyway? So we're looking at that. And
6 whether really, when you look at the pricing data,
7 whether that is the reality of the situation. So we've
8 gone and collected a lot of data from suppliers in terms
9 of what they charge various retailers, and we're taking a
10 look at the extent to which the big retailers really are
11 getting systematically better prices than smaller
12 retailers. To date, it's not clear that they actually
13 are.

14 So I'm not going to really talk much more. I
15 just thought I'd give you -- I've finished my time, but I
16 will repeat that website. We've got a lot of evidence
17 there. You can see the various papers that have been
18 submitted to us by people, both erudite research papers
19 as well as lots of letters from farmers who are very
20 upset the way they're being treated by the supermarkets.

21 You can also see the various working papers
22 which we've published to date. And we continue to put
23 more and more material up there until such time as we
24 publish our provisional findings in September.

25 Thank you.

1 (Applause.)

2 MR. SALINGER: Well, thank you.

3 To get a perspective on this from outside the
4 government, we have David Parker, who's a manager at
5 Frontier Economics in London. He's worked on a wide
6 variety of E.U. and U.K. antitrust cases, including the
7 GE/Honeywell merger and the removal of resale price
8 maintenance on U.K. medications.

9 David.

10 MR. PARKER: Good morning. Thank you for
11 inviting me. My reason for being here is that I work for
12 Tesco, the largest U.K. grocery retailer. That name has
13 come up once or twice already.

14 What I wanted to do was talk about one of the
15 issues that has come up in the grocery inquiry, not
16 particularly because I want to have a debate about what's
17 right or wrong, but I want to talk about an empirical
18 technique that we've used that may be interesting, not
19 just in the context of market definition in market
20 inquiry, but also in potentially merger inquiries in
21 other retail industries.

22 The theoretical framework in the U.K. is
23 basically the same SSNIP test, demand and supply side
24 substitution as used in the U.S.

25 There was an important merger inquiry -- the

1 Safeway case -- a few years ago which defined the local
2 market primarily based on local customer shopping
3 distances, on average 10 minutes. The CC proposed a set
4 of rules about which firm could acquire which stores.
5 Many firms wanted to acquire Safeway, but that would have
6 led to a lot of overlaps in certain catchments. And the
7 idea of the rules was that each firm would have to divest
8 those if they had four to three fascia or fewer in those
9 local markets.

10 This led to arguments about Geographic
11 Information Systems. Is this store 10 minutes away from
12 that store, or is it 10.2 minutes away, or is 9.8 minutes
13 away? And how fast do you drive along this road, and how
14 long do you stop at that junction, and so on.

15 The current Groceries inquiry has seen similar
16 suggestions made about should you have a similar
17 restriction on organic growth designed to encourage
18 choice in local markets. In other words, if a store has
19 already got a position in a local market, should you be
20 allowed to buy more stores or acquire more land?

21 As a bit of context is -- I'm sure you're all
22 aware of this -- Great Britain is crowded compared to the
23 U.S. The overall population density in the U.K. is about
24 eight times that of the U.S. And urban population
25 density in particular, which is defined here as areas of

1 500,000 people, is about three times as large. So towns
2 in the U.K. don't spread out as much as they do in
3 the U.S. And what that leads you to is something of
4 potential interest for the arguments about geographic
5 market definition, which is the chain of substitution.
6 So I'll just take a bit of time to try to explain this
7 diagram because there's a lot of information on it.

8 This diagram shows part of South London. The
9 red and yellow circles are grocery stores. The red
10 stores are Tesco stores above 1400 square meters in size.
11 The yellow stores are rival stores above 1400 square
12 meters. The concentric not quite circles are isochrones.
13 So an isochrone, I'm sure you know, is 10 minutes drive
14 time (or whatever type of journey you're employing) or 5
15 minutes drive time, say, in every direction. So it's not
16 quite a circle because you go faster down some roads than
17 others. But isochrones are broadly circular.

18 The little red quasi-circle is 5 minutes around
19 the store at the center. The blue is 10, and 15, 20, 25.
20 These show you the distances you can travel in South
21 London.

22 The black dots, which look like they've been
23 scattered like confetti all over the diagram, that's
24 where people live. These are our Census Output Areas.
25 This is the smallest aggregation for which census data is

1 published in the U.K. It's about 110 households per dot.
2 So in the U.K., that's quite a small area. It's half a
3 street or a street, depending on how big your streets
4 are.

5 If we think about the market definition test,
6 what we're saying is our potential market is a 10-minute
7 isochrone in an urban area, which is the indigo circle.
8 The hypothetical monopolist is assumed to be able to
9 raise prices in that 10-minute area by 5 percent.

10 Now, that may or may not be right. The
11 constraint on the hypothetical monopolist is that if it
12 raises prices at the stores inside; people within the
13 market could switch to stores outside that local market.
14 So you can see there's lots of dots -- where the
15 customers are -- close to the edge of the 10 minute
16 market (but inside it). And there's quite a few stores
17 in the 10- to 15-minute isochrone, where in principle you
18 could start switching to.

19 To give us a sense of whether we can say that
20 switching is sufficient to constrain the hypothetical
21 monopolist? Can we say that 10 minutes is a local
22 market? What we've done is tried to use the fact that
23 we've got very detailed geographic information to try and
24 get a sense of what size should the local markets be if
25 you think that all these local markets are somehow

1 different.

2 So we have a very simple theoretical framework.
3 Let's say you take your 10-minute isochrone, so your
4 indigo circle, and you say that all the customers there
5 travel to their nearest store. This is very simple,
6 Hotelling-type approach. All stores in that market raise
7 their prices by 5 percent. That's our SSNIP. All those
8 customers that are inside the market they face a choice.

9 On the one hand, they can remain at their
10 current store, but they pay 5 percent more on that
11 basket. On the other hand, they could go to the nearest
12 store outside that market which hasn't raised its price,
13 and they incur an extra transport cost instead. And you
14 could switch if one is greater than the other.

15 If enough customers switch away because they've
16 got these options outside and they're prepared to switch
17 to them, that wouldn't be a market. But if not many
18 customers slip away, then that seems like a reasonable
19 definition of the market. If it fails, you widen and
20 then you try again, and try again.

21 To implement this, you need four types of data.
22 The first thing you need is good data on locations --
23 locations of stores and you need locations of customers.
24 Well, the client has got a very good store database;
25 that's quite an important part of its competitive armory,

1 knowing where everyone's stores are. There are also
2 publicly available similar types of store data.

3 The customer locations, as I said before, are
4 from the U.K. census. So you use these census output
5 areas, half a street. You then have pretty accurate
6 information on where the customers are and where the
7 stores are.

8 You can use Geographic Information Systems with
9 drive time assumptions to calculate the distance from
10 home to store for each combination of customer and store,
11 in this case, it uses the client's software because they
12 spend a lot of time thinking about this because it's
13 important for sales forecasting and so on. But off-the-
14 shelf packages exist. You've probably come across
15 them -- MapInfo is one example.

16 The second thing that you need to
17 operationalize this is the cost of travel time. So you
18 need to know how much customers value savings on travel
19 time in order to know whether they'd pay the extra
20 5 percent. We derive this econometrically. We take TNS
21 Worldpanel data. This is a panel of customers who scan
22 in all their grocery purchases over a period of time.
23 And this panel refreshes. As far as I can tell from the
24 description, it's the same type of data that Jerry
25 Hausman used in his paper on Wal-Mart pricing effects, if

1 you've seen that recently.

2 You've got the panel of customers -- I think
3 it's about 10,000 -- who scan in all their purchases.
4 And you can see which stores they went to and so on. So
5 it's potentially quite accurate. It's certainly the best
6 that we've got.

7 What you can do with that data is see what
8 customers did -- you see where they chose to shop. What
9 you don't see is where they could have shopped but
10 didn't. And that's what we're really interested in. I
11 could have shopped at this low priced but far away store,
12 but I chose to shop at this high priced but close store,
13 in order to get some sense of the tradeoffs between, in
14 this case, price and distance.

15 What the client managed to do was ask TNS to
16 link the choices back to the customers and then use their
17 data to identify which other stores they could have
18 shopped at and the characteristics of those stores, and
19 then take out the customer data again so that it remained
20 anonymous.

21 And what you now have is customer X, and we
22 know that they shopped here and they spent this amount.
23 But they also could have shopped at all these other
24 places with these characteristics, and decided not to do
25 so. You can do a conditional logit model to try and

1 identify all the different tradeoffs. And that gives you
2 a price/distance tradeoff.

3 The third thing is you need to have some sense
4 of a basket distribution because if you use an average
5 basket size, that potentially underestimates switching
6 because it's large basket people who would be more
7 prepared to switch. It makes sense. You face a higher
8 cost from the price increase. If I'm spending \$100, then
9 it's an extra \$5. If I'm spending \$10, that's an extra
10 50 cents. But the extra distance I travel is the same
11 either way because I've got the same choices. So large
12 basket customers are more likely to switch.

13 In previous inquiries, Andrew was mentioning
14 that they talked about this weekly one-stop shop market.
15 Now, it's not quite clear what a one-stop shop is. It's
16 clearly something like a trip that accounts for a large
17 proportion of your average weekly grocery shopping. But
18 quite what proportion that should be is not entirely
19 clear. That's, I think, a common-sense interpretation.

20 One of the issues is that a customer's one-stop
21 shop will vary depending on who you are. So someone who
22 is single and has no kids will have a very different one-
23 stop shop in terms of basket size to someone who's got
24 four kids ravenously chomping their way through
25 groceries.

1 So you want to try and calculate one-stop shops
2 for each of these customers, on an individual basis for
3 each customer, and form a distribution of the one-stop
4 shops trips. And then as a way of operationalizing this,
5 you have to assume that this distribution is the same in
6 each census output area. Otherwise it just gets
7 extremely complicated (if not impossible) because we
8 don't have any information on how these distributions
9 should vary by census output area.

10 The last thing you need is an estimate of store
11 margins because that determines the profitability. When
12 customers switch the store loses sales, but they don't
13 lose all the profit associated with the revenue from the
14 sales because they save some cost as well.

15 So you look for costs that could be saved for
16 sales loss over the relevant time period under the SSNIP
17 framework. Think about maybe a year.

18 For instance, consider the cost of goods sold.
19 If you lose 10 percent of sales, you just don't buy
20 10 percent of goods in. So you save all of that. You
21 probably spend a bit less on promotions. Staff, well,
22 you can save some on staff, but there are staff-level
23 fixed costs. Distribution again, you can probably save
24 some, but this may also have some fixed costs. Property
25 costs, unlikely to be able to save very much for a

1 reduction in sales. We use the assumptions that the
2 client used in its internal business.

3 To show you what happens, then what you have to
4 do is just to turn the handle. You calculate this
5 through -- across all customers and stores. And this is
6 a very mechanical but quite big exercise.

7 This diagram shows you hopefully that it's
8 doing the sort of thing that you'd expect. This is a
9 place called Holbeach, which is a fairly rural area. The
10 bit out to the northeast is the sea. What you've got is
11 you've got a store in the middle, which is Holbeach.
12 You've got another store over to the left, which is
13 marked R, which is just inside this market -- in this
14 case, a 15-minute isochrone because this is a rural area.

15 Then you've got a store that's just outside,
16 marked J, which is a possible place that people can
17 switch to. You'll see up at the top there's a couple of
18 stores marked A and E in the town called Boston. There's
19 another town called Wisbech just down to the southeast.
20 All of those are places that people could switch to
21 outside the isochrone if the people inside the isochrone
22 raised their prices.

23 What we've done is we've showed every census
24 output area to say how big is the basket size for which
25 you'd switch? The darker the area, the more likely you

1 are to switch -- the lower the basket threshold that gets
2 you to switch.

3 What we find is this potentially can widen
4 these markets if we do this again and again -- and by
5 quite a lot. In fact, pretty much all markets are larger
6 than we previously identified, because actually 10
7 minutes is pretty small. Also, lots of customers are
8 closer to the edge. In 10 minutes, if you think about
9 just simple πR^2 -- 10 minutes is four times as
10 big as 5 minutes. So given a constant population
11 density, three-quarters of the people are closer to the
12 edge than they are to the store at the middle. So
13 there's lots of switching possibilities potentially going
14 on, which may well be relevant for all sorts of merger-
15 type analyses and calculating competitive constraints in
16 any kind of retail industry, we believe. I should say
17 this is a matter of some dispute at this stage.

18 What I'm trying to illustrate is an empirical
19 way of investigating some quite simple, I think,
20 theoretical concepts that stores outside any arbitrarily
21 defined catchment area will constrain stores inside to
22 some extent. The question is how much, and does this
23 chain actually end?

24 I think it's relevant to merger analysis even
25 if you don't have a market definition stage because

1 implicitly you have some kind of market definition stage
2 by saying, what's the 1/0? What's the overall leave of
3 what's in and out when you're doing an analysis? What's
4 in the outside option? So even if you do a full-blown
5 competitive effects at the first stage and you don't
6 split things out, you're still making some kind of
7 decision.

8 And then the advantage, I think, certainly in
9 the U.K., and I don't know how this reads over to the
10 States, is that we've got lots and lots of data. So
11 we've got lots of locational data and customer data. So
12 you can actually tone down your theory, up-weight your
13 data and have a very simple theory, and then it's just a
14 turning the handle exercise.

15 Thank you very much.

16 MR. SALINGER: Great. Thank you.

17 (Applause.)

18 MR. SALINGER: Well, we have just three
19 minutes. And I feel that if I open it up to questions,
20 there are going to be many more questions than we have
21 time for. So I'll just pose one question for all the
22 panelists.

23 I think one of the themes that's going to
24 emerge today is that when we do grocery store merger
25 analysis, that market definition plays a central role.

1 And the question is, is it capturing the effects of
2 mergers accurately?

3 And so if we compare the U.K. sector and the
4 U.S. sector, are there major differences where you might
5 say that there are aspects of the other country's sector
6 that you think should be emulated? Or is there -- is
7 public policy standing in the way of the development of
8 the industry, and is the analysis we're doing part of
9 that problem?

10 MR. PARKER: I'll pass this to the authority in
11 the first instance.

12 MR. SALINGER: Benoit?

13 MR. DURAND: Well, thank you. That's a great
14 question. Well, as Andrew presented, the history in the
15 U.K. of merger controlling in groceries has developed
16 rather rapidly over the last decade or so. And we have
17 devised some simple rules for market definition.

18 And often the reason for that was that the
19 Office of Fair Trading, which is looking at merger in
20 phase one, would have a quick and dirty, so to speak,
21 type of rule of thumbs to apply when they will look at
22 merger and decide whether they will send this to us.

23 Now, obviously, when we look at this in the
24 phase two, in the more in-depth investigation, I like to
25 think that we are not doing something too badly so that

1 we prevent actually the emergence of the good efficiency
2 or benefits to consumers. We are trying to essentially
3 determine to which extent the two merging parties will
4 constrain each other.

5 And obviously, we are developing and refining
6 our analysis every time, in every inquiry. We're trying
7 to learn from what we've done in the past. And we also
8 obviously are acquiring more and more data because more
9 and more data is available. So hopefully, that is
10 informing us on what we are doing.

11 MR. SALINGER: You were kind to say that it was
12 a good question, but it came out pretty garbled.

13 But let me try to focus it more with David,
14 which is: Your presentation I'll take as being in some
15 ways critical of how the agencies are approaching the
16 analysis of the industry. But what you're doing is
17 you're not being critical in the large; you're being
18 critical in the details. You're saying, okay, really if
19 you just do market definition right, then you'll get the
20 right answer.

21 But I guess the broader question is: Should we
22 be so focused on market definition, or should there be
23 some broader sorts of questions we should be asking?

24 MR. PARKER: I think for me one of the key
25 questions that needs to be asked is the nature of price

1 variation on a geographic basis. So certainly in the
2 U.K. there's a view amongst the academic community that
3 store-by-store pricing has to be the right way to go.
4 Their view is that there must be benefits to store-by-
5 store pricing, and so why wouldn't you?

6 But I think empirically in the U.K., that
7 certainly isn't the case. I don't know what the
8 situation is in the U.S. My understanding is there is
9 price variation, but it's on a sort of zonal basis. This
10 suggests if you think of things on a law of one price
11 basis as defining a market, maybe that's the
12 dimensionality we should be looking at. Perhaps at a
13 national in the U.K., a zonal level in the U.S., not a
14 highly micro-level approach. If we're asking the
15 question "Is something within 10 minutes or is it 10.2
16 minutes or is it 9.8 minutes" I wonder whether that's
17 missing the real driver of competition.

18 MR. SALINGER: I'll give each of the
19 panelists -- do you have any final words you want to say
20 before we break?

21 MR. ELLICKSON: Well, I guess when I was doing
22 the work in my thesis on explaining market structure, I
23 started out at a much more desegregated level in looking
24 at MSAs as markets. And for the questions that I was
25 interested in asking, those were exactly the wrong

1 markets, that the markets that I was interested in were
2 much bigger, that I used the markets that -- basically
3 based on distribution areas.

4 And I still think that's something that people
5 need to pay a little bit more attention to. These guys
6 that are operating distribution centers with 200-mile-
7 radius throw areas are potential competitors everywhere
8 in that radius. And that to me is the more interesting
9 set of firms, is the people that can put a store into an
10 area from a relevant distribution area. And that's
11 something I guess I'd like to see thought about a little
12 bit more.

13 MR. SALINGER: Well, the idea behind this
14 conference was to have us think a lot more about that.

15 With that, we will break for 15 minutes.

16 (A brief recess was taken.)

17 MR. SALINGER: Well, this is our "get down into
18 the trenches" section of the day.

19 We are going to start out with Deborah
20 Feinstein. She's here on behalf of Kroger. When we were
21 organizing this conference, I talked with Paul Heldman,
22 who's the general counsel of Kroger. He was supportive
23 of the idea of having the conference, and said that
24 Kroger wanted to participate. So we're grateful to them
25 for that.

1 For personal reasons, he was not able to be
2 here today, so Debbie is pitching in. She is a leading
3 antitrust lawyer, principally focusing on merger and
4 acquisition matters before the FTC and the DOJ. She is
5 named to the best Lawyers in America 2007 for antitrust
6 law, and Global Competition Review named her on its
7 international list of the top 100 women in antitrust.

8 So Debbie, take it away.

9 MS. FEINSTEIN: Right. Thanks. I am doing
10 this without slides.

11 MR. SALINGER: You can choose whether you want
12 to be there or --

13 MS. FEINSTEIN: No. I think people can't see
14 me there so I'm happy being here.

15 Well, thanks for inviting me to speak. I am
16 making these remarks on behalf of and with the assistance
17 of Kroger, who's been a client of mine for over a decade.
18 And I want to talk a little bit about their perspectives
19 on the supermarket industry and our collective
20 perspectives on how the FTC has looked at transactions
21 over a number of years.

22 A few facts about Kroger. It has over 2,000
23 combination food and drug stores under a wide range of
24 banners. Some of the familiar names are Kroger, Ralphs,
25 Dillons, Smith's, and Fry's. It operates 145 warehouse

1 stores under the Food4Less and FoodsCo banners. It also
2 has multi-department stores, convenience stores, and
3 supermarket fuel centers. Its revenues last year were
4 \$66 billion with \$1.1 billion in earnings.

5 A few significant trends about customer
6 shopping habits are worth noting because I think it gives
7 some big picture perspectives on what the grocery
8 industry is facing. Customers now shop for groceries 1.9
9 times a week, on average. The one-stop shop that people
10 used to talk about is long gone, I think, and people
11 typically now have one store for perishables and another
12 for the center store items, the dry goods, that sort of
13 thing. That's according to the Food Marketing Institute.

14 Supermarkets are rapidly losing their shares of
15 the food dollars to every format every year. According
16 to Nielsen data, shoppers choose to visit grocery stores
17 57 percent of the time for their purchases. They choose
18 to visit mass merchants 27 percent of the time,
19 drugstores 11 percent, dollar stores 7 percent, and club
20 stores and C stores each 5 percent of the time. So it's
21 clear customers are shopping multiple locations to find
22 what they want at the best prices.

23 The supermarket business always has been and
24 continues to be a very competitive industry. And it
25 really has to be. According to a recent FMI study, price

1 is the overriding reason that customers select a
2 supermarket. Did you hear that? Price. It doesn't say
3 distance or location. I think that's a really important
4 fact.

5 It's also a really vibrant industry. You saw
6 that of the list of supermarkets that were in the first
7 presentation, half of those names or more don't exist
8 today. But as old stores go and new stores come, there's
9 a lot of turnover in this industry.

10 I'm going to discuss in a minute in more detail
11 Tesco, which is Britain's largest grocery operator, which
12 you heard a bit about from our European colleagues. It's
13 actually planning to enter into the United States later
14 this year. So there is still fertile ground for new
15 entry in this country.

16 Now, you can't talk about supermarket
17 competition without talking about supercenters. These
18 are the large combination food and mass stores operated
19 by Wal-Mart and Kmart and Target and Meijer. A recent
20 UBS report found that consumers are increasing the number
21 of trips they take to supercenters, but are decreasing
22 the number of trips they take to traditional
23 supermarkets.

24 For these reasons, the FTC has properly for
25 many years recognized that supercenters are part of the

1 relevant market. I'm going to talk a little bit more
2 about their effect with respect to competitive effects
3 analysis in a minute.

4 Now I want to turn to other formats, which I
5 think haven't been properly recognized as being part of
6 the competitive landscape. Club stores: Club stores
7 have recently, and only recently, been included in the
8 competitive set for some of the transactions that have
9 been analyzed. In earlier deals, certainly the ones I
10 did, it was just decreed that club stores couldn't
11 possibly be a competitive alternative and weren't part of
12 the market.

13 Kroger sees club stores as very real
14 competitors. They price check them. They look to them
15 for ideas. The traditional supermarkets have
16 increasingly started carrying larger sized packages to
17 compete with club stores. I think you can't overlook
18 their effect on supermarket competition.

19 Mass merchandisers: These have never been
20 thought of as being part of the relevant competitive set.
21 But mass merchandisers, such as the traditional Target
22 and Wal-Mart and Kmart, are increasing the amount of food
23 that they have. I don't know if you've walked through
24 one lately.

25 The new Target up on Rockville Pike is worth a

1 walk-through some time. It has aisle after aisle in its
2 refrigerated section. It has everything that you would
3 want to buy in a grocery store, with the possible
4 exception of fresh produce, fresh meat and fresh deli.

5 But most of the things that you buy, 80 percent
6 of what you're putting in your grocery shopping basket,
7 you can now find in a traditional Wal-Mart mass
8 merchandiser, a Target, that sort of thing. And I think
9 people have to increasingly think about the effect they
10 have on the marketplace.

11 Mass merchants also typically stock a
12 significant number of household goods. Indeed, according
13 to a Citigroup report -- no, this is FMI -- 54 percent of
14 all dollars spent on laundry supplies, 25 percent of all
15 dollars spent on snack items, and 20 percent of all
16 dollars spent on carbonated beverages, are sold at mass
17 merchants.

18 Every dollar spent at a mass merchant is a
19 dollar that, for these types of items, could have been
20 spent at a supermarket. They're very real competitors to
21 supermarkets. And if you were to go through the files of
22 Kroger, you would find lots and lots of references to the
23 effect that mass merchandisers have on their business.

24 Indeed, mass merchandisers are increasing the
25 amount of food that they sell. Target has plans to move

1 to the self-distribution of food items, which is certain
2 to fuel even more growth of their food sales.

3 And then there's drugstores. These, too, are
4 increasing the amount of food, both shelf-stable and
5 refrigerated, that are offered in these stores. And
6 again, they're taking sales away from the traditional
7 supermarkets.

8 So all of these are formats that Kroger is
9 paying a lot of attention to and has for some time now.
10 To ignore them is to ignore a very real element of
11 supermarket competition.

12 Dave Dillon, who is the chairman and CEO of
13 Kroger, probably said it best in a recent speech at the
14 Lehman Brothers retail conference. "As the retail food
15 industry evolves, one certainty remains. The environment
16 in which we operate continues to be intensely
17 competitive, and we believe it would be even more
18 competitive in the future.

19 "Kroger faces a wide variety of competition for
20 the customer's food dollar. In addition to traditional
21 supermarkets and supercenters, we also compete with a
22 variety of nontraditional formats, including natural
23 foods retailers, drugstores, convenience stores, dollar
24 stores, warehouse clubs, even restaurants." So that's
25 what the CEO of Kroger was telling investors. And if he

1 were here today, he would certainly be telling you the
2 same thing.

3 And for an industry that has existed for
4 hundreds of years, it is hardly stagnant. For instance,
5 Tesco, Britain's largest supermarket, has plans to open a
6 number of stores on the West Coast beginning later this
7 year. The thought is that they're going to bring to the
8 U.S. their "express store" concept. It combines the
9 convenience of a C store with many of the typical items
10 available in a grocery store, such as fresh produce, and
11 it aimed to be both near where people work and where they
12 live.

13 Tesco has a number of other formats as well,
14 ranging from 10,000 square feet to as large as
15 supercenters. If Tesco is successful here, these other
16 formats could follow as well.

17 Now I want to turn to Wal-Mart. You cannot
18 have a conversation about supermarket competition without
19 spending a fair amount of time talking about them. We
20 all understand that supercenters are now part of the
21 product market. But the important thing is to think
22 about how they fit into the competitive effects analysis
23 as well.

24 The numbers alone are staggering. Wal-Mart
25 opened its first supercenter in Washington, Missouri in

1 1988. Within ten years, it had 544 supercenters. Today
2 it has almost 2,000 supercenters nationwide. Most
3 traditional Wal-Marts that are being built, the mass-only
4 stores, are being constructed in a way that there's a
5 wall that you can quickly knock through to expand into a
6 supercenter if that's something that they want to do.
7 And they have in fact expanded a number of their
8 traditional mass merchandisers into supercenters.

9 Everyone knows its stated objective is low, low
10 pricing. And it can offer such pricing because of its
11 incredible economies of scale. They derive from a couple
12 of factors. First, they get incredible volume discounts
13 from vendors, and have amazing partnerships to make sure
14 that they get the newest products at the best prices.

15 They have an amazing automatic replenishment
16 inventory management system that helps it manage its
17 inventory, and a distribution system that is
18 unparalleled. Finally, it has a huge amount of data to
19 manage exactly what it's going to do to figure out
20 exactly what customers are buying and exactly how they
21 should be selling the products.

22 Their database is so extensive it was once
23 described as being second in size only to that of the
24 U.S. government, and only second in capacity to that of
25 the Pentagon. These guys know what they're doing.

1 Furthermore, and this is important to think
2 about with respect to the competitive effects analysis,
3 Wal-Mart typically prices its supermarket items as loss
4 leaders to draw people into the store to purchase the
5 higher margin durable products. So their supermarket
6 prices are always going to be low.

7 Kroger doesn't attempt to meet Wal-Mart's
8 prices. It simply can't. What it tries to do is make
9 sure that the range is not so high that it loses an undue
10 amount of customers to them. That's really important
11 point to think about.

12 Its employees are non-union. They have lower
13 wages and lower health care costs. This, combined with
14 the use of part-time employees, gives it significantly
15 lower costs.

16 Once Wal-Mart enters into a market, it's never
17 quite the same. Certainly the smaller, less efficient
18 stores go out of business. That's inevitable. But the
19 ones who remain figure out a way to compete better. They
20 do it by offering better services and better prices.

21 This happens even before Wal-Mart actually
22 shows up on the scene. And they give people plenty of
23 warning. I remember in Phoenix, they actually sent
24 videotapes to consumers' homes saying that they opened
25 were coming well in advance of the time that they opened

1 their first store in Phoenix to get people excited about
2 the Wal-Mart concept and what it was going to mean to
3 them.

4 So as soon as it gets word that Wal-Mart is
5 going to come into a particular market, Kroger starts
6 beginning to take steps. It begins to lower its prices
7 because it doesn't want consumers to suddenly feel, when
8 Wal-Mart enters, that there's this big difference in
9 price. It does it in anticipation of Wal-Mart entry. So
10 even if it's going to take two years for a store to be
11 built, actual impact of that entry occurs at the time
12 that Kroger learns about it.

13 They often upgrade their stores. They remodel
14 them. They enlarge them. They improve the service.
15 They do all of the things they need to do to make sure
16 that when that Wal-Mart does come, they're prepared.
17 They come up with specific action plans to figure out
18 what will work best in that particular city to make sure
19 that they can combat or at least have a chance of
20 surviving the threat of Wal-Mart entry.

21 And it's not just Wal-Mart. Target has 180
22 supercenters. Meijer has 170 supercenters, largely
23 across the Midwest, and Kmart has approximately 55. It's
24 a very real element of competition and a very important
25 part of the competitive story that you have to tell in

1 thinking about whether or not a supermarket transaction
2 is likely to have an anticompetitive effect.

3 Wal-Mart hasn't stopped at supercenters. It
4 has also introduced the Wal-Mart Neighborhood Market.
5 First introduced in 1999, these are smaller stores.
6 They're more likely to be in cities than in the suburbs.
7 They capitalize on the same distribution system,
8 economies of scale, low prices and low costs that all of
9 the other Wal-Mart's have. Currently there are more than
10 95 Neighborhood Markets nationwide, and Wal-Mart has
11 plans to open another 12 to 20 new Neighborhood Markets
12 in the next year. Obviously, this is something that will
13 continue.

14 A couple of other points to mention about
15 Wal-Mart. Often you see that the shares that they are
16 noted for having in a city aren't as significant as maybe
17 some of the more established retailers like, say, a
18 Safeway. This isn't surprising if you think about it. A
19 dollar spent at a Wal-Mart goes a lot farther than a
20 dollar spent at Safeway.

21 I think you can't just simply say, oh, well,
22 Wal-Mart's only number three in the market; therefore,
23 it's not particularly significant when you're looking at
24 the numbers based on the revenue data because those
25 same -- if you translated the same goods that are being

1 sold, they would cost more at Safeway. That doesn't mean
2 that Safeway is more of a competitive threat in that
3 market than is the Wal-Mart. You just need to think
4 about what those numbers in fact mean.

5 How many of you have ever been in a Wal-Mart
6 supercenter? To call them a supermarket is not
7 understanding the reality of these, particularly out in
8 the suburbs. They are in fact Main Street, USA. You are
9 going to find your bank. You are going to sign your kid
10 up for Little League there. There's virtually nothing
11 you can't do in some of these supercenters when you're in
12 the middle of a small town. And so people drive long
13 distances to go to them.

14 This isn't a situation where people think of
15 the Wal-Mart Supercenter as someplace that they are just
16 going to run down to the grocery store to get a jug of
17 milk. And of course you're only going to drive a couple
18 of miles for that.

19 In fact, the data show that people routinely
20 drive nine, ten, or more miles to go to a supercenter,
21 more the way you think about driving to the mall. And I
22 think that's important in thinking about both the
23 geographic dimension and the impact that a supercenter
24 can have on a market, even if geographically looking at
25 it on a map, it's more on the fringe rather than in the

1 middle of the town.

2 I want to turn for a minute to the acquisitions
3 that Kroger has made to give you a little perspective on
4 why they've done them and how they saw supermarket
5 competition at the time they entered into those
6 transactions.

7 In 1999, Kroger responded to the increasing
8 threat of Wal-Mart, which operated over 500 supercenters
9 already, and entered into an agreement to acquire Fred
10 Meyer. At that time, Fred Meyer had 800 supermarkets and
11 multi-department stores.

12 The transaction was almost exclusively
13 complementary. I think that tells you something about
14 why they were doing it. They weren't doing it because
15 they wanted to increase market size in a particular area.
16 They are simply looking to get scale whenever they do a
17 supermarket transaction. So it was largely
18 complementary.

19 There were a few overlaps in small towns that
20 were problematic. Those were readily dealt with. The
21 battle ground was over Phoenix and Tucson. There was a
22 second request issued, and it took probably about seven
23 months for the transaction to go through the entire
24 analysis.

25 After an extensive investigation, the

1 Commission determined that there were no problems in
2 Phoenix and Tucson. The reason? I previously mentioned
3 those tapes that Wal-Mart had sent to everybody saying
4 they were coming. In fact, there were clear plans. We
5 were able to take clear pictures of sites under
6 construction. We were able to get information from local
7 zoning boards that had approved them. The evidence was
8 quite clear that Wal-Mart was coming. And for that
9 reason, the Commission properly concluded that there
10 weren't any issues with the transaction.

11 At the time, Kroger anticipated merger-related
12 synergies eventually totaling \$225 million by year four.
13 Of the merger-related synergies, Kroger anticipated that
14 \$115 million would come from better purchasing of food,
15 drugs, and general merchandise. They also planned to
16 coordinate volume purchasing of various operating
17 supplies, capital equipment, and raw materials for
18 manufacturing.

19 The balance of the efficiencies were to come
20 from lower costs due to integration of production
21 facilities, distribution, manufacturing, advertising, and
22 rationalization of various general and administrative
23 expenses.

24 Kroger realized these efficiencies and then
25 some. For the combination of Fred Meyer and Kroger

1 alone, not taking into account synergies from previous
2 Fred Meyer transactions, it achieved aggregate synergies
3 of \$75 million by year one, \$150 million by year two, and
4 \$225 million by year three.

5 Taking into account the ongoing synergies that
6 Fred Meyer was already projected to get, it got synergies
7 of over \$260 million by fiscal 2000, \$345 million by
8 fiscal 2001, and \$360 million by fiscal 2002. This was
9 in a press release. It actually looked at what the
10 synergies had anticipated and the synergies that it
11 actually got, and told the investment community that it
12 delivered on its promise.

13 Two years later, Kroger entered into an
14 agreement to acquire the Dallas/Fort Worth operations of
15 Winn Dixie. This was motivated by the poor performance
16 of both sets of stores. The Kroger stores were well
17 underperforming Kroger stores in other cities, and the
18 Winn Dixie stores were on their last legs.

19 The deal would have allowed Kroger to expand
20 its store base, spread its overhead among stores, and
21 lower its prices. Among the traditional supermarket
22 competitors, putting aside Wal-Mart, Kroger was the
23 lowest priced in the market.

24 The synergies expected were \$40 million yearly
25 as of year three: from consolidation of advertising,

1 reducing administrative overhead, consolidating
2 warehouses and transportation, cost savings from
3 increased private label purchases, and a reduction in
4 overhead at Kroger's manufacturing facilities. It had
5 far more private label than did Winn Dixie. Kroger also
6 projected a one-time savings of approximately \$20 million
7 from the reduction of inventory that would have occurred
8 from the closing of Winn Dixie's Fort Worth warehouse.

9 And there was every reason to believe that
10 these synergies were real. Kroger achieved \$3.8 million
11 in cost savings when it had merged the administrative
12 function of its Houston and Dallas operations and put
13 them under one umbrella. And I've just told you the
14 incredible experience they had with Fred Meyer. So they
15 certainly believed that these efficiencies were real.

16 Now, what did the competitive landscape in
17 Dallas/Fort Worth look like? There was Albertsons.
18 There was Safeway. There was Kroger. There was Wal-
19 Mart. You also had a number of smaller chains.
20 Minyard's, Brookshire, and Whole Foods, along with other
21 smaller and independent operators, all competed.

22 And if that weren't enough competition, Wal-
23 Mart had plans to add up to 15 supercenters, five Sam's
24 Club stores, and it was bringing its neighborhood concept
25 to Dallas/Fort Worth. Super Target had begun

1 construction on five sites in Dallas/Fort Worth, and
2 H-E-B, another Texas chain, had also announced plans to
3 build stores in Dallas/Fort Worth as well.

4 Kroger's plans were to acquire 73 stores and
5 operate virtually of them. It had plans to close down
6 maybe three or four that were right near where it was
7 either going to upgrade into the Winn Dixie store or it
8 simply didn't need both stores.

9 The market shares were in the 30 percent range.
10 Yet the government decided to block the transaction.
11 They said that combining the second and third largest
12 players in Fort Worth -- they defined the market as
13 limited to Fort Worth -- would create a dominant
14 competitor. That assertion came despite the presence of
15 Safeway, Albertsons, Wal-Mart expansion, H-E-B entry, and
16 Super Target entry.

17 We believe history has shown that blocking that
18 transaction did not benefit consumers. What would have
19 happened if the deal had gone through is that Kroger
20 would have immediately changed the banner on those Winn
21 Dixie stores and made them Kroger stores.

22 And the evidence showed quite clearly that
23 Kroger priced lower than its other competitors in the
24 market, most notably Winn Dixie. So if it immediately
25 just put into place the Kroger banner and the Kroger

1 pricing, every single one of those Winn Dixie stores
2 would have had lower pricing than they had beforehand.

3 More importantly, we argued that in the face of
4 all this competition Winn Dixie not likely survive. In
5 fact, it didn't. Within two years, Winn Dixie had
6 announced plans to exit the market entirely. Of those 73
7 stores, Kroger ended up being allowed to buy quite a
8 number of them, all of the ones that it in fact most
9 wanted. Many stores were bought by other competitors,
10 but many stores went dark. These were stores that
11 otherwise would have been operated by Kroger at low
12 prices but instead simply don't exist any more.

13 I think that's one worth taking a look at to
14 see why the predictions of what was likely to happen
15 turned out to be different than what did, at least in
16 terms of the staff's perception.

17 I think the government has gotten better at
18 recognizing the importance of changing conditions in the
19 supermarket industry. Chris will probably tell you a
20 little bit about the American Stores experience. We kind
21 of followed on one of those.

22 In 2002, Kroger sought to acquire Raley's
23 stores in Las Vegas in a transaction that was so small it
24 was not reportable. Staff was extremely concerned about
25 that transaction when it was first announced. This,

1 after all, was a market that in the American Stores/
2 Albertsons investigation had been found to have high
3 entry barriers and was problematic. And for that reason,
4 staff threatened an injunction if we didn't give them a
5 little time to look at it.

6 We argued that there should be a way to make
7 sure that this investigation went quickly. We were
8 afraid that we were going to lose the deal altogether,
9 and who knows what would happen to those stores. It's
10 really important in thinking about investigating these
11 transactions what happens when these stores are out there
12 for too long.

13 One of the things that happened in the Winn
14 Dixie transaction was that as the investigation dragged
15 on and everybody knew that Winn Dixie was getting out,
16 shoppers stopped going to the stores. Employees started
17 leaving the stores despite significant stay bonuses.
18 Winn Dixie wasn't interested in investing even before the
19 transaction, but especially not after. The mere fact of
20 the lengthy investigation, helped bring about how quickly
21 Winn Dixie plummeted.

22 So we urged the Commission to find a way to
23 work quickly with us to determine whether there really
24 was a problem in Las Vegas. And they did so, to good
25 effect. We were able to demonstrate that while in 1998,

1 they had said that barriers were high, by 2002, Wal-Mart
2 had come in a big way for Las Vegas. It had entered with
3 five stores, and had a share higher than Raley's at the
4 time of the acquisition. It planned five more
5 supercenters -- again, we had the pictures of where they
6 had the "Wal-Mart Coming" signs -- and planned four
7 neighborhood markets. This time, after a quick
8 investigation, the Commission allowed the transactions to
9 proceed.

10 Now, what kinds of transactions are you likely
11 to see in the future? There may be another couple of big
12 transactions. You know what you have going on at the
13 agency right now. But I think, from Kroger, you're also
14 going to see smaller transactions. You're going to see
15 particular cities where a competitor is unable to deal
16 with the onslaught of competition and is looking to sell.

17 The only company who's going to be interested
18 in buying in a number of these markets is one who's
19 already there, who already has the distribution facility,
20 who already has the scale economies to bring advertising
21 to market. And so people are often going to go to Kroger
22 to see if they want to pick up some of the stores.

23 Kroger is going to be interested in doing this
24 again, for the scale reasons. It has no additional costs
25 to add another couple of stores on its advertising with

1 newspapers. It's not going to cost them much more to
2 serve from a distribution center. So there are real
3 efficiencies to this. And of course, the purchasing
4 scale economies from the large manufacturers are going to
5 bring them the ability to lower prices to compete more
6 with Wal-Mart and other supercenters and the new entry
7 that they're facing.

8 So I think you're going to see that these
9 transactions are going to raise questions in your mind if
10 you look only at market shares. But I think you need to
11 look beyond that to the whole picture.

12 I think FTC analysis of supermarkets could be
13 refined in a couple of areas. And in fairness, I haven't
14 seen what they've done over the last couple of years.
15 There may have been investigations that are closed. It's
16 hard to tell because there have rarely been closing
17 statements in the supermarket transactions to know
18 exactly what the FTC is doing and why they're doing it.
19 But a couple of things, I think, are worth thinking
20 about.

21 First, I think the day of calling a traditional
22 supermarket the only kind that can be in the market is
23 gone. I think you really need to think harder about the
24 impact of other nontraditional forms -- the mass
25 merchandisers, the club stores, and the like, especially

1 as they increasingly have the kinds of products in them
2 that you used to find only in traditional supermarkets.

3 Second, I think you need to think hard about
4 what geographic markets look like. The FTC's case in
5 Winn Dixie was premised on the notion that Dallas and
6 Fort Worth were actually separate geographic markets
7 based only on documents that sometimes listed Dallas
8 entry and Fort Worth entry, or Dallas store list and Fort
9 Worth store list.

10 Those documents were meaningless in looking at
11 how competition actually worked. How competition
12 actually worked is that there was one price zone in that
13 city. The exception was that for a few areas in Hispanic
14 parts of town, there were different price lists created
15 to deal with the fact that there were different produce
16 products in that store.

17 Otherwise, how much you paid for a pound of
18 hamburger, a head of lettuce, a box of cereal, was the
19 same at the farthest end of Dallas as it was at the other
20 end of Fort Worth. They for all intents and purposes
21 thought about competition in that holistic way. So
22 that's one thing to think about.

23 We have heard in some of the investigations
24 that we've done more recently in some of the smaller
25 deals that the government has looked only at what's

1 within three miles, even though consumers travel farther,
2 especially for supercenters. And it's been kind of
3 almost ignoring the idea of the concentric overlapping
4 circles. Maybe I'm not going to travel six miles, but
5 maybe the guy who lives on the outer boundary can easily
6 travel half a mile to go to the next circle. And it
7 wasn't clear to us at all how they were looking at
8 geographic market in at least one investigation they
9 conducted of a Kroger acquisition.

10 It turned out fine because there was so much
11 competition it didn't matter in that particular
12 investigation. But I think more transparency in how
13 you're thinking about geographic markets and looking at
14 how does competition actually work rather than where a
15 particular individual is likely to drive is going to be
16 really important.

17 Third, entry and expansion continue to occur.
18 It's true that you're going to find some smaller
19 operators being forced out of business. But others are
20 expanding. Every city is incredibly dynamic. I mean,
21 look at the Washington, D.C. metro area, an area I
22 thought might never actually get additional supermarket
23 competition. And the number of new competitors into this
24 MSA in recent years has been pretty impressive. And of
25 course, you've got Tesco coming, and who knows what

1 effect that will have on U.S. supermarket competition.

2 Just a couple of quick points. Increased
3 concentration doesn't mean increased prices. We've
4 actually heard some on the staff express the concern that
5 Wal-Mart has been bad for supermarket competition because
6 it's forced some of the smaller players out, so that's
7 meant the market has become more concentrated, and
8 concentration is bad.

9 That completely ignores the fact that what it's
10 getting rid of is small, inefficient competitors that
11 it's replacing with low, low pricing. The mere equation
12 of "increased concentration because of new entry is bad"
13 simply cannot be a credible economic theory of harm from
14 the entry of Wal-Mart. In fact, Wal-Mart has led to
15 lower prices. It has forced other people to respond to
16 that. And that trend is going to continue.

17 Finally, you have to think about whether price
18 increases as a result of acquisitions in fact are
19 sensible given the state of the economy. I think the
20 place that you really need to think hard is in the
21 competitive effects analysis. You know, is coordination
22 really likely where Wal-Mart is part of the picture?
23 It's the ultimate maverick.

24 Not only are its prices considerably lower, but
25 it's going to stay that way because it uses these

1 groceries as a loss leader to get people to bring in the
2 higher margin products. So it's unclear to me that you
3 can ever tell a credible story of coordination with them.

4 Nor is it likely that you can tell a credible
5 story of unilateral anticompetitive effects in many of
6 these transactions given the rationale for them, what the
7 documents show, and how people are thinking about it. In
8 fact, in not one of the supermarket deals I've ever done
9 has there been even a hint that there's a single document
10 that suggests in any way that the transaction was
11 motivated by anything other than the desire to get
12 efficiencies and be able to pass them on to consumers so
13 that they could compete more effectively. As I
14 mentioned, those efficiencies are real, and they need to
15 be considered in the analysis.

16 Thanks very much for your time.

17 (Applause.)

18 MR. SALINGER: Our next speaker is Chris
19 MacAvoy. He's a partner at Howrey. He's done a lot of
20 supermarket deals.

21 MR. MACAVOY: Bear with me while I attempt to
22 open this PowerPoint. Thanks for coming up and helping
23 with this. I'll just say, by way of introduction, I'm
24 going to start -- really, thank you very much -- really
25 where Debbie left off, which is talking about what

1 things, at least in my personal opinion, the Commission
2 and the staff could be doing differently in the way it
3 looks at supermarket mergers. And some of the ground
4 I'll cover will be familiar because you've heard about
5 some of it from Debbie already. But these are my own
6 views, and so I will try not to be duplicative.

7 I really think that these are the keynotes,
8 recognizing how dynamic retail grocery markets really
9 are. If you've spent your whole career or a big part of
10 your life inside the Washington area, for many, many
11 years, as Debbie said, your choices primarily if not
12 exclusively were Giant and Safeway. And even Washington
13 is no longer like that. And certainly outside of
14 Washington, that's just not the case. Retail grocery
15 markets really are dynamic.

16 The second point: We -- and I mean all of us
17 inside and outside the agency -- we shouldn't be
18 constantly trying to force supermarket deals into these
19 two Procrustean beds, either the one-stop shopping market
20 definition or trying to make everything the next Staples
21 case.

22 My use of the word "Procrustean," this is kind
23 of an homage to Jim Brill, who loves this word. I'm
24 quite sure that the first time I ever heard him use that
25 word was at a meeting at the Commission in the mid-'80s

1 on a supermarket transaction. And I'll bet anything he
2 was flinging that word at Steve Newborn.

3 Procrustes, in Greek mythology, was a bad actor
4 who would force travelers to fit into a bed. If you were
5 too tall, he'd cut your legs off. If you were too short,
6 he would stretch you. And so Jim loved to use that word
7 as applied to the traditional view of supermarkets,
8 especially market definition on the product side.

9 Third, we should be applying a consistent, or
10 at least transparent, approach to geographic market
11 definition. I think you've heard some very useful things
12 already here this morning about that. Before the break,
13 the very interesting presentation on the chaining and
14 critical loss effect is, I think, maybe part of the
15 direction that I personally would like to see. And I'll
16 come back to that.

17 Next, we should not be presuming that store
18 closings are anticompetitive. In most large
19 transactions, there are going to be some mentions in the
20 companies documents of what is the slate of stores going
21 to look like post-transaction. And there will be some
22 stores that are at least discussed as, gee, maybe we
23 ought to close that store because it's just not going to
24 be performing well. It's not performing well now, and we
25 don't expect it to improve any after the acquisition.

1 Traditionally, the staff has looked very, very
2 unkindly at that, and there's been almost a presumption
3 that that is "taking capacity out of the market." And
4 those become immediately red flags, really, for
5 divestiture. And I want to suggest that that is a
6 position, to the extent that it's still the position,
7 that should be revisited.

8 And finally, and again you've heard about this
9 in, I think, some detail already from Debbie,
10 efficiencies need to be revisited. And I'll come at that
11 perhaps slightly differently. But it's certainly a point
12 that I think we are in agreement on.

13 Now, on the dynamism of retail grocery markets,
14 some of the recent developments -- the Kroger/ Raley's
15 transaction, which Debbie was involved in representing
16 Kroger. I was in the unhappy position of having
17 represented Albertsons just three year earlier where our
18 client was blocked from acquiring the very same stores.
19 We divested them -- Albertsons divested them to Raley's,
20 and now just a few years later Raley's is selling them to
21 Kroger.

22 Well, essentially Kroger -- when you look at
23 where the shares line up, Kroger was being allowed in
24 2002 to do the very same deal that Albertsons had not
25 been allowed to do.

1 Now, I can't prevent you from making unkind
2 comparisons because Debbie's capabilities and mine. I
3 wish you wouldn't. But to be fair to the agency and to
4 the staff, this was not some arbitrary decision. The
5 closing statement there in 2002 does articulate why the
6 different result -- unanticipated entry and expansion
7 since 1999; the rapid growth of the market.

8 Now, one could, though, quibble a little bit
9 about this. And I guess I'm the one who must. In 1999,
10 we certainly were making these arguments on behalf of
11 Albertsons. Las Vegas was already in the cross hairs of
12 Wal-Mart. They were, as I recall, building or had built
13 a new distribution in Las Lunas, New Mexico. Everybody
14 knew how far they were going to supply stores and how
15 many from that distribution center.

16 But we did not have the stores already under
17 construction. So we were not able to convince the staff
18 and the commissioners, ultimately, that this was a market
19 that Albertsons should be allowed to make the acquisition
20 in.

21 2002, the changes had not arguably been all
22 that dramatic. There were five Wal-Marts in by that
23 time. That was some expansion, entry and expansion, by a
24 smaller operator called King Ranch. Nevertheless, I'm
25 certainly not arguing at all that the Commission made the

1 wrong decision in 2002 when Debbie came along. They
2 absolutely made the right decision, in my opinion.

3 If you look today, there are more stores, not
4 just these more Wal-Mart supercenters but everybody, just
5 about, has expanded. I've got 2005 data. I think there
6 are about 13 Wal-Mart supercenters in that MSA as I speak
7 here today. So I do think that the Kroger/ Raley's
8 approach, and really fully crediting the dynamism of the
9 market, is the way to go.

10 Wal-Mart/Amigo: This is the transaction in the
11 same year, in 2002, in Puerto Rico where for the first
12 time recently -- and I'll come back to the "recently"
13 part -- for the first time recently, the Commission
14 explicitly included club stores in the market.

15 Now, in the papers, the Commission was careful
16 to limit it to the facts of this case. In Puerto Rico,
17 in Puerto Rico. But nevertheless, I think that the
18 acknowledgment here of the fact that consumers in this
19 market were using and are using the club stores to do
20 their one-stop shopping for groceries is an important
21 breakthrough -- although again, it's not maybe so much of
22 a breakthrough as maybe people might think. If you
23 really want an eye-opener, go back and look at the Grand
24 Union decision of the Commission from 1983.

25 That was from the Grand Union/Colonial Stores

1 transaction, where there was a pretty extensive
2 discussion there by the Commission. This is on a full
3 record. In fact, if you want to know when was the last
4 time the Commission fully litigated a supermarket merger,
5 that's it.

6 And on a full record, the chairman writing the
7 decision said that the product market in this supermarket
8 deal includes all retail grocery stores, club stores, and
9 all these other kind of limited assortment stores, which
10 were really just emerging in the early '80s, are in the
11 market. So history is perhaps coming back around.

12 I won't belabor the Kroger/Winn Dixie
13 experience in Dallas/Fort Worth in 2000, the transaction
14 that was -- well, I won't say blocked; the Commission
15 moved to block it, then it was abandoned. But this is an
16 excellent example of how dynamic a major market can be.

17 At the time of the FTC investigation, there
18 were just 14 Wal-Mart supercenters in the Dallas/Fort
19 Worth metro area. Actually, some were supercenters; some
20 were neighborhood markets. The preliminary injunction
21 brief said, basically, should what? Scroll forward a few
22 years later, after the deal has now fallen apart: 41
23 supercenters. Last year, 88. And there's certainly --
24 it's probably around a hundred today.

25 And it's not just the supercenters and the

1 neighborhood markets. Everybody has been adding stores
2 there. I would have to say that looking back at that
3 merger challenge decision of 2000, it is one that didn't
4 go the right way.

5 I do think that the Commission should continue
6 to follow the trend that the Kroger/Raley's non-challenge
7 really suggests that it's started to take, and that is
8 dig in and take a hard look at some of these long-held
9 assumptions about retail markets, grocery retail markets,
10 being static and unchanging, and hey, it's the same
11 people year after year.

12 You would get that picture perhaps if you had
13 spent your life in Washington, for year after year, Giant
14 and Safeway, Giant and Safeway. It's certainly not true
15 in most markets. It's not even true in this market any
16 more.

17 Getting beyond what I think had been a
18 traditional acceptance of the notion that you have to
19 have large-scale entry or you have to have "critical
20 mass" to be successful. Yes, it can help, and yes,
21 that's often an important driver of transactions.

22 But there are many examples of operators who
23 have expanded from smaller toeholds, or have done very
24 well in a market with a relatively small footprint -- not
25 just done well for themselves, but also done well in

1 terms of having a pretty dramatic effect on competition
2 without having some massive store base.

3 The third point here is that increasingly
4 you're seeing retailers operating sort of a portfolio of
5 formats, and experimenting and re-juggling with it all
6 the time. So it's not just, I've got my traditional
7 store. There are a lot of people, Kroger being just one
8 of them, that have different things that they're fooling
9 around with. Well, I've got a price impact store. I've
10 got a small footprint store for their urban areas.

11 These boxes are very flexible. A 40,000 square
12 foot box, there's lots of different things you can do
13 with it. There are departments you can pull in or out.
14 You can decide, I'm going to have a pharmacy. You can
15 decide, I'm going to have a bakery. You can say, no, no,
16 no, I'm just really going to focus on the center store
17 and go kind of not so heavy up on these peripheral
18 departments.

19 On the Procrustean beds, Jim's favorite term,
20 one of his favorite terms, we've already heard, I think,
21 some things today that suggest lots of data points that
22 we should be looking at that indicate that this notion of
23 the typical one-stop shopping experience is maybe
24 something of the past. And I'd like to come at that in a
25 couple of ways.

1 One that's already been mentioned is that there
2 really is no longer some unique core of grocery products
3 that's available already only at supermarkets or almost
4 exclusively at supermarkets. The entire package, if you
5 will, has been disaggregated and is available. If not in
6 total at some other formats, it's certainly available in
7 very large overlaps at other formats. Some Debbie
8 mentioned, some are listed here, club stores being one;
9 supercenters, conventional mass merchandisers, drugstores
10 being other formats that are very much a part of the mix.

11 So already -- and I apologize for the tiny
12 print -- already at current prices, this disaggregation
13 has occurred. The median size of a supermarket
14 transaction last year, the ring, as they put it, was \$29.
15 So that's not a whole -- that's my son buying a bag of
16 Slim Jims. I mean, that's not a big stock-up.
17 already -- and that's just supermarkets. Already people
18 are using supermarkets for pretty much quick hit shopping
19 very frequently. Yes, a lot of it is a big stock-up.
20 But \$29.

21 Debbie mentioned as well people visit 1.9
22 supermarket trips a week. And in some of the same recent
23 survey data -- this is coming from Food Marketing
24 Institute; you can get at this on their website -- when
25 asked, where have you shopped in the last 30 days, 87

1 percent identified a supermarket.

2 That's been declining steadily. Forty-four
3 percent mentioned a supercenter. I believe when they
4 asked people, what is your primary food store, it was in
5 the high 60s people identified a supermarket. And
6 supercenters was in the 24 or 25 percent range, I
7 believe.

8 Consumer, what drives your choice of stores?
9 Number one, low prices, 31 percent. Convenience, high
10 quality produce, high quality meat, important but down
11 quite a bit below low prices. There's no inherent
12 advantage that the conventional supermarket has.

13 Wal-Mart/Amigo, the Puerto Rico case, also
14 suggests that the FTC has started recently, in the last
15 five years, to move away from this notion that we're just
16 going to look at what is the number of SKUs that is in a
17 supermarket, and we're going to match up the SKU overlap
18 with these other formats; or we're going to ask, where do
19 you price check, and limit the market to where you price
20 check. There seems to be a broader look.

21 The Commission, in the Wal-Mart/Amigo papers,
22 referred glancingly to consumer survey evidence, similar
23 to the kind of evidence I just mentioned, asking people,
24 where do you shop. More telling would be the question,
25 and I'm not sure whether it was addressed there, is where

1 would you shop if prices went up. Well, that's a
2 question that has been asked in merger investigations,
3 grocery merger investigations, before.

4 Mike Hunter, who I'm glad to see here from CRA,
5 will probably recognize these last bullet points.

6 This is from some survey work that he and his
7 colleagues did with us on a transaction in the '90s,
8 where they were asking -- through a survey, they were
9 asking consumers, where would you shop if prices went up?
10 And there were some interesting results. These were
11 presented to the Commission staff in that investigation.
12 And people were saying, yes, we will shop more at club
13 stores if prices go up and club stores are convenient to
14 us.

15 Econometric evidence has been presented in the
16 past. When we ask, well, why not more, and I have to say
17 I do think of this a little bit like -- it's like
18 shopping for a car. I mean, there's the base price of
19 the car, but then if you want these add-on packages, it's
20 more.

21 Well, if you're in merger investigation where
22 the base price already of the second request is 5 million
23 and your client is already giving a \$3-1/2 million check
24 to the company that's imaging the documents, all right,
25 how much does the econometric package add in terms of

1 both cost and time, and then how much does the
2 efficiencies package cost? Well, these are not trivial
3 considerations. So that may be just one reason why you
4 don't see more heavy-duty econometrics.

5 Another reason, though, I have to say, is that
6 in the past when we've done this, there just -- I would
7 never say it's fallen on deaf ears because that's not the
8 image I'm -- that's not been my experience. But let's
9 just say that the interaction, the follow-up with the
10 staff, has been less than satisfactory, which is to say
11 we've never really in the end been sure did it make any
12 difference or even what did the staff think about these
13 results.

14 We did present one multi-market study that
15 looked at club stores, among other things, presented to
16 the staff that showed that club stores really did exert a
17 significant downward effect on supermarket prices. I
18 don't know what the staff thought of that. In fairness
19 to the staff, they would say, well, you presented that
20 perhaps a little too late in the investigation; you've
21 got yourselves to blame. I do want to acknowledge that
22 viewpoint, which you do run into from time to time.

23 But I do think, in fairness to everybody, that
24 we can say that with the tools that are at, I'd say, its
25 disposal -- at our disposal, outside counsel, economists,

1 and people on the inside of the agency -- I don't think
2 that it's any excuse any longer to just ride along on
3 this one-stop shopping notion. Certainly that's not the
4 approach the Commission is now taking in department store
5 mergers, and the closing statement in the Federated/May
6 matter more recently is certainly worth a read in that
7 regard.

8 Another Procrustean bed I'd like to stay away
9 from is the attempt to jam every deal into the Staples
10 mold. I personally, having lived through the Kroger/
11 Winn Dixie matter in Dallas/Fort Worth, found that to be
12 an especially frustrating aspect of that investigation,
13 where the theory, or at least one of the theories, that
14 the staff argued and prevailed, five-zip, before the
15 Commission on was that Kroger and Winn Dixie uniquely
16 constrained each other, which just went against
17 everything I thought I knew about groceries and about
18 that market in particular, when you had a number of other
19 very much mainstream competitors in the form of
20 Albertsons, Safeway, Minyard's, and others, let alone Wal-
21 Mart Supercenters.

22 And I did have the impression that that was
23 perhaps an -- not perhaps, I really did think that that
24 was an over-extension of a unilateral effects analysis
25 and an effort to emulate the outcome in Staples in a way

1 that I did not think was appropriate to the facts.

2 Geographic market: At one time -- I mean, if
3 you go back and look at the consent orders from the
4 Commission, the '80s and really into around the 1994 time
5 frame, you will see that many of the complaints define
6 the geographic market as an MSA. And occasionally
7 they'll say the MSA and smaller markets contained
8 therein, without being specific about it.

9 And there does seem to have been an acceptance
10 back at that time of the kind of chaining effect that you
11 heard about in the interesting presentation before the
12 break, that you've got -- yes, the primary trade area of
13 an individual store may be about three miles; 70 percent
14 of the sales are probably going to be within three miles
15 in a typical area. But in an MSA, you've got this
16 overlapping grid of trade areas. And absent some
17 physical barrier, a major rail yard or a river or
18 something like that, you're typically going to get this
19 chaining effect.

20 That approach seemed to fall into some disfavor
21 in the last ten years, although I don't know what the
22 approach really has been since. There has been, at least
23 to my view, a bit of arbitrariness about it. I'd like to
24 see that black box opened up somewhat.

25 Debbie has mentioned this: Sometimes you're in

1 there with maps where you're going literally block by
2 block, and that's what the staff is interested in. Other
3 times you're looking at very broad areas and you're not
4 really sure why these two things are different,
5 especially when you've got a situation, as we did, in
6 Dallas/Fort Worth where the prices, the merging parties'
7 prices, are the same across this entire wide area, and
8 where they've got one warehouse that is serving the whole
9 area, and they're advertising in the same newspaper. So
10 going street by street, block by block, seems puzzling
11 and incorrect. There hasn't been much guidance on this
12 issue in the consent orders in the last ten or so years.

13 I've mentioned store closings already, and I
14 won't -- I just want to suggest that this is a -- when
15 the documents of a company talk about maybe some stores
16 should be closed, that that ought not to be automatically
17 a red flag. Let's look at those stores. I mean, in
18 other industries, you would expect and think it was
19 healthy that, post-merger, some of the inefficient assets
20 get consolidated. And that doesn't seem to be the
21 approach that's taken when supermarket mergers are looked
22 at.

23 And part of that is that -- perhaps part of
24 that is that closed stores are widely viewed as blights.
25 I mean, that's something that clearly local officials

1 complain to the Commission about or complain to Capitol
2 Hill about. We don't want closed, dark stores. That's
3 not a trivial issue for local officials. But as an
4 antitrust issue, that's really not the question that this
5 agency addresses, of course.

6 This is the kind of heartrending statement that
7 greeted Debbie and me when we got the Commission's PI
8 brief in the Kroger/Winn Dixie matter ten days or so
9 before our clients abandoned it, where the efficiencies
10 claims were dismissed. And why then haven't we seen more
11 diligent efforts by people in grocery mergers to push the
12 efficiencies?

13 Well, results such as that, some of the very --
14 "scorched earth" is my term; I don't know why I put it in
15 quotes -- but what arguably have been kind of a scorched
16 earth treatment of efficiencies in other distribution
17 mergers -- Staples, Cardinal Health, and Heinz -- that's
18 pretty daunting when you see that.

19 But that's not to say that we and others and
20 Jim have not been in here talking a lot about
21 efficiencies. I think part of the problem, though, is
22 that there just hasn't been very much of a constructive
23 dialogue. You make the presentation, and then what
24 happens to it? It doesn't really seem that it plays out,
25 and you don't get much reaction to it.

1 Yes, in fairness to the staff, often that gets
2 overtaken by other events. You're on to the consent
3 order discussions. You're on to investigational
4 hearings. Maybe you put the efficiencies paper in too
5 late. Recognize, if you're outside counsel, that you're
6 doing yourself a disservice if you do put it in too late.

7 But the efficiencies are real. I'm happy to
8 see that these are largely the same types of categories
9 that Debbie has identified. These are the types of
10 efficiencies, significant efficiencies, that we have
11 articulated and presented on behalf of our clients,
12 Albertsons being one, in some of their acquisitions in
13 the past. And I'm not here on behalf of any client, but
14 I understand that in many if not most of the mergers,
15 these have played out.

16 Now, Albertsons' very large acquisition of
17 American Stores had problems in the integration.
18 Arguably, some of those problems may have had something
19 to do with the number of stores they had to divest, 144
20 divestitures. Many of the efficiencies perhaps -- I'll
21 say this is not based on any inside knowledge; this is
22 just my intuition that perhaps some of the efficiencies
23 in that transaction may have been divested away. That's
24 perhaps a hunch.

25 But that transaction aside, mostly these things

1 have borne out. And we feel comfortable that if I came
2 in tomorrow, that these are the things that we would want
3 to be talking about.

4 One thing, though, that I'll close on, though,
5 about efficiencies, and that -- not unique to grocery
6 retailing, but something that can be difficult for
7 practitioners, it seems to me that in the documents, more
8 maybe than in other industries, there's a lot of talk of
9 best practices and what kind of best practices we're
10 going to apply to the merged store base.

11 I don't know why that is. Perhaps it's because
12 in this industry there is a big guy out there that is
13 sort of the -- everybody knows, here's the best
14 practitioner. And so there's been a tremendous angst
15 over the last 15 years to identify what are those folks
16 doing and what should we be doing.

17 But you do see the language of best practices
18 in the documents a lot. Well, then you get people in
19 investigational hearings, and they're being asked
20 questions the gist of which is, why do you need to
21 acquire somebody to do those best practices? Why can't
22 you just hire different people?

23 And I've walked out of investigational
24 hearings -- not during them, but at the end -- not
25 often -- and had clients look at me, senior executives

1 look at me, and say, with a little bit of ire, golly,
2 I've been in this industry 30 years and here I've just
3 learned from somebody in this hearing that all I had to
4 do was think harder and we'd be Wal-Mart. A little bit
5 of an over-exaggeration at the end of a long day, but you
6 get the picture.

7 Everybody understands what merger specificity
8 means. But I think perhaps that when you see the word
9 "best practice," we should not leap to the conclusion
10 that oh, therefore it's not merger specific because you
11 could just hire people. You don't have to acquire
12 somebody.

13 So those are my personal thoughts on what has
14 been done and what could be done in grocery mergers. And
15 I'll turn it over to Jim Fishkin, who I'm sure will tell
16 me that I've missed a few things. Thank you very much.

17 (Applause.)

18 MR. SALINGER: Thanks. The idea behind this
19 morning was to take a historical view of merger
20 enforcement, and so we wanted to have a presentation
21 about how, in the past, the Commission has looked at
22 grocery store merger.

23 So we're very happy to welcome Jim
24 Fishkin back. Jim was at the Commission for 15 years,
25 where he did a lot of grocery store mergers. He's

1 currently at Dechert. When he was at the Commission, he
2 won the Paul Rand Dixon award, which is a very
3 prestigious award within the Commission. So Jim.

4 MR. FISHKIN: I just want to say thank you very
5 much to the folks at the FTC for inviting me to come to
6 this conference. I think it's a great idea to have a
7 conference on grocery and supermarket retailing. It was
8 a very significant and substantial portion of the FTC's
9 merger enforcement during the late 1990s. It probably
10 represented 10 to 15 percent of all of the Commission's
11 merger enforcement, just one industry.

12 Part of that was due, in fact, to a large
13 amount of consolidation that was going on. But before I
14 go into all the details, I just want to set out a few
15 points regarding what I'm going to say.

16 I talked to the general counsel's office when I
17 was asked about making this presentation because I'm here
18 to talk about my knowledge of the FTC supermarket merger
19 cases during about a five-year period from 1997 through
20 2001 when I worked at the FTC as lead attorney on many of
21 these cases. And as everybody who practices antitrust
22 knows, 99 percent of that information is nonpublic.

23 So I can't say anything that's nonpublic. For
24 example, in the Kroger/Winn Dixie matter, all of the
25 Commission's documents and exhibits that were presented

1 as evidence are, to the best of my knowledge, still filed
2 under seal, under protective order, in fact, to protect
3 Kroger and Winn Dixie from their documents and testimony
4 being released to the public. So I'm sort of here with
5 one arm tied behind my back.

6 And in the introduction, I was introduced as a
7 guy who did a lot of supermarket deals. And I should
8 just say in all fairness, in private practice I do
9 represent supermarket chains and supermarket wholesalers,
10 and I have a lot of contacts and discussions with people
11 in the industry.

12 In fact, late Friday afternoon, I got an e-mail
13 from the general counsel of a client of mine who said,
14 hey, I see you're going to speak at the FTC conference.
15 And I said, well, how did you find out about this? And
16 he said, well, we saw it on their web page, or the trade
17 association sent an e-mail around to everybody. And
18 that's how he found out. So he actually found out a
19 little more about today's program than, in fact, I did.

20 So anyway, just with those caveats -- and I'm
21 not speaking on behalf of any of my clients or Dechert
22 LLP. This is similar to what Chris said. These are just
23 my thoughts. And I'll try to run through and give a
24 little summary of what happened in the 1997 to 2001 time
25 period. And some of those cases Debbie and Chris have

1 already talked about. But I'll throw them in there
2 because there were quite a few.

3 What I did was I went through and I thought,
4 well, let's just find out what were all those supermarket
5 merger actions. There were a total of twelve supermarket
6 merger actions, and I listed them by period. And again,
7 this was all as a result of a much, much larger set of
8 supermarket acquisitions that were occurring during this
9 time frame.

10 And Debbie had said, well, at least for Kroger,
11 they were in response to maybe certain actions by Wal-
12 Mart and what they were doing. And I'm sure there were
13 quite a few reasons for why they took place, some of
14 which obviously I can't say based on what I learned when
15 I worked at the FTC.

16 So you can see on the side there were quite a
17 few. They varied all over the place in terms of their
18 size and scope and to what extent certain firms were
19 overlapping. Some were what I call total in-market
20 acquisitions, where acquiring the firm was not entering a
21 single area where they didn't already have a store -- to
22 the exact opposite, where over 90 percent of the deal,
23 there was no overlap of any kind. The overlap was just a
24 very, very small percentage of the deal.

25 And some deals were very large in size, over

1 \$10 billion -- there were a couple of those -- down to,
2 obviously, all of these were -- to much smaller sizes.
3 So I just wanted to go through these cases with you.
4 Those were the twelve cases. So what I'm going to try to
5 talk about based on what I can say from the general
6 counsel's office statement is sort of an aggregation
7 across a dozen or so cases.

8 And of course, these were just the supermarket
9 merger matters where the FTC sought and obtained
10 enforcement. They're not the ones where obviously there
11 were filings coming in all the time, people came in and
12 talked about deals, and they didn't result in any
13 enforcement.

14 I think what's very important, which hasn't
15 really been addressed today particularly -- I know we
16 have a lot of people here from the U.K. and elsewhere --
17 is that the states played a significant role. This all
18 resulted from the California v. American Stores case,
19 which gave the states the ability to conduct their own
20 investigations, either with the FTC or separate from the
21 FTC and obtain enforcement under the Clayton Act or a
22 state could investigate under its own antitrust law.

23 And so you can see the list on the side -- and
24 this was to the best of my memory. I don't want to make
25 any state feel left out. There may have been other

1 states that participated on other matters. This is what
2 I could remember basically the other night. And for at
3 least five of the cases, those states had very
4 significant participation.

5 There were other cases where the states, in
6 essence, took more of a minor role, where they sort of
7 thought, well, if the FTC is doing their work and
8 everything is going fine, they'll just sit back and wait
9 and they won't exercise any authority if they were going
10 to be happy with the outcome. So I definitely want to
11 mention that states have played a role and certainly
12 could play a role in any matter that the FTC also could
13 pursue.

14 I told Dan Hosken that I would try to discuss
15 the primary issues that were common across the cases.
16 And the first issue, obviously, and this is following the
17 Merger Guidelines, was the product market.

18 And the question is: Are supermarkets a
19 relevant product market under the Horizontal Merger
20 Guidelines, the 1992 Merger Guidelines, where you look at
21 the merging parties' products and then you see whether
22 the hypothetical monopolist -- that is whether, for
23 example, all those supermarkets, hypothetically if one
24 guy bought every single supermarket in the city, could
25 they raise their prices a small but significant amount,

1 and whether that would be profitable or not. So that's
2 really the question.

3 And one of the things in terms of supermarkets,
4 and I thought -- one of the things I just want to throw
5 in here, is last month at about the time of the ABA
6 Spring Meeting, the FTC was handing out these brochures
7 called "Competition Counts." So I picked one up, and I
8 noticed a picture, it appeared to be the aisle of a
9 supermarket. I don't know which one the FTC went in and
10 took a picture of and reproduced it; quite often, it's
11 also on their website.

12 And the FTC, which obviously covers many
13 industries, as you know, in merger work and non-merger
14 work and all kinds of antitrust activity, said in the
15 brochure, "What if there's only one grocery store in your
16 community? Without competition, the grocer may have no
17 incentive to lower prices." And then they've got some
18 other references and things like that in the brochure.

19 So our whole issue was, are stores like this a
20 relevant product market? Are they sufficiently different
21 from other food retailers? So that was a key question
22 that the FTC faced in all twelve of those investigations.
23 And I can assure you those investigations covered
24 multiple bureau directors and different commissioners
25 over the five-year time periods.

1 And the same issues were always reinvestigated
2 over and over again. It wasn't just because in case
3 number one supermarkets were a product market, then all
4 of a sudden they're a product market for case number two
5 and three and four and five. In fact, that's why the
6 second requests went out, the boxes came in, the
7 investigational hearings were done, et cetera, et cetera.

8 The next issue -- and this is following the
9 Guidelines; this is consistent with all those cases -- is
10 which retailers should be counted in the product market?
11 Who are the other supermarket operators? And we've heard
12 today lots of discussion about other retailers and things
13 like that. But that was always a key issue.

14 I'll quickly go through the rest. The other
15 issue was what's the geographic market and how big is it.
16 We've had some discussions here about MSAs and local
17 areas and areas within MSAs and things like that, and
18 that was always a key issue.

19 Then, of course, once the market participants
20 in the markets were identified, the FTC, as usual, the
21 staff did go through and determine market concentration.
22 And I'm going to show you some of the HHI data from what
23 the FTC publicly released. But the FTC always also
24 looked at -- in addition to the market concentration the
25 number of significant remaining competitors. Is it a

1 market of four to three, or is it a market of ten to
2 nine? How many players are left? I have some other
3 slides on that from the publicly released information.

4 Then, of course, the staff analyzed competitive
5 effects. I mean, obviously that's the big issue for
6 these merger cases, whether it's a supermarket merger
7 case or any other merger case. And the key issues are,
8 can the merged firm unilaterally raise prices or reduce
9 services? That's a big issue. And prices could be in
10 the form of not just shelf prices, but discounts, double
11 coupons, triple coupons, length of sales, a whole host of
12 things. Services could mean store hours, staffing,
13 issues like that.

14 And also under competitive effects, the issue
15 is whether the merged firm and the remaining firms can
16 coordinate in some way, that's just the coordinated
17 behavior section of the Guidelines, to either raise
18 prices or reduce services in some way?

19 And I know there's been a lot of discussion on
20 entry, and obviously entry is a very serious issue in
21 retail cases. And the key questions were: Were other
22 firms planning entry that would have a market impact?
23 And would other firms enter in response to a price
24 increase? And of course, following the Guidelines, would
25 the entry be timely, likely and sufficient to defeat a

1 price increase? So these were the common issues that
2 fell across all of those cases.

3 I want to discuss -- and again, this is sort of
4 combining product market discussion over a large number
5 of cases into a slide or two. So what was the evidence
6 that, in my view, the FTC relied on to support a
7 supermarket product market?

8 And the actual product market definition, if
9 you look in all these public complaints, was the retail
10 sale of food and grocery items at supermarkets. And then
11 it's sort of, what's a supermarket? And I know Debbie
12 said this earlier, but I want to make emphasize one part
13 in particular.

14 And it's the only point I put in bold in the
15 entire slide show. The FTC had followed -- or at least
16 when I was at the FTC, I can remember, about when the
17 very first Wal-Mart Supercenter opened up. And the FTC
18 followed the development of those Wal-Mart Supercenters
19 from when they had a handful of stores to many, many
20 stores to the 2,000-plus supercenters that they have now.

21 And I know, and I'm partly saying this because
22 there are a lot of people in the industry and on Wall
23 Street, maybe at the FTC itself, I don't know, who have
24 what I think is a poor understanding of the supercenter
25 issue. The FTC staff always, always included Wal-Mart

1 supercenters in the same product market as supermarkets.

2 Since all supercenters, by definition, contain
3 a full line supermarket within the supercenter, I don't
4 think there was ever a time when they were not included
5 in the product market. But I can say I remember reading
6 in the last few weeks an analyst trade report saying the
7 FTC has never included supercenters in the product
8 market. And that's just a mistake.

9 And the other issue, though, is whether you
10 include the total sales at the Wal-Mart Supercenter or
11 just the supermarket section of the Wal-Mart Supercenter.
12 And this morning, Paul Ellickson from Duke had some very
13 nice slides on this issue. So I refer people back to his
14 slides on this issue.

15 But essentially, a Wal-Mart Supercenter has,
16 let's say, 180,000 square feet; 40- or 50,000 may be your
17 full line supermarket section. So there is a way for the
18 government to learn what are those sales, and those are
19 the sales that were included in the market concentration
20 analysis rather than total store sales, which would
21 include kids' clothes, things like that; auto parts;
22 sporting goods; those types of products, which Wal-Mart
23 sells quite a few of.

24 And the other issue was -- and again, this is
25 all information that was based on company documents and

1 testimony from company executives and other sources that
2 the government used in their investigation. So the first
3 thing is: What are the characteristics of a supermarket?
4 Why are they different? In what way?

5 Well, there is a distinct set of products and
6 services for consumers who desire to one-stop shop. And
7 I know Debbie gave the one-stop shop statistics, most
8 recently of, what, 1.9 shopping trips per week. During
9 this time period, I remember the FTC folks looking at
10 stuff very carefully, and at that time they were in the
11 very low 2s, maybe 2.1, 2.2. Someone can check the
12 historic data. So even at that time, a one-stop shop
13 wasn't based on a consumer only shopping once a week.
14 The average consumer at that time was shopping about
15 twice a week.

16 Supermarkets carry a large variety of products.
17 I know there was a discussion earlier today about the
18 total number of SKUs, stockkeeping units. And during
19 this time period, based on the trade data and other
20 sources, they were typically around 30,000 in a typical
21 supermarket. Obviously there were a lot of supermarkets
22 that were very large, that had upwards of 50,000
23 stockkeeping units. And you obviously need a big box to
24 put all those products in.

25 So there was never this absolute fine line

1 discussion based on the size of the store that defines a
2 supermarket. But of those chain stores merging and other
3 supermarkets, there was rarely a store lower than 20,000
4 square feet. And that included, for example,
5 independents and other chain stores, operators. I don't
6 want to say there were never supermarket less than 20,000
7 square feet, but the average sizes were way above 20,000
8 square feet. So these supermarkets are pretty large
9 stores.

10 And I'd already mentioned earlier the last
11 bullet in the slide about documents and testimony
12 supporting these facts.

13 So then the other issue that the FTC spent a
14 lot of time on was pricing because that's really what
15 merger analysis is about. It's not about -- there's this
16 whole world, obviously, in the marketing world and things
17 like that and the business field about competition. But
18 antitrust is really about who else would price constrain
19 the supermarkets. So the first thing you have to figure
20 out is how do they set their prices.

21 So there are certain things that the
22 supermarkets generally did, and this isn't specific to
23 any one firm. But supermarkets regularly conducted, at
24 that time at least, price checking at competing
25 supermarkets. These were usually weekly price checks,

1 where they would go in with the bar code scanners, run
2 the scanners across bar codes, and a supermarket chain
3 could tell to within 1/100th of a percent whether their
4 competitor has moved up or down on price. And that's
5 pretty easy to do if you're looking at 10,000 different
6 products a week and you're averaging them by department
7 or category.

8 And then what the FTC looked at was, well, who
9 else do they price check, and the frequency of the price
10 checks. So it would be sort of case in and case out.
11 The supermarket chains usually price checked each other
12 every single week, and sometimes more than once a week.

13 And then, well, who else sells food? Well,
14 obviously there are lots of other retailers who sell
15 food. Then you look at the frequency and the depth of
16 the price checks at the nonsupermarket food retailers.
17 And suffice it to say that the facts showed they were not
18 price checked by supermarkets anywhere near the depth and
19 level and frequency that supermarkets price checked each
20 other.

21 And then the other issue was how frequently did
22 supermarkets change their prices and why did they change
23 their prices. How frequently did they change their
24 prices because their competitor ran a sale or moved their
25 pricing format in one way or another versus how often did

1 they change their prices in response to a nonsupermarket
2 retailer selling food? So these were all factors that
3 were very important in establishing factual evidence
4 using the Guidelines analysis to support a supermarket
5 product market.

6 Supermarket chains also used price zones to
7 charge different prices. And I know Debbie had
8 mentioned -- she had brought up price zones for Kroger,
9 at least, saying that Kroger had one price zone for the,
10 I guess, Dallas and Fort Worth combined metropolitan area
11 at the time of the Kroger/Winn Dixie investigation.

12 But generally, the idea was that there were
13 price zones. Supermarkets could easily change their
14 price zones. They frequently did. And then the question
15 was: Were they changing them and the stores within the
16 price zones based on other supermarkets, or were they
17 doing it in response to any other retailers?

18 And the evidence generally was pretty strong
19 that at least at that time -- and again, this is the time
20 period of basically the late 1990s -- that it was in
21 response to other supermarkets, not other types of food
22 stores.

23 And that's why I should go back. Of those
24 twelve cases, all twelve were unanimous votes by the
25 Commission. So in essence, it was sort of like a 60 to

1 nothing vote on the supermarket product market. And I
2 can assure you that each commissioner examined the
3 product market issue separately, based on the number of
4 meetings I had. So those were the Commission's views at
5 that time.

6 In terms of geographic markets -- and Chris had
7 brought up some very good issues about geographic markets
8 because that was always a very challenging issue.

9 So the first step was how do you establish
10 geographic markets. And I've had a lot of people talk to
11 me about this over the last few years. And some of the
12 issues were basically looking at how far away do
13 consumers shop for groceries. And I noticed, when Paul
14 was talking about the U.K. examples, it was based on
15 drive time and things like that. That was one issue.
16 And were the limitations on driving further based on the
17 perishability of the food products and other issues. And
18 consumers' time is valuable, which also constrain how far
19 people will shop for groceries. So those were issues.

20 And the FTC generally got some pretty good
21 detailed data for the customer draw areas for the various
22 stores. And based on that information, it was pretty
23 easy to identify overlaps. And overlaps, I can certainly
24 say, weren't based on just drawing three-mile or five-
25 mile or any particular distance around particular stores.

1 They were based on looking at where the consumers
2 actually shopped.

3 And I only put in information for one slide.
4 And this is following up exactly on what Chris was saying
5 earlier. The staff did look at -- demographics were very
6 important in areas. People only drive in certain
7 neighborhoods, and even if other areas are pretty close
8 by, when you look at those customer draw areas, they were
9 usually anything but concentric circles.

10 There were also natural and manmade barriers to
11 consider. There were low density population breaks
12 between areas. And basically, the FTC looked at all
13 these draw areas and overlapped them, and that's how
14 these areas generally grew into somewhat larger areas
15 than just neighborhoods, for example, an MSA or something
16 similar to a metropolitan statistical area. An MSA is
17 just a U.S. Office of Management and Budget figure. It's
18 not necessarily designed to reflect consumer shopping for
19 groceries, an exact duplicate of what could be a relevant
20 geographic market under the Merger Guidelines.

21 And of course there are examples. I didn't go
22 through them because there are 129 different geographic
23 markets in those twelve cases. Some of those had smaller
24 markets. There were other ones with larger markets -- so
25 they do vary, and they varied by the facts.

1 One of the things I wanted to point out to you,
2 in 2004, I think it was Malcolm Coate of the Bureau of
3 Economics who did a lot of work on putting this data
4 together. They put together these market concentration
5 tables. And there was a table specifically for
6 supermarket merger cases. I picked the one that was
7 closest in the fiscal years to the time period I'm
8 discussing.

9 And so these were the released information.
10 And as you can see, the FTC never brought a supermarket
11 merger case with an HHI post-acquisition below 2,000. So
12 that's not skirting 1800. Even at 2,000, there was never
13 a single case during this time period. The number below
14 2400, out of 129 markets, was slightly under 10 percent.
15 It was twelve markets.

16 Then you can see the escalation up. Most of
17 these were -- and everyone has got their different
18 opinion on how do you characterize something as a 3,000
19 or greater HHI. But I think most people would say that's
20 a fairly highly concentrated market. So that's the
21 distribution that came out of these.

22 And of course, I'm a firm believer in it's not
23 just HHIs, but it's actually the number of significant
24 competitors. And as an aside, when the FTC first
25 released this information, they just released HHI data.

1 And so I talked to Malcolm and I said, why don't you
2 release the number of significant competitors because
3 that's very important? So I'm not taking credit because
4 he probably would have done the work anyway. But I
5 thought that's more revealing in looking at FTC
6 enforcement.

7 So as you can see, this was the breakout. Now,
8 I'm not -- when I reread last night what's the definition
9 of significant competitor in the FTC report on Horizontal
10 Merger investigation data, frankly, I couldn't understand
11 it. So this is somebody else rereading memos, probably,
12 from a few years ago and looking at what's a significant
13 competitor.

14 So clearly, 15 of those 129 markets were merger
15 to monopoly, where I guess what the FTC "Competition
16 Counts" brochure would say, "what if there were only one
17 grocery store in your community." So 85 percent of the
18 129 markets(109 markets) had only three or fewer
19 significant competitors. And then there were
20 15 percent(20 markets) that had more than three remaining
21 significant competitors. And I'll be the first to admit
22 the Kroger/Winn Dixie case, if those numbers are included
23 in this, would have been one of those 20 markets, or at
24 least for the Fort Worth area.

25 So I thought that was pretty revealing. And I

1 should say the FTC came out earlier this year with a
2 similar table for FY 2001 to 2003, so there's a little
3 bit of overlap, not too many additional FTC supermarket
4 merger cases. And they had eight markets, and seven of
5 the eight were four to three. So that would be 87-1/2
6 percent. So it's a very similar number in the more
7 recent years.

8 Unilateral effects: What was going on? These
9 were supermarket chains. They were head-to-head
10 competitors. They were generally very close to each
11 other spatially. That is, they're within a short
12 distance of each other -- they're across the street. A
13 mile away. They're basically competing to get the exact
14 same customers.

15 They also had a lot of very similar store
16 formats. Earlier today there was a discussion regarding
17 all food retailers, not just supermarkets. You could
18 have -- at least if you just look at all retailers who
19 sell food, you can go on one end of the spectrum to these
20 extreme value stores up to value stores, stores that sell
21 a lot of value-added products that aren't necessarily
22 trying to be the lowest player in the market because they
23 have a lot of extra products and services for consumers;
24 up to, for example, membership club stores, where you pay
25 your membership fee and you buy a 144-ounce can rather

1 than a smaller size.

2 So within that, generally these merging firms
3 were very close in format. That is, if you're looking at
4 closeness, that's where they were coming out. And how
5 did the FTC learn this? It wasn't that the FTC went out
6 and talked to consumers or conducted their own customer
7 surveys. They relied on surveys that the chains produced
8 regarding their own customer base.

9 And it's very common in the industry for chains
10 to want to know, how many of our customers primarily shop
11 us, and where do they do their secondary shopping? And
12 back and forth, and things like that. So a lot of these
13 surveys were showing that as a significant percentage of
14 the customers at each of the merging chains were listing
15 the other chains as their first or second choices.

16 And in some respect, and I just want to follow
17 up a little bit on what Chris said about store closings.
18 In some of these cases the closeness of these merging
19 firms, which was defined as both physical proximity and
20 store format, was used to support company plans to close
21 competing stores or, in fact, to raise prices, or at
22 least plans to raise prices after the acquisition.

23 So, in clarifying the store closing issue that
24 Chris talked about, at least from what I can say without
25 going over the line from the general counsel's guidance,

1 is that it wasn't just a store is poorly performing and
2 the selling firm probably would have closed it down
3 anyway because it was old or there was only a year left
4 on the lease, and the acquiring firm doesn't want to go
5 out and renew it, so they just plan to close it down.

6 That's a different scenario than the acquiring
7 firm planning to close a profitable store because they're
8 very close and competing for the exact same customers.
9 In essence, it's like, well, we don't have to close it.
10 We could just raise the prices at that competing store,
11 and X percent of the customers would be diverted to the
12 acquiring firm's store. So there's a little difference I
13 just want to point out to people on that issue.

14 I'll move on to, real briefly, coordinated
15 behavior.

16 MR. SALINGER: Jim, can I encourage the "real
17 briefly" thing? I have let us slip a little bit. But I
18 want to give Dave 15 minutes.

19 MR. FISHKIN: I'll just run through -- these
20 are just basic dynamics about coordinated behavior on the
21 slide. The one thing I want to say that was maybe unique
22 not just to supermarkets but to retail is that unlike a
23 lot of industries where competitors don't know each
24 other's prices and they don't know what their sales
25 volume is, everything in retail is public in one form or

1 another. So it's very easy for competitors to know these
2 facts generally. And there were market conditions that
3 could facilitate coordinated behavior -- I put down in
4 one of the bullets about signaling price changes and
5 things like that. So I'll just leave it at that.

6 We're at the very end. I think this is the
7 last slide, the slide on entry -- there are a lot of
8 questions because some legitimate entry issues have been
9 raised by both Debbie and Chris.

10 So what the FTC was looking at on entry under
11 the Guidelines. Look at timely. How long does it take
12 to plan, build, and open a new supermarket? And that
13 includes time to find a suitable site, going through the
14 internal company approval process, negotiating terms for
15 the lease, getting regulatory approval, and construction
16 time.

17 And it's one thing for the FTC to find out how
18 long it takes everybody else to open a new store. But
19 the FTC always asked the parties to state how much time
20 they took to open each of their new stores from the
21 planning stage. And I can say across these cases, it was
22 rare to find a supermarket firm able to open up a new
23 store from time of planning to opening in under two
24 years. Likely -- and this is slightly off the Guidelines
25 if you look at the Guidelines literally -- but it was

1 more used as, will a competitor enter in response to a
2 price increase? Sufficiency of entry was whether a new
3 entry was likely to attain sufficient scale to defeat a
4 price increase.

5 And I think the last bullet is pretty
6 important. In every merger, obviously there are
7 competitors, and the question is what are they planning
8 to do regarding the opening of new stores in the next
9 several years? And I'll just leave it at one line here:
10 The FTC did send out civil investigative demands to third
11 parties, and or the companies had to respond to the CIDs
12 about what they were planning regarding new stores. And
13 I think the FTC relied on these third party responses at
14 that time, relying on what competitors told the FTC under
15 oath.

16 That's it.

17 (Applause.)

18 MR. SALINGER: Thank you.

19 Well, I think the real question is whether this
20 is the Procrustean bed or whether it's getting it right.
21 And there's no one better able to comment on it than my
22 predecessor as bureau director and the person who first
23 brought me to the Commission, Dave Scheffman.

24 MR. SCHEFFMAN: I don't know about "better,"
25 but as you know, I will comment. I'll be brief; we're

1 going over. But I'll try and be pithy. I think I do
2 have some things that you might find interesting.

3 I was there at the beginning. One of my
4 messages -- I'm going to talk about the long history,
5 like back when Paul and I did -- I can't remember whether
6 you did the supermarket mergers, Paul. But supermarket
7 merger analysis was begun in the '80s when I was at the
8 Commission. Jim certainly advanced the art, but the
9 basic analysis was put in place there.

10 There's two industries which haven't changed
11 from the '80s, in comparison to every other industry, the
12 agency's review, and that's supermarkets and oil. Both
13 of them are investigated and largely treated exactly the
14 same way as the '80s, although there has been some
15 Herfindahl creep.

16 But the approach to market definition, the
17 reliance on market definition, et cetera, in those two
18 industries is dramatically different from the practice in
19 every other industry now. And there's reasons for that.
20 These are political industries that are of concern to
21 people.

22 So I was there in the '80s when we did this
23 stuff. I'm going to tell a little bit about the history.
24 I then went on to Vanderbilt and business school, and
25 started the business strategy program there. And for

1 years I've studied Wal-Mart because it happened to be
2 nearby, and retailing, and taught retailing and things.
3 And I may have some things to say about that, about Wal-
4 Mart and its impact on this industry.

5 The history: Grand Union came down in 2003.
6 You need to remember, the Commission horizontal merger
7 statement didn't adopt the guidelines, the merger
8 guidelines, as promulgated by Bill Baxter. The
9 Commission horizontal merger statement advocated a very
10 non-structural approach.

11 So Grand Union came down with a very
12 non-structural approach. The merger guidelines were
13 issued. Despite the Miller Commission not adopting the
14 guidelines, Tim Muris did adopt the guidelines from the
15 beginning. And that's the sort of analysis we had in the
16 beginning in the '80s.

17 And what we see in supermarkets is the artifact
18 of really what we did in product market back in those
19 days, which in most cases has dramatically changed. And
20 that's why we still have supermarkets is the market and
21 that's really the deciding factor, as opposed to any sort
22 of in-depth competitive effects analysis.

23 So what happened? Shortly after, in about -- I
24 forget -- '84 or '85, we were presented with a merger.
25 Furr's bought Safeway. And what we were presented with

1 was a merger monopoly in a couple small towns in New
2 Mexico.

3 Well, what were we going to do? There was
4 clearly a problem. So we challenged those. There was no
5 dispute by anyone in the Commission that those
6 transactions shouldn't be allowed to proceed. And on its
7 heels, within a year, I think -- Bruce Springer probably
8 remembers; I think he worked on one of those deals -- we
9 had two big supermarket mergers in California. And that
10 all of a sudden set -- first Safeway opened the gates and
11 California merger analysis was supermarkets are the
12 market. Local markets, we look at the same sort of
13 things -- driving distance, are there natural barriers,
14 all the sort of stuff Jim was looking at.

15 And we had a lot of divestitures, and then very
16 importantly, the state AG came in afterwards and got even
17 more divestitures. So that really upped the political
18 ante in the Commission in how it treated supermarket
19 mergers.

20 Nothing has really changed in the basic
21 analysis of supermarkets, which is, much more than any
22 other areas other than the oil industry, market
23 definition and concentration is the answer in
24 supermarkets. And that's not what we do in virtually any
25 other industry. It's an input. We've gone far beyond

1 that in other areas.

2 It's very odd when you think about it: This is
3 a very dynamic industry. I know we say a very dynamic
4 industry, and we've made a lot of good comments on behalf
5 of our client. But it is. We're doing the same basic
6 analysis and the same enforcement decision now that we
7 were in the 1980s, where we had no supercenters. We had
8 no real club stores. High T was just beginning.
9 Supermarket pricing has fundamentally changed. Product
10 merchandising has changed. Formats have changed.

11 The players have changed dramatically. None of
12 the players are the same that they were before. Most of
13 them are gone, for the top ten, or have been bought by
14 someone, or the management has fundamentally changed and
15 the strategy has fundamentally changed, like Kroger.

16 So this is an industry that's had dramatic
17 change, and we're still doing the same analysis and the
18 same approach that we did in the '80s, which is that
19 supermarkets -- even though there's clubs, there's
20 supercenters which are in the market, and there's all
21 this other information about how consumer shopping
22 patterns have changed, how IT is important, et cetera,
23 we're still doing the same sort of analysis that we did
24 in the 1980s.

25 Now, another thing I learned early when I first

1 came to the Commission -- I can't remember; maybe Paul
2 would remember this. There used to be these yellow
3 booklets. There used to be data collected on the
4 supermarket industry which is at the local level. I
5 think the Commission may have required that. And the
6 Commission was very busy in the supermarket area when I
7 got there in '79.

8 And I looked at the data in there, and what was
9 very interesting was true, was interesting data. What it
10 showed is -- I'm not sure you can get those data now, but
11 you can get it by company -- is that margins at the local
12 level were quite small, that margins were quite small, a
13 few percentage points, across all areas. So the margins
14 were small and the range was small.

15 Now, you have to be careful interpreting
16 margins and trying to make some inferences. But what
17 that showed is that in this industry, you could just
18 see -- well, clearly across areas, the structure,
19 industry structure, varied a lot, and lots of other
20 things varied a lot. But what you see overwhelmingly is
21 the margins are really small.

22 So one of the things I think the Commission
23 realized -- I remember making some intemperate remarks
24 during that time: Why are we looking at this industry,
25 given these margins? But I don't agree with that;

1 there's certainly a reason to look at supermarket mergers
2 generally if we look at them in the right way.

3 But you have to realize the reality of what
4 we're talking about in supermarket mergers. Dave Parker
5 talked about the hypothetical 5 percent price increase
6 after a merger. A hypothetical 5 percent price increase
7 for a supermarket would lead it to being the most
8 profitable supermarket in history.

9 Their margins are tiny. You would have a
10 multiple of any existing margins if you had that big a
11 price increase. And I don't know what Jim thought, but I
12 don't think -- and I think when I was back, none of us
13 ever thought the price increase would ever be that large.

14 That's not to say we shouldn't worry about
15 supermarket mergers. The usual argument is 1 percent of
16 people's savings of their expenditures on grocery
17 products is a lot of money, so we should care about it.
18 And that's sort of the same argument that's made in oil,
19 where it's not really a belief that there be a 5 percent
20 price increase in most cases.

21 So you have to understand that context. And
22 let me briefly talk about retailing economics, which is
23 in antitrust we focus on pricing and on margin.
24 Retailing, and supermarkets in particular, margins are
25 quite important. But really, what's important is turns,

1 sales per square feet because you have -- the reason why
2 supermarkets make very little money on each sale on net
3 margins, the way you make money is sell a lot.

4 What do you do to that? You have a lot of
5 traffic, and you try and have transactions values as high
6 as they can be. That's part of the Wal-Mart magic.
7 Remember, Wal-Mart has significantly lower operating
8 costs than any competitor in any industry that it
9 competes with, supermarkets or Target or anyone. It
10 gives away a significant part of that operating cost
11 advantage in terms of lower prices. It has lower margins
12 than anyone, not for loss leading reasons; I'm saying
13 across the board, its margins are lower.

14 Why? Because it's part of its overall model of
15 dramatically increasing sales per square feet. That's a
16 little bit too simplistic, because the real -- how do you
17 make money? You make money on return on assets. You
18 don't make money on the margin; you make money on the
19 investment, on the amount you're making on your
20 investment.

21 So the whole idea is turns, asset utilization,
22 which is get more traffic. Get average transaction sizes
23 up. So that's not to say margins aren't important
24 because margins are so small, if you could increase
25 margins some, even a little bit, that would significantly

1 increase margins. The issue is where the rubber really
2 meets the road.

3 And this is particularly important for how food
4 retailing has evolved, because the one thing the
5 Commission really never does and the parties never really
6 do is actually implement the guidelines; if not fight
7 about market definition, at least fight about competitive
8 effects.

9 And what is the tool? It's critical loss
10 analysis. What would the loss in sales be if you raised
11 the price? And in that sort of analysis, you cannot
12 ignore the non-supermarket competitors. Remember, as the
13 data Debbie talked about indicated and is well known,
14 think about the market definition we have here.

15 The average person is -- many of the average
16 people are buying exactly the same products in different
17 stores, supermarkets and non-supermarkets. They're
18 buying exactly the same products. It just depends on
19 where they choose to shop at that particular time.

20 So in that situation, you necessarily have to
21 ask the question: If you did elevate prices, what would
22 you elevate prices for? Which is something I don't
23 know -- during Jim's time they probably worried about it,
24 but certainly in the '80s, when the economists were
25 wrestling because they were all coordinated action cases,

1 if you had a supermarket coordinated action case, what
2 were the specific things you were going to raise the
3 price for, given that a lot of things were available in
4 other venues? And that's even much more true than it is
5 today.

6 So there's really a lack of actually performing
7 the basic critical loss analysis and trying to see how
8 much sales would be, trying to get a handle on how much
9 sales would be lost. It's not about one-stop shopping.

10 A very substantial percentage of supermarket
11 sales are very small transactions. They're top-up.
12 Those same people that are going there for one-stop
13 shopping are going there for top-up, and they're going to
14 other places and buying the same thing. So that has to
15 come into the analysis.

16 Now, I'm not saying that you would never worry
17 about supermarket mergers. Of course you would, in
18 certain circumstances. And it might be circumstances
19 even when there were clubs and Super Wal-Marts. It would
20 depend on the situation. Put differently, the Grand
21 Union Commission, if it had been presented with a merger
22 at that time of Giant and Safeway, of course would have
23 blocked it.

24 So even though under its analysis there were
25 other competitors in food retailing, it depends on the

1 situation. It depends on the environment. It depends
2 on, in those markets, who the non-supermarket retailers
3 are, what people buy from them, et cetera, things like
4 that.

5 So product market: The problem with
6 supermarkets is the same problem the Commission has
7 generally on retail, which is they look at formats. I am
8 a marketing professor, in part. Formats are meaningful
9 from a business point of view. There is a match between
10 formats and what the retailer's core customer base is
11 trying to be.

12 Yes, a supermarket is trying to be a one-stop
13 shopping. That's one thing it does offer. But a very
14 substantial percentage of their sales are not those core
15 customers, or the transactions are not that. So there's
16 a difference between format.

17 It's a fundamental problem of not using
18 critical loss, which is, when looking at format, you're
19 looking at what the inframarginal customer is. Of
20 course, in critical loss in the guidelines, the issue is
21 what's the marginal customer going to do? What's the one
22 who would switch, and how much of those are there?

23 Now, we know that, as the data Debbie indicated
24 and are well-known, a lot of shopping is outside the
25 supermarkets for buying exactly the same things that you

1 can buy in supermarkets. So it goes back to you need to
2 do critical loss. You need to do some actual analysis
3 beyond maps.

4 Let me turn now to geographic market. What has
5 advanced, and it's lucrative for all of us that do this,
6 is generating maps. It's real expensive. It's neat.
7 What's the point?

8 Look, I was interested in the U.K. I remember
9 I visited the commission, U.K. commission, at the time
10 they were looking at, I think, the Safeway transaction.
11 And they said the major chains all price -- they price
12 the same at all their stores in England.

13 I said, that's not possible. You'd be
14 underwater. Given the difference in operating costs,
15 you'd be underwater in London and you'd be making money
16 in the hinterlands. But the fact is that they do, and
17 they did. They still do.

18 So what's the point of looking at local markets
19 unless it's part of some -- local markets are of some
20 interest if you think about, well, what the competitive
21 effects analysis would be in the broader market. We've
22 seen the same thing happen in the U.S., which is, in the
23 '80s when we first started doing this, you had very
24 localized pricing. And as most retailing, the zones have
25 gotten bigger and bigger as the biggest cities are

1 larger.

2 Okay. Let me make two more comments. Paul
3 Ellickson gave a very nice presentation, but he couldn't
4 be more wrong about Wal-Mart. It's just shockingly
5 wrong. Wal-Mart has had the most profound effect on
6 retailing in the world of anybody, ever, including in
7 supermarkets.

8 Look at the California supermarket strike.
9 What was that about? They could compete with one
10 another. The reality was that everybody realizes that
11 Wal-Mart, or others who figure out how they can somehow
12 do the Wal-Mart model, which is actually very hard to do,
13 are actually going to have significantly lower costs than
14 any of the supermarkets do today. And that's what they
15 see as the bogey, is they're chasing that Wal-Mart
16 efficiency.

17 Whether Wal-Mart is in the market that they
18 compete with when it does have a dramatic effect, or even
19 if it's not, any sensible supermarket realizes it's a
20 long way from a cost structure which is going to be
21 competitive, given that someone is going to figure out
22 how to better match Wal-Mart in the supermarket industry,
23 and it better be then.

24 So finally, to go with Mike's question in the
25 first panel today, which I'd paraphrase to say, we're

1 doing all this stuff on market definition. Is that
2 right? And I think the answer is no. But we need to
3 think seriously about the competitive effects analysis.

4 There are supermarket mergers, I'm sure, that I
5 would agree to challenge. I had no problems with
6 Furr's/Safeway, and I don't think anyone would. But I
7 can conceive of much less dramatic situations where I
8 might think there's a problem after the analysis. But
9 it's got to be based on a competitive analysis. And we
10 have to start actually with the guidelines, which is
11 fundamentally based, as you know, on critical loss.

12 Thanks a lot.

13 (Applause.)

14 MR. SALINGER: Thank you.

15 Well, I'm sitting here trying to make the
16 tradeoff between lunch and discussion, and then I realize
17 that there really doesn't have to be any tradeoff because
18 we can have discussions during lunch. So for those of
19 you who ordered lunch, it's available out here. For
20 those of you who didn't order lunch, there are a variety
21 of eateries around. You will have to come back through
22 the security, I remind you.

23 We're going to resume in here at a quarter of
24 1:00.

25 (Whereupon, at 12:20 p.m., the conference

1 adjourned, to reconvene at 1:00 p.m.)

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L U N C H E O N S E S S I O N

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MR. SALINGER: We are very privileged today to have as our luncheon speaker Bill Kovacic. Commissioner Kovacic was sworn in as a commissioner on January 4, 2006. Before that, he was the E.K. Gubin Professor of Government Contracts Law at G.W. Law School, where he'd been teaching since 1999.

He is a recidivist at the Commission, having been the general counsel from 2001 through 2004, and previously he worked at the Commission from 1979 to 1983, first with the Bureau of Competition's planning office and later as an attorney advisor to former Commissioner George Douglas.

After leaving the FTC in 1983, Commissioner Kovacic was an associate with the Washington, D.C. office of Bryan Cave, where he practiced in the firm's antitrust and government contracts departments until joining the George Mason University School of Law in 1986.

Earlier in his career he spent a year on the majority staff of the Subcommittee on Antitrust and Monopoly at the U.S. Senate Committee on the Judiciary. He also clerked for the Honorable Roszel Thomsen, U.S. District Judge for the District of Maryland.

So with no further ado, Mr. Kovacic.

1 COMMISSIONER KOVACIC: Thank you, Michael. And
2 my gratitude to the Bureau of Economics for organizing
3 what I'll identify as being a hallmark of what the agency
4 has done particularly well, and what it's done especially
5 well during Michael's tenure as head of the Bureau.

6 I'd like to relate today's proceedings to a
7 larger theme about what competition agencies should do,
8 and to underscore what I think is the importance of
9 convening proceedings of this type and others that
10 involve an examination of more fundamental trends in
11 individual sectors and specific types of commercial
12 phenomena, and to underscore that this type of proceeding
13 and activity is critical to what a good competition
14 agency does.

15 A basic question that runs throughout the
16 literature on public administration, and I know there are
17 many students of that literature in the room today, is
18 how to define good performance. When we talk about the
19 work of a competition agency over time or any public
20 institution, a basic question is, is it doing a good job
21 or not?

22 To attempt to ask that requires a fundamental
23 effort to define what we mean by good performance. What
24 exactly is it that we ought to be measuring? What means
25 should we use for conducting the assessment? Why does it

1 matter?

2 Well, having a concept of what an agency ought
3 to do, the type of work it ought to perform is vital to
4 making future policy choices, forming a view about what
5 works and what doesn't, what has an impact and what has
6 no impact or what has a bad impact, is indispensable to
7 forming judgments about how resources should be allocated
8 and to a basic assessment of the soundness of the
9 underlying regulatory scheme that's entrusted to the
10 agency's enforcement.

11 And it also has a basic impact on the agency's
12 reputation. And the fact of having a good reputation or
13 a bad one or an indifferent one matters in ways that
14 simply go beyond the sense of personal pride and
15 satisfaction that incumbent managers and the professional
16 staff of the agency have at any single time.

17 It's critical to one's ability to go into court
18 and get good results. I'm convinced that there is, in
19 effect, a fictional supermarket on which public
20 institutions trade, and if your stock is trading at a
21 premium, you get the benefit of the doubt from judicial
22 overseers who review your work. It's the equivalent of
23 having a hall of fame-like reputation in professional
24 baseball as a pitcher. And the benefit there is that you
25 get the pitch that's around the plate.

1 The famous story told of Rogers Hornsby
2 standing and watching pitches from a rookie pitcher that
3 seemed to be going across the plate, and the catcher
4 turned in dismay and said, "What's wrong with that one?"
5 And the umpire said, "When your pitcher has thrown a
6 strike, Mr. Hornsby will let you know."

7 Having the benefit of the doubt in close
8 matters counts a lot in litigation. It counts in the
9 view of consumers about the legitimacy of what the agency
10 is doing in the eyes of companies that are subject to its
11 controls, where even if they dislike specific
12 interventions, they respect the general process by which
13 those interventions are taken.

14 The ability to recruit the kind of professional
15 staff that you need to excel. And increasingly, and this
16 is a point that I wish to emphasize, gaining the respect
17 of competition agencies and regulators in other
18 jurisdictions.

19 You're all aware of how our field has become
20 one of extraordinary complexity and multiplicity. I
21 remember 30 years ago finishing school in law school and
22 talking to one of my instructors, who said, "What do you
23 aspire to do with a law degree over time?" And I said,
24 "I'm interested in working in the field of international
25 competition policy."

1 And my instructor, a very thoughtful scholar,
2 long experience, said, "That's intellectually
3 interesting, but I could never recommend that you enter a
4 field that will have little practical significance during
5 the course of your professional lifetime."

6 That wasn't a foolish assessment in 1978. Yet
7 today we know it's a world of over 100 jurisdictions that
8 have competition laws. By my rough guess, at least a
9 third of those are applied with a degree of emphasis,
10 seriousness, that business managers must take them
11 utterly seriously.

12 And in a world of shared authority, one does
13 not gain respect or acquiescence simply by turning up the
14 volume. You have no more effect as a competition
15 official than talking to someone in a foreign tongue and
16 thinking you will be understood simply by speaking more
17 loudly and slowly. There's no substitute in the world of
18 shared authority, diverse authorities, to persuade except
19 by leadership, intellectual leadership that generates the
20 better idea that compels attention over time.

21 What I'd like to do is to talk a bit about the
22 conventional report card by which I think competition
23 authorities have been evaluated during my professional
24 career, and then to emphasize investments of this kind,
25 alternative criteria that don't dismiss the importance of

1 litigation and prosecution as a measure of what the
2 agency does, but underscores the indispensability of
3 investments and knowledge, the capital budget that builds
4 intellectual leadership. In doing this, I'm giving you
5 my views, not necessarily those of my colleagues or my
6 institution.

7 What I want to do is to underscore how
8 institutional design and capability shape policy results.
9 There are a lot of academics in this room or folks who,
10 though it's not your full-time career, have spent lots of
11 time in classrooms.

12 When I teach subjects like competition law,
13 when I give presentations to other audiences, the keenest
14 matter of concern tends to be matters of doctrine,
15 substantive policy developments. What did the Supreme
16 Court do in Twombly? What's it going to do in Legion?

17 The moment you begin talking about the
18 institutional factors that generate policy, you begin to
19 see -- certainly at a convention -- you get to read the
20 back of the newspaper, or you see the attendees nervously
21 looking through the brochure to see if there's a parallel
22 session they might be able to skip out to.

23 Yet the institutional arrangements and the
24 manner in which they're shaped provides the
25 infrastructure over which policy travels. As one of my

1 colleagues at G.W. has put it, "Policy is the content
2 that travels through the pipes." And if you aspire to do
3 broadband-like policy content, you can't do it with a DSL
4 infrastructure of institutions. You have to have
5 conduits that match the policy demands that you want to
6 place on them.

7 And I want to promote acceptance of a norm over
8 time that we judge agencies by their willingness to
9 invest in exactly the kind of activity that's taking
10 place today and related types of work, by which the
11 Bureau of Economics and other elements of the FTC,
12 independently or collaboratively, have increased the base
13 of knowledge on which judgments about policy, in this
14 field and others, ought to be based.

15 What counts in the conventional report card, if
16 you were to ask, how are we measured? New regulatory
17 interventions are, simply stated, cases, cases, and
18 cases. Special credit to the big high-profile matter
19 that captures the first page of the business section in
20 the New York Times and the Washington Post, or makes it
21 to the front part of the paper in the Wall Street
22 Journal.

23 The question is how to count or classify
24 matters. But the emphasis is on how many cases have you
25 brought. And that is overwhelmingly the matter of

1 concern by those who grade us over time. Relatively
2 little emphasis on the following: smaller matters that
3 can make big law.

4 If you'd gone back to 1978 and you'd seen the
5 day when Indiana Federation of Dentists was filed during
6 Mike Pertschuk's chairmanship, you would have said, how
7 quaint. A bunch of dentists in Indiana. Not a very big
8 state. Not a lot of dentists. How amusing. Yet that's
9 the case that, as much as any in the 1980s, really shaped
10 the development of the law coming from this agency, a
11 powerful case, a small matter that made huge law.

12 And non-litigation activities get brushed aside
13 casually. Studies, who cares? Interesting study.
14 Interesting paper. Interesting research. And least of
15 all is there emphasis on making capital investments.
16 It's all on consumption, not investment. Production, not
17 R&D. And what kind of incentives does this create for
18 agency leadership, like me, the political appointees?

19 The first is the emphasis on inputs rather than
20 outcomes. If we were an airline and you looked at the
21 incentive structure, it is an airline that gets evaluated
22 by the total number of departures. And if you ask, have
23 the planes come down? What about the arrivals? Oh, we
24 don't pay attention to arrivals at this airline. We just
25 pay attention to how many planes we send up in the air.

1 The mere fact of lots of activity tends to be
2 confused with accomplishment because when you're doing
3 things that are relatively risky or difficult, there's
4 always the hope that by the time it comes to ground,
5 especially if it's a smash-up, you can say, not on my
6 watch. Things were going pretty well while I was still
7 in charge. The landing was the result of a succession of
8 others who came behind. We were doing a good job when it
9 was in my hands.

10 And non-litigation strategies tend to be
11 de-emphasized. Advocacy before other public
12 institutions. Studies and reports that quite often can
13 identify first best solutions. And I point to the work
14 that the FTC has done with patent reform as being an
15 example.

16 In so many areas involving IP, my
17 interpretation is the U.S. competition policy system and
18 the European competition policy system has handled
19 matters that get tossed into the wake of a patent system
20 that is not often enough rigorously evaluating the
21 qualification of potential claims for rights to be
22 granted. And the impact of challenging private
23 restraints: that is, to examine in great detail through
24 studies the actual effects of what we've been doing tends
25 to be diminished.

1 And the consequence is too few investments in
2 capital. A budget that tends to emphasize production of
3 cases. Too little investment in capital.

4 And why might that happen and what are the
5 effects? There's a danger there that your commitments
6 can outrun your capabilities because your base of
7 knowledge is being diminished over time and you're not
8 restoring it. The real causes of problems, again, tend
9 to be overlooked.

10 And in the course of handling cases, you don't
11 ask, why are we seeing lots of cases of this type?
12 Whether it's bid rigging involving public procurement,
13 where the fundamental cause might be deficiencies in the
14 procurement bidding system itself; and a short-term
15 credit claiming impulse is a voice like a siren that
16 beckons at the ears of public officials like me all the
17 time.

18 And what does the voice say? It says things
19 like, pick the low-hanging fruit, one of Washington's
20 beguiling idiotic aphorisms. Why is it idiotic? Well,
21 unless someone is whispering to you, plant some trees as
22 well, you have a lot of fruit gatherers running around.
23 Indeed, the larger message is, don't just pick the fruit.
24 Chop down the wood, too, to light a fire when it's cold
25 outside. And all of a sudden there's no orchard left.

1 Someone has to be not just picking the fruit but planting
2 the trees.

3 And why is capital investment important? It
4 involves a commitment -- and the projects I've seen bear
5 this out -- it involves a commitment to make investments
6 today that will not be appropriable until well after
7 you're gone.

8 The rough rule of thumb, I think, for any
9 incumbent set of managers is that to an extraordinary
10 degree, the success of what you do depends on investments
11 that were made by your predecessors. There's success in
12 recruiting. There's success in making investments in
13 knowledge and building it. Often, long-lead-time
14 projects that will not come to fruition until well after
15 incumbent managers are gone.

16 What you need is a norm that emphasizes this
17 cumulative, sustained effort as being the key ingredient
18 to doing good work over time. And by norms, I mean
19 formulating a consensus view about how members of a group
20 ought to act.

21 And why do I raise this message with this
22 audience? You're the audience that helps create the
23 sense that the norm matters. It's got to be a norm
24 absorbed internally in the agency, but it's got to be
25 pressed upon the agency by outsiders, experienced

1 observers of what the agency does. The question that's
2 posed in academic journals and in conferences is not
3 simply, how many cases did you bring this year, but what
4 investments did you make today that will make the agency
5 better off later on?

6 Tim Muris and Bob Pitofsky, in a conversation I
7 heard them have long ago, defined their job as making the
8 life of their successors easier. What did you do now
9 that made their work and their life better later on?
10 Good advice not simply for agency leadership but for the
11 managers who run the key operating offices.

12 Some of the larger lessons that ought to be
13 taken to heart is that policy development tends to be
14 cumulative rather than sharply discontinuous. The real
15 model is a relay rather than an individual race. And you
16 know how relays work. Where do they fall apart? Bad
17 exchanges in the zone where the baton is passed from one
18 runner to another.

19 It's a collaborative process in which it's the
20 success of the whole team over time that determines the
21 effectiveness of the team compared to others. It's a
22 process of prototyping and experimentation where
23 individual techniques are evaluated, tried. Experiments
24 that involve perhaps enforcing too much sometimes or
25 enforcing too little, but with humility to recognize that

1 what we're engaged in in many instances is a continuous
2 process of testing what works.

3 And far more often than not, the cumulative
4 process of policy-making involves an evolutionary process
5 of change featuring some fairly sharp departures from
6 past practice. But the general trend of good policy
7 development is evolution rather than simply revolution.

8 And the aim ought to be to make sure the
9 capabilities are well matched to commitments. And the
10 story that I've told to some in this audience that I'll
11 repeat again was told to me by one of my colleagues at
12 G.W. years ago.

13 He used to say, "Suppose that I told you
14 tonight I've got tickets to see Beethoven's Ninth
15 Symphony. Do you want to go? And the answer you might
16 give me is, 'Who's playing?' And if I told you it's an
17 enormously enthusiastic middle school ensemble -- they're
18 thin on experience; truthfully, they're awful, but they
19 try very hard; they play with enormous vigor -- you'll
20 find any other number of possible uses for your time.
21 But if I tell you it's the Vienna Philharmonic there at
22 the Kennedy Center, you say, 'When do we meet?'"

23 And the point of the story is that judgments
24 about what an agency ought to do can't possibly be taken
25 out assessments of the quality of the people who will

1 perform the compositions to be judged. And this
2 underscores the need to build capability and knowledge
3 over time.

4 Avoid being trapped in the wrong model, which
5 my agency was in the 1970s after it made beg-your-agency
6 commitments on the Kellogg case and the Exxon case. You
7 might decide that you do one of them, but to continue to
8 double your bets in the face of a basic change in the
9 literature that suggested your model was wrong was the
10 real vice of the policy-making at the time, not the
11 pursuit of the cases in and of themselves.

12 It wasn't having the over-the-horizon radar
13 that told you to be cautious in the face of a fundamental
14 change in the analytical model; to respond to new
15 industry learning and developments, and to assess the
16 wisdom of the regulatory status quo, which means that
17 part of the capital budget every year ought to include
18 some increment for the assessment of what you've done in
19 the past. And to some extent, a means to doing that is
20 precisely this type of conference.

21 What are some of the techniques for doing this?
22 The first is to have a research agenda by which you're
23 tearing out within your own walls, a process of examining
24 industry developments and matters of theory, to perform
25 studies by which your economists in particular build the

1 equivalent of what Pauline Ippolito of this agency has so
2 wisely called economic precedents.

3 What are economic precedents? They're not the
4 equivalent of the doctrine that appears in the Federal
5 Reporter, doctrine that binds the decisions, or at least
6 influences the decisions, of other tribunals. These are
7 precedents that inform our judgment about how to treat
8 identical or different circumstances in the future.

9 One cannot point to a better example of this, I
10 think, than the work that this agency did and inspired in
11 the 1970s dealing with the health care field: the
12 examination of the effect of restrictions at the state
13 level on the sale of eyeglasses and optometric services.

14 What happened as a result of that work? It
15 became possible to say, you can formulate whatever
16 judgments you wish about the efficiency and significance
17 of these restrictions, but here's good empirical work
18 that tells you what happens, and this kind of work
19 replicated in other areas.

20 Much of it has been generated by this agency,
21 by the bureau that hosts this event. These become
22 economic precedents, if their work is done well, that
23 informs our judgment about similar circumstances, an
24 enormously valuable capital that's based on good
25 research.

1 Public consultations are a key element of this.
2 I think the genius of Bob Pitofsky's chairmanship in many
3 ways does not so much reside simply in the successful
4 pursuit of cases, but is recognition of the unique
5 comparative advantage of this institution, one that could
6 only come from someone who had spent their studying the
7 FTC day in and day out.

8 And Bob's intuition was the capacity to do
9 research, the ability to gather evidence, both through
10 voluntary or compulsory means, to do empirical studies,
11 to act as an advocate for competition, was a unique
12 resource of this agency. And it was foolhardy to allow
13 that assembly line to atrophy.

14 And Bob breathed enormous life back into it
15 through a large set of public consultations. And much of
16 the most successful work the agency has done has not come
17 from forcing individuals to provide data, although we do
18 that now and then, with great success, too; but it's come
19 by inviting them to come and tell us what they know.

20 And the little secret that we've discovered is
21 that if you hold an event like that and you have a
22 limited number of days, you could auction off the right
23 to talk. They would pay you. You have to chase them
24 away. There's nothing so alluring to human beings to
25 have an event and say, we have a limited number of seats

1 at the table. They won't ask you at the discussions
2 about it; they'll just say, I've got to have one. I must
3 attend.

4 And the FTC has found in a repeated set of
5 proceedings that having a good eye for a topic, inviting
6 the right people, can be an enormously valuable approach
7 to generating discussion, debate, and collecting
8 information that people have about individual topics.
9 Today's event, I think, is a perfect illustration of that
10 at work.

11 Ex post assessments: One of my favorite
12 topics, going back to my time as general counsel. Some
13 allocation in the budget every year to look back,
14 notwithstanding enormous methodological difficulties, but
15 at least to try to creep up on the answer to the
16 question: How did it all turn out?

17 What were the landings, not just the
18 departures? Where did the plane come down? In what
19 shape? Did it land in the destination that you expected
20 it to achieve when you sent the plane into the air, or
21 were there surprises along the way that placed it
22 someplace else?

23 And to build good internal think tanks, this
24 means a conscious effort by a competition policy agency
25 to establish the equivalent of university-quality

1 research teams inside its own borders. And the real test
2 over time of whether you're doing this well is whether
3 the universities and think tanks in fact are coming to
4 poach your people away.

5 And a good test for me is the group that Susan
6 Dasantie ran during my time as the general counsel of the
7 FTC. When I take the six people in that office, three of
8 them are teaching now and another two had officers to do
9 so.

10 I didn't see that office as being a recruiting
11 ground for academics, but that's the kind of intellectual
12 fire power you want to draw to this process and have in
13 the agency because to do the studies and not have the
14 very best, to not have the measure of success being have
15 we taught the world something it did not know before we
16 did this, is the real test of what you're doing. To
17 launch these initiatives without hitting that target of
18 performance is not a successful endeavor.

19 To have links to other public agencies so that
20 the work we do, work that related agencies do, is tied in
21 to our own work, to have a collaborative process of work
22 with others, and I think to have more robust links to
23 academics and think tanks on the outside.

24 Some of the best experiments I see taking place
25 are occurring in other jurisdictions, where the

1 competition agency is developed a deliberate and periodic
2 process of consultation: with academics with an interest
3 in law, economics, and public administration; where a
4 conscious part of what they do is to engage them in the
5 agency's work; to create a two-way flow of information by
6 which the academics tell the agency on a regular basis
7 what they're learning; and the agencies have an
8 opportunity to encourage academics to do applications of
9 their work that is useful to what the agency does, not by
10 happenstance but by a conscious design of continuous
11 interaction.

12 Some examples that I think are well-known to
13 this office of the enormous payoff of doing this kind of
14 work that goes well beyond informing judgments about the
15 prosecution of cases, cases that I do regard as being the
16 anchor tenants in the mall of competition policy. But
17 they're not the only retail outlets, and you don't have a
18 good mall without an ensemble of others.

19 What might those others be? Good reports and
20 studies. I've had the opportunity since 2003, when the
21 FTC's patent study was published, to go to many
22 jurisdictions outside this country, most recently a week
23 ago. It was a conference in Brussels on patent policy
24 and the reform of patent systems.

25 And as I began to talk about the FTC's report

1 in 2003, the report "Innovation," I saw throughout the
2 office people pulling out their dog-eared, yellow-
3 colored, tabbed copies of that document. And the head of
4 one association said, "We printed out a thousand copies
5 of that document and circulated it to all of our
6 members." And representatives of the European Patent
7 Administration said, "We've all read that document." And
8 with our own country, you have a process of
9 reconsideration of the appropriate operation of the
10 patent system taking place.

11 Not a case, but there is the possibility here
12 that that report, which was the result of this kind of
13 dedicated investment and effort that goes back to Bob
14 Pitofsky's chairmanship, that really goes back to earlier
15 efforts at the FTC reaching back to the 1960s, with its
16 first cases involving the pharmaceutical sector and
17 licensing and patent office issues, could quite possibly
18 have the biggest effect of anything this agency has done
19 in its modern era.

20 In the era of health care, I mentioned the
21 economic precedents generated in the 1970s on eyewear,
22 the remarkable work that Pauline Ippolito and her
23 colleagues have done on nutrition and advertising, the
24 extraordinary influence of the FTC'S study in 2004 on
25 health care, which has had the same ripple across

1 jurisdictions -- not by force, not by compulsion, but
2 because of the compelling intellectual vision presented
3 in the document.

4 And yes indeed, even though it doesn't seem to
5 have a really active audience these days, as Michael and
6 I have discovered just this week, I'm convinced that when
7 the story of this agency is told decades from now, people
8 will look back and say, the work that was done on
9 petroleum was simply its finest hour; an incredible
10 documentation of how the market responded to Katrina; an
11 OECD meeting of five months ago where I saw -- no honor
12 in one's own country -- but external observers saying,
13 this is the best thing we've seen on how markets operate.

14 Perfect in all its respects it couldn't
15 possibly be. But this is a remarkable documentation of
16 how markets respond in a very concrete way in the face of
17 economic crisis. And many academics at that meeting say,
18 "I teach this document now. I have my students in basic
19 economic courses study it."

20 The role of the agency as a convener of the
21 extraordinary program that the Commission hosted, again
22 through Michael's leadership and that of his colleagues,
23 on behavioral economics. The IO roundtable that David
24 Scheffman put together. Tragic day, September 11, 2001.
25 Perhaps it was simply because people could not leave our

1 building. There was nowhere to go. But we proceeded
2 with a program that generated a remarkable transcript,
3 where some of the best industrial organization economists
4 in the country reflected on their work and what needed to
5 be learned.

6 What should the report card look like? Well,
7 of course you have to articulate your goals and strategy
8 carefully. You do have to take account of the types of
9 cases and measure outcomes. What are you doing on the
10 advocacy front? But to me, terribly important and part
11 of today's proceedings, investments in capability, in
12 knowledge.

13 Investments in the infrastructure that have a
14 long capital life and outlive the tenure of individual
15 management. The revelation of results, and a continuing
16 questioning process that takes place every year. How
17 well are we doing is a matter of process and outcome.

18 So what's the essence of good leadership? What
19 does it mean to have a good agency? As Bob and Tim would
20 have put it, you maximize positive externalities for the
21 agency and new leaders in the future. You develop a norm
22 of critical self-assessment. You promote public debate
23 about issues of keen concern. You have regular public
24 consultations in which you engage those outside your
25 borders, outside your own building, in what an agency

1 ought to do.

2 I never liked the phrase "best practices."

3 Best practices, to me, always suggested that's the final
4 destination. You're there. It's the best. It changes
5 all the time. It's really the pursuit of better
6 practices. And yes, if the U.S. agencies want to have
7 influence overseas, the way they will do it is by the
8 better intellectual vision. It's by putting out the 1982
9 merger guidelines, which no jurisdiction was compelled to
10 follow.

11 But you can go everywhere you want in the world
12 today, whether it's Ulan Bator, Singapore, Cape Town, and
13 you will hear people talk about the SSNIP test, something
14 you would never have heard 25 years ago. Simply the
15 consequence.

16 How did it work? It was a compelling
17 intellectual vision. Nobody was forced to do it. It's
18 looking at the patent report and saying, that's the best
19 thing I've ever seen. And in a world of multiple
20 decision-makers, shared authority, parallel authority,
21 the way to develop over time is to have the investment in
22 intellectual leadership.

23 And to finish with a caution: Many of our
24 counterparts overseas understand this now. They're
25 increasing their investments in this area. And to stay

1 abreast of them, one has to double and expand one's own
2 area, one's own efforts. That's a competition worth
3 having.

4 Thank you.

5 (Applause.)

6 MR. SALINGER: Well, thank you very much. In
7 my opening comments today, I said that Bill was one of
8 the biggest advocates for doing this sort of activity
9 that we're doing today. So I think from that speech we
10 all see the passion that we've brought to it. And I
11 thank you again for the tremendous support you've given
12 to this kind of activity.

13 COMMISSIONER KOVACIC: A pleasure. Thank you.

14 MR. SALINGER: And with that, we're going to
15 move on to the first afternoon panel. And Chris Adams is
16 going to take over as the moderator.

17 MR. HOSKEN: I think we're ready to start
18 again. We have two, I think, pretty interesting papers
19 here to talk about today, so I'm not going to spend any
20 time talking so we could have more time listening to the
21 papers.

22 First David Bell is going to talk about some
23 internet grocery research he's been doing, and then
24 Catherine Tucker will discuss his work. Then John Seaton
25 will talk about pricing in the U.K. and some pretty

1 interesting changes that have taken place recently, and
2 Raphael Thomadsen will talk about that.

3 So please go ahead.

4 MR. BELL: All right. Let me just start by way
5 of introduction. My name is David Bell. I'm an academic
6 at the Wharton School. Can you guys all hear me okay?
7 Oh, by the mike? So I've got to go back there. All
8 right.

9 So I'm here to talk about some work that I've
10 been doing recently in the area of the internet. And
11 this is actually a little bit of a departure for me
12 because my early academic career involved analyzing
13 scanner panel data from Nielsen Information Resources,
14 looking at a lot of consumer switching behavior and what
15 goes on in the supermarket industry, issues of everyday
16 low pricing, high/low pricing, and so forth.

17 So what I'm doing today is a departure. But
18 it's kind of a new direction for me that I hope to
19 continue in. And one of my colleagues at the Wharton
20 School always prefaces any discussion of the internet
21 with a very funny quote, so I'm going to take that from
22 him.

23 The proportion of groceries that are bought on
24 the internet -- we're spending a lot of time this morning
25 discovering a lot of interesting facts about the

1 institutional reality of grocery retailing. The
2 proportion of groceries bought on the internet in 2007 is
3 roughly what it was in 1707, with rounding. So it's
4 pretty close to zero.

5 But I'm hoping -- and again, I looked at some
6 FTC data before I came along here, and it turns out --
7 the internet is a big phenomenon. Internet retailing is
8 one of the biggest growth areas. The paper I'm going to
9 focus on is going to be specifically about a grocery
10 retailer. And there's really interesting stuff that came
11 up from David earlier this morning. Also, Chris
12 mentioned some things about the industry in terms of the
13 frequency of shopping, and also how do we define these
14 market areas.

15 Well, I'm going to deal with an internet
16 retailer, a grocery retailer, for whom the spatial area
17 is really the entire contiguous United States, and how
18 does that essentially change what goes on in terms of
19 competition.

20 I don't have any slides on this today, but
21 another business that I'm analyzing now is a business
22 called 1800Diapers.com. So a bunch of MBA students at
23 the Wharton School are quite enterprising not only in
24 studying but also, it seems, in producing babies during
25 their tenure in the executive program out in San

1 Francisco.

2 So one of my students, he and his wife had a
3 baby, and he decided, and as a process of going to the
4 grocery store in the Bay area, that the diaper market was
5 really underserved. And so he started 1800Diapers.com,
6 and he now has about 130,000 customers all throughout the
7 United States. And he has a very interesting system of
8 referral.

9 So if I buy diapers and I give my code to David
10 and David buys diapers, then I get a \$1 credit to my
11 account. And I've actually mapped out his entire
12 referral network, and it turns out that 10,000 customers
13 that engage in such referral bring in 40,000 additional
14 customers. And the top 100 super-customers are connected
15 to about 10,000 other people spatially distributed around
16 the United States.

17 So what I'm going to talk about today is
18 density, but it's more about the issue of customer
19 density as opposed to retail density because there is
20 just one retailer, but the customers are potentially
21 feeding into that retailer from all around the U.S.

22 So let me start by just sort of outlining the
23 talk. And again, this is really back to the future.
24 Most of my academic talks I like to use -- get away from
25 PowerPoint because in MBA school, I think as was

1 discussed earlier, MBA school makes you use PowerPoint.
2 So normally I'll use acetates. That's why they don't fit
3 exactly on the screen here.

4 But I'm going to start out just with a little
5 bit of motivation. I'll spend maybe five or ten minutes
6 on the model. And then I want to show you guys the data.
7 I think that's the most interesting part of the talk.

8 What I'm really trying to isolate here: Is it
9 the case that when customers try grocery retailing
10 alternatives on the internet, is it the case that there's
11 some kind of mechanism whereby they're emulating other
12 people in spatially proximate areas? So either by direct
13 word of mouth; I enter into my apartment building in New
14 York City and I see NetGrocer.com on a box that sends me
15 to a website.

16 So what I'm going to try and isolate: Is there
17 any effect of social contagion or word of mouth or
18 customer density in explaining the space/time evolution
19 of the store?

20 So with that in mind, let me just show you
21 first of all a little bit of background here. So this is
22 a quote that I got from our friends north of the border.
23 I notice, actually, the whole conference seems to be
24 taken over by people from the Antipodes. We've got
25 Australians running around. I'm from New Zealand, so I

1 thought I'd better get someone else in from the
2 Commonwealth. Here's the Canadian quote.

3 The Canadian quote is all about in traditional
4 retailing, the essence of retailing is really location.
5 Now, we saw some interesting data this morning that said
6 price is important. Assortment is important. But of
7 course, location and where you put that store determines
8 in some sense the trading areas. Right?

9 And we had David and others show with the
10 concentric circles how one might define trading areas in
11 terms of driving district and so forth. But what I'm
12 going to argue, at least on the internet, is the notion
13 of location really goes out the window. And what may be
14 important is not the location of your store but the
15 location of your customers to existing or potential other
16 customers.

17 So two things that are different about internet
18 grocery retailing. One is the geographical boundary is
19 really defined by your shipping area. It's no longer
20 defined by your trading area or people driving, but it's
21 defined by where it is that you can ship.

22 And it turns out in the 1800Diapers.com data,
23 they have two warehouses, one in California -- one in
24 Reno, sorry, and one in Connecticut. And depending on
25 where you live in the country, there's a differential in

1 terms of how many expected days it takes for the product
2 to ship. So we're actually in the process now of trying
3 to decide where they should place the third warehouse in
4 order to generate the most sales of diapers.

5 So Chicago is a very, very large area, but it's
6 really under-represented in the data because the shipping
7 time from either Reno or Connecticut is too long. So
8 we're thinking about locating another warehouse in New
9 Jersey -- sorry, in Illinois.

10 It turned out at the time of these data for
11 NetGrocer that everything was shipped from New Jersey via
12 Federal Express for a fee of about \$6.99 throughout the
13 United States. And what's interesting also is not only
14 is your customer base unconstrained, but now you
15 potentially take on hundreds if not thousands of
16 additional competitors. So it's not just Safeway
17 competing against the local Lucky. If I'm NetGrocer, I'm
18 competing against different kinds of alternatives in
19 different spatially dispersed markets.

20 Just very briefly, I want to show you some data
21 here right at the end, if I can pull it up. I just want
22 to show you this map here. So what I've done here is
23 I've basically just plotted the cumulative distribution
24 of sales for NetGrocer.com from the period when they
25 opened -- they actually opened ten years ago, in May

1 1997, and they've been in continuous operation ever
2 since. These data go through January 2001.

3 And so what we have here is the darker areas
4 indicate higher cumulative total sales for NetGrocer.
5 The lighter areas indicate less sales. And so two things
6 are pretty obvious here. One is clearly there's a big
7 spatial variation in terms of where it is that they get
8 their sales.

9 And then secondly, you can see that it's
10 probably related, at least in some sense, to observable
11 characteristics of the region. And regions with higher
12 population and regions where people are more savvy about
13 the internet and regions where you have dense urban
14 centers, they tend to have more sales of NetGrocer
15 products.

16 If you then look at the average basket size --
17 so we learned this morning, I think, from Debbie, either
18 Debbie or Chris, that the average basket size is about
19 \$29 in the United States, which is completely consistent
20 with the data I've looked at from Information Resources.
21 It turns out, on the internet, the average basket size is
22 about double that.

23 And there's all sorts of interesting perhaps
24 psychological and behavioral models about how people are
25 amortizing the cost of shipping and how that is different

1 in some sense to travel distance. So what you see here,
2 when you look at the average basket size, this is much
3 larger in the interior regions, presumably where people
4 have less access to retail services.

5 So what I'm going to try and do is explain the
6 spatial variation in the sales of NetGrocer from the day
7 they opened the doors in May 1997 through 2001.

8 So now I'll just show a little bit of the
9 research questions. I think I'm going to, in the
10 interest of time, skip over some of the literature
11 review. But basically, what I'm going to do here, for
12 those of you interested in the model, is I'm going to use
13 a hazard model. I'm going to try and predict the timing
14 of adoption at the level of the zip code.

15 So it turns out there are about 29,000
16 residential zip codes in the United States. And what I
17 want to do is I want to see what's the probability that a
18 zip code that has not yet seen orders at time period T
19 minus 1, what's the probability at time period T they
20 took over and have an order.

21 So let's say Jim lives in California, 90210.
22 At time period June 2000, 90210 has seen no orders at
23 NetGrocer. However, the contiguous neighbors around
24 Jim's area have seen orders. And so what I want to do is
25 I want to model the probability that an order takes

1 place, given that one hasn't taken place yet, as a
2 function of characteristics of the region and also what's
3 going on in the surrounding areas.

4 I'm going to define three units of analysis
5 here. This turns out to be a data issue. And again,
6 it's sort of interesting that I'm here at the FTC. Some
7 of the best data that I got, at least on the internet,
8 was obtained from the FTC.

9 So one thing I'll obviously have to control
10 for, but if you're looking at internet grocery sales, you
11 need to know in each region how many people actually have
12 access to the internet because what you don't want to
13 model is just the diffusion of high speed access itself.

14 So the observational units we have here are
15 essentially individuals like Jim ordering groceries on
16 the internet. Jim lives in 90210, and he engages in
17 certain behaviors at time period T, May '97, June '97
18 through January 2001.

19 Now, what I'm going to do here is define
20 something called the risk set. This is just more of a
21 technical issue. What I'd like to be able to do is model
22 the probability that all of us as individuals use
23 NetGrocer.

24 Now, computationally, that's not really going
25 to be possible because I don't have individual-level

1 information. I don't know how old Jim is, how much
2 income he makes, et cetera, et cetera. But what I do
3 know -- and this ties in to what David showed with GIS --
4 what I do know is at the zip code level, a lot of stuff
5 about how many people in that zip code have access to
6 automobiles, what the average income is, what the ethnic
7 composition is. I know how many supermarkets are there,
8 drugstores. At the level of zip code, the code area
9 information is actually very, very good.

10 So what I'm going to do is I'm going to model
11 the probability that an order takes place at the level of
12 the zip code, assuming that when a zip code has an order,
13 it was because somebody in that order felt inclined to do
14 so. So that's the basic structure of the model.

15 There's some academic research that kind of
16 ties into this. One of the big areas that people are
17 talking a lot about now is social contagion, social
18 networks, the way people emulate other people, and how
19 this is kind of playing out on the internet and other
20 environments.

21 There's also traditional economic work. So Ann
22 Case, for example, showed that investing in public
23 schools, schooling infrastructure, was highly correlated
24 with what was going on in contiguous neighbors. So if my
25 continuous neighboring districts put another dollar into

1 the local schools, I put in another 70 cents.

2 Austin Goolsbee had a very interesting paper,
3 where he looked at the diffusion of the PC. And he found
4 that the probability that people adopted PCs was highly
5 correlated with the proportion of people in their social
6 area also using PCs. So the idea that spatial processes
7 operate is a pretty old idea in economics, and that's
8 really where the theory for this is going to come from.

9 One of my favorite studies here -- let me just
10 mention this briefly -- for those of you who want
11 something to talk about at a cocktail party, you can talk
12 about the Oyen and DeFleur 1953 article. This was a
13 study that was done in Washington state in the '50s,
14 where what they did was they flew planes over Washington
15 state and they dropped leaflets, paper leaflets onto
16 people's home.

17 And so Jim picks up this leaflet, and there's
18 some description: We're going to be invaded by some
19 other country. Some terrible calamity is going to take
20 place. And they wanted to see how quickly that
21 information diffused.

22 And what they found was the further somebody
23 was from the drop area of the leaflet, the higher the
24 probability that they learned about the message through
25 social contact. So if I live right under the drop, I

1 pick up the message and I read it. But Michael, if you
2 live a long way away, you're less likely to find the
3 information but you still get the information because it
4 propagates through these social networks. So that's kind
5 of the background and motivation.

6 In terms of the research questions, what I'm
7 going to try and look at here: Is there any structure to
8 the way sales for this internet grocery retailer take
9 place? And in particular, can I find something called a
10 neighborhood effect, which means the probability that I
11 do something is increasing, and the probability that it's
12 happening around me and other people are also doing it.
13 That's what I'm going to try and identify here.

14 And the way it's going to be done in terms of
15 the model is I'm just going to link the theory of
16 utility. So the reason I do something is because I get
17 utility out of doing it. When my utility crosses a
18 certain threshold, I'm going to link that to the hazard
19 rate. So this is something that's been known for many
20 years in the economics literature. I think it was Madala
21 that showed this in the '80s.

22 Basically, random utility theory, the theory
23 that underlies the logit model, is the same theory of a
24 discrete time hazard model. So the only difference is in
25 the discrete time hazard model, your utility is for, do I

1 try NetGrocer now or not? If I do, then you observe
2 trial. That means my utility threshold has been crossed.
3 So it's essentially the same model.

4 So I'm going to look at somebody like Jim over
5 time, and I'm going to track him through a series of
6 binary decisions: No, he doesn't use NetGrocer. No, he
7 didn't use it again. Oops, then he used it. And then
8 I'm going to truncate the data from that point onwards.

9 So there's a lot of other things that could be
10 done with this data in terms of: Does he repeat? Does
11 he buy a certain order quantity? I'm going to ignore all
12 of that and just focus on the initial trial. That's the
13 key idea here.

14 So maybe in terms of the -- since we've had
15 lunch, after lunch we probably don't like to see formulas
16 of the logit model and things like that. But let me just
17 get to one issue here that's maybe somewhat interesting
18 or important.

19 What I'm assuming is Jim, individual Jim living
20 in 90210 in January 2000, has a certain utility that
21 depends -- so based on his own preferences for shopping,
22 he gets a certain utility out of using the NetGrocer
23 option or not. And I can explain this as a function of
24 his characteristics -- his income, his occupation, his
25 opportunity, cost of time, how many regular supermarkets

1 he can have access to. And then there's a random
2 component that I can't explain.

3 Now, for the reasons I said earlier, I'd like
4 to model this at the individual level. But I can't
5 because I don't have data on the 300 million people that
6 live in the United States. But I have very, very good
7 data on the 29,701 residential zip codes.

8 So this is what I'm going to assume. I'll just
9 say it in words. I'm going to assume that the
10 probability that the zip code -- notice now the
11 probability expression has Z. There's no I there any
12 more. So the probability that 90210 sees an order is the
13 probability that the maximum utility person -- let's
14 imagine we all live in 90210, this group here, and we all
15 have our own utilities. But if one of us, the maximum
16 utility person, crossed the threshold, then an order is
17 observed. That's the assumption that I'm making.

18 And if you do that, you end up with this nice
19 little expression, which I'm going to focus on right
20 here. This is the probability that 90210 has an order at
21 a certain time period, as given by this nice closed form
22 expression that's called the complimentary log/log.

23 And notice what goes on in here is there's an
24 adjustment that's based on the number of people that live
25 in Jim's zip code. So just imagine Jim lives in 90210.

1 He has 10,000 neighbors. Okay? Let's imagine Chris
2 lives in 19123, in Philadelphia. He only has a thousand
3 neighbors. Obviously, the probability that NetGrocer
4 sees an order is going to be greater in areas where there
5 are more people. All right?

6 And so what this expression does explicitly is
7 it controls for the fact that different regions have
8 different numbers of people. And it puts them all on the
9 same scale. This is why you have the log of the number
10 of people that live there.

11 So this is basically the setup. What I want to
12 do is show you the results. But before I do, let me show
13 you by way of a graph, and then I'm going to give the
14 last five minutes to Catherine to discuss.

15 So let me show the graph here. I'm going to
16 start with this one here. And what I've done at the
17 level of the zip code -- I'm just going to wander away
18 from the mike for a moment -- what I've done here is I've
19 plotted zip codes that have had orders six months after
20 NetGrocer has been going.

21 Now, for the sake of this map, I haven't
22 controlled for the size of the zip codes. Those of you
23 who do this kind of analysis, as you move from east to
24 west, zip codes get larger and so forth. But if you just
25 look at the time snap, what you can see -- here's one

1 year after operation. Here's a year and a half. Here's
2 two years. Two and a half. Three years.

3 So it's almost like a disease, spreading
4 throughout the United States. And what's interesting to
5 me as an academic, at least, or from a person who's
6 interested in retailing and consumer behavior, is I don't
7 know of any other store, any other physical supermarket
8 in the United States, that draws customers from 18,000
9 zip codes.

10 But here's a store that does draw customers
11 from 18,000 zip codes. And yes, at the moment they only
12 have about a half a million people involved. But let's
13 imagine the future is going towards internet retailing.
14 What is it that we can learn about this phenomenon?

15 So that's how it spreads through the United
16 States in aggregate. There are 29,000 zip codes. They
17 have about a 60 percent trial rate four and a half years
18 in.

19 Now, in terms of the specific phenomenon that
20 I'm trying to model, the question is: Is this growth
21 just random through space and time? So when the new
22 customers appear on the map, do they just appear
23 somewhere randomly, or is there structure to the way they
24 appear on the map?

25 And so the next chart that I'm going to show

1 you indicates, without a model -- I'm going to show you
2 the model-based results -- that there is some structure.
3 So what I've done here is I've taken a snapshot of the
4 East Coast and the West Coast of the United States. The
5 dark areas are areas that had orders in 1997 in May. The
6 website had only been open for three weeks. Notice most
7 of their customers are coming either from New Jersey/tri-
8 state area, and then some early adopters out there in
9 California.

10 Now, if you do the time snap here, what you can
11 see or potentially see is the probability of trial in a
12 zip code that hasn't yet tried is a function of what's
13 going on in the contiguous neighborhood. So new trials
14 are more likely to appear in areas contiguous with areas
15 that already have trial. It's basically the pattern that
16 you can see here in the closer snapshot of the zip codes.
17 And if you continue on, you can see how it's kind of
18 filling out.

19 It actually turned out -- I checked this before
20 I came down -- I forget the number, but the zip code that
21 is the most receptive to the NetGrocer offering is a zip
22 code in Washington, D.C. I don't know why that is the
23 case. But for whatever reason, Washington, D.C. seems to
24 like NetGrocer.com. So the thing just sort of keeps
25 going, keeps filling out and filling out, et cetera.

1 So how did I analyze this more formally? If I
2 go back to the notes over here, what I did then with this
3 particular model is took the model to the data. This is
4 just some technical stuff that's in the paper about why
5 this is an appropriate statistical model, why it has
6 economic rationality behind it, and so forth.

7 So I took this model to the data. These were
8 the data that I had. I had about almost 400,000
9 individual-level transactions. I broke the data into 45
10 discrete time periods, so from May 1997 through January
11 2001.

12 I then went to the census and I collected a
13 bunch of information at the zip code level about
14 intrinsic characteristics. So how many people in the zip
15 code are working? How many single mothers are there?
16 How many people own a car? What's the population
17 density? How big are the housing units? Et cetera, et
18 cetera.

19 Then there's a company now, ESRI, who I've just
20 obtained some more data from, located here in Virginia.
21 What they do is they collect, for every zip code in the
22 United States, how many supermarkets there are, how many
23 convenience stores, how many drugstores. So what I was
24 able to do was proxy for how convenient supermarkets and
25 drugstores were for any individual, like Jim living in

1 90210. What's his expected travel distance? What's the
2 density of retail per population, and so forth.

3 And then a few -- go on and look at a little
4 bit of descriptives. You find that on average, the
5 NetGrocer orders are about twice the size, approximately,
6 of what you see in a traditional supermarket. This maybe
7 has something to do with the way people amortize the
8 shipping cost. So in some other research I've done,
9 people are very, very sensitive to the shipping cost.

10 You think about a traditional supermarket, you
11 incur two kinds of costs as a customer to go there: You
12 incur the fixed cost of the time and the travel, and then
13 you incur the variable cost of what you buy. So one
14 thing we know about supercenters and Wal-Marts and so
15 forth, what people are willing to do: They're willing to
16 travel further to go to those stores because they can
17 amortize the fixed cost of inconvenience over a larger
18 basket of savings. It's the whole idea of big basket
19 shopping and fixed and variables costs.

20 Here, on the internet, what's interesting is
21 you as the firm can control the fixed cost by the
22 shipping fee that you give people. And so what I've
23 found, for example, looking at Amazon data, when Amazon
24 lowered their threshold for free shipping from \$50 to
25 \$25, what people do is they ordered more frequently from

1 the website and the average order size was quite a lot
2 smaller.

3 So by changing the shipping threshold and
4 imposing different levels of fixed cost on the customer,
5 you can really influence the basket size.

6 MR. SALINGER: David, you have about five
7 minutes.

8 MR. BELL: Five minutes? Yes. I will be done
9 in five minutes.

10 So the space/time and the local space/time,
11 those were the pictures that I just showed you. So now
12 let me get to the main empirical results here. Since I
13 only have five minutes, I'll just summarize the main kind
14 of results.

15 So what happens is after controlling for all
16 kinds of things at the local level, so access to the
17 internet, age of the population, education, income
18 levels, ethnicity, et cetera, et cetera -- what you find
19 is after controlling for all of that, also including
20 fixed effects and random effects in the model, that the
21 coefficient that picks out the probability that I do
22 something in my neighborhood as a function of how many
23 people around me have already done it is positive and
24 significant.

25 And what I've shown here is at the zip code

1 level, what it implies is if all of my contiguous
2 neighbors -- so each zip code in the United States has
3 5.6, on average, contiguous zip code neighbors -- if
4 they're of average size and a reasonably large fraction
5 of them start to use NetGrocer, then the probability that
6 that zip code has an order goes up from about 2 percent
7 to about 14 percent.

8 So this seems to be a pretty economically
9 important effect. But what's interesting here is it only
10 operates on trial. So after I've tried NetGrocer, I have
11 my own utility cost/benefit comparison. I don't care
12 what what Eric thought about it. But before I try it, I
13 take a cue from his behavior, potentially. That's what
14 that's saying here.

15 The other empirical findings were very much in
16 line with what you would expect. So you see evidence of
17 the digital divide, so conditioned along demographics.
18 You find people who live in higher areas with minorities
19 are slower to adopt this service. You find the kinds of
20 effects relating to traditional competition that you
21 would expect.

22 If I live a long way from a warehouse club, I'm
23 much more likely to buy my nonperishable groceries from
24 NetGrocer.com. If I live a long way from a supermarket,
25 however, I'm less likely to use this service. And the

1 reason is this service only offers perishables.

2 So if I eat nonperishables, I've got to go to
3 the supermarket anyway. Given that I've got to go
4 anyway, I might as well buy my nonperishables as well.
5 Therefore, there's a negative effect of supermarkets but
6 a positive effect of warehouse clubs here.

7 And the last minute, in terms of where I would
8 take this research: One thing I'm looking on now is how
9 people sort of agglomerate on the internet based on
10 socio-demographic characteristics. So people who live in
11 very different parts of the country start doing the same
12 thing at the same time because they're somehow
13 demographically similar even though they're spatially
14 distant.

15 And then the final thing I'm working on now is
16 this idea of preference minorities, which says if I'm
17 somebody with a lot of kids who lives in a zip code where
18 everybody is old, I'm much more likely to buy my diapers
19 on the internet because I'm locally isolated.

20 So what's, I think, really interesting about
21 the internet is the interaction between something that's
22 roughly uniform across space, across the whole country.
23 We can all go to Amazon. But our local options vary
24 substantially. And it's the interaction between the
25 local option and the ubiquitous option that's basically

1 driving the sales process here.

2 So I think I took an extra 15 seconds, but
3 we're good to go. So that's what I've been doing. And I
4 think even though it's a small number at the moment in
5 terms of the proportion of the whole grocery industry,
6 there's a lot of interesting things that are happening
7 here. And I think this is going to be the future.

8 You certainly see in the U.K., Tesco and
9 Sainsbury's and so forth, their internet businesses are
10 very, very successful and something I think we want to
11 pay more attention to.

12 Thanks, guys.

13 (Applause.)

14 MS. TUCKER: Great, well, I'm Catherine Tucker.
15 I'm also a marketing professor at MIT Sloan. And I'm
16 very glad to get to discuss this paper.

17 So what's the basic question? The basic
18 question is, well, if someone tries an online grocer,
19 does that make their neighbors more likely to try it?
20 And we got really quite a substantial result, which David
21 discussed, which is that if we add 20,000 people to the
22 neighboring zip code, then this increases the probability
23 of trial in that zip code from 2.7 percent to 14 percent.
24 So it's quite a positive neighborhood effect.

25 Now, what I liked about this is that it's a

1 really interesting question, which is: Does neighborhood
2 effects still have a role with our brave new internet
3 world? And I also think it's got quite a bit of
4 applicability to antitrust considerations because what it
5 suggests is that if there are these big neighborhood
6 effects, that you have to have some kind of critical mass
7 of customers before you can obtain trial, then that's a
8 form of value to entry which is going to affect entry
9 dynamics in the evolution of the grocery industry.

10 The authors should be commended for their
11 unique data. We've been hearing today that while there's
12 data, widespread data, on entry decisions by grocery
13 stores, it's far more difficult to get transaction-level
14 data. And that's what these authors have. And though
15 David skipped through it in the presentation, there's a
16 lot of technical sophistication in terms of what they're
17 doing, and thinking carefully about how to use a hazard
18 model at a zip code level.

19 Now, the last thing I should notice -- and this
20 is a paper which is actually in print; it's got the
21 ultimate accolades from our profession -- and so as a
22 discussant, I'm not going to quibble with the paper as it
23 stands. It's got all the kudos it can. Instead, I'm
24 going to suggest three new papers that I think that David
25 should be thinking about writing in the future.

1 So the first new paper is really thinking hard
2 about what this neighborhood effect means because if you
3 think -- David mentioned various things it could be. And
4 I think it would be actually very important to try and
5 understand exactly what this neighborhood effect is.

6 Is it, for example, that I see someone
7 purchasing from NetGrocer and I'm suddenly -- I didn't
8 realize NetGrocer existed before, and now I'm informed,
9 and as a result I go out to buy from them? Or is it some
10 kind of quality inference? I see someone buy food from
11 that grocer, and then they don't die, and then that's
12 quite good, and so I end up deciding there aren't health
13 risks involved with it and purchase it, too?

14 And the reason this might be important from an
15 antitrust perspective is that if it's just about
16 awareness, then there are some ways we can compensate for
17 that through extensive advertising. However, if it's
18 really a quality inference story, then that's going to be
19 in some ways a far more difficult barrier to overcome the
20 dynamics of the industry evolution.

21 I was thinking about, well, how might you
22 actually do this? And I was thinking, well, there are
23 various models which have been proposed by your colleague
24 weren't much help tease apart these effects.

25 Another alternative is to use some actual

1 transaction-level data, and perhaps distinguish between
2 people who are abandoning their shopping carts and seeing
3 whether or not that in neighborhoods where there aren't
4 that many people, there's a difference -- there aren't
5 that many other people using the service, that people
6 tend to be abandoning their shopping carts more, i.e.,
7 that they're more unsure about the quality of the
8 service, and compare this to just whether or not they're
9 ever getting to the shopping cart stage. And you might
10 be able to tease out whether people are nervous about
11 quality.

12 The next thing is really thinking a little bit
13 more about the question of cause or fact. Now, there's
14 obviously a large economics thinking about how you can
15 never tease out a social effect, given that everyone in a
16 zip code tends to be very similar. And what the authors
17 do here is that basically we have -- they say it was a
18 helicopter drop of 20,000 people in the period before,
19 and we're going to see how people react to that in the
20 next period.

21 I was thinking, well, I mean, that's the data
22 they have, and so that's why they do that. But maybe it
23 might be nice to get some other data, perhaps exploiting
24 some of David's contacts from Wharton, and persuading and
25 using the use of exclusive invitations in testing phases

1 for websites, and perhaps having some randomization in
2 terms of that to actually tease out these causal effects.
3 Go back to the 1950s cocktail world where we can actually
4 do our own helicopter drops, although perhaps not of
5 terrifying leaflets.

6 The last paper I want to suggest is really
7 thinking a little bit harder about whether or not -- it's
8 always going to be a positive effect from having your
9 neighbors using this grocery store. And I was thinking
10 in particular of, say, a Whole Foods and a Kroger
11 comparison.

12 So if we have a more mass market grocery store,
13 then perhaps there's always going to be a positive
14 effect. But maybe with a store such as Whole Foods,
15 where there's an exclusivity, a certain chi-chi-ness --
16 you want to be unique; you want to feel special by
17 shopping there -- it's not so clear, perhaps there's
18 always going to be a positive neighborhood effect.
19 Instead, people might want instead to feel a little bit
20 unique, a little bit fashionable. So it might be
21 interesting to tease that out.

22 So to summarize, I enjoyed the paper very much,
23 and it is in print. And so to try and say something
24 substantial, I made three suggestions of other papers
25 that perhaps they might consider writing next: first of

1 all, teasing apart this social influence mechanism, what
2 it is exactly that's going on behind it; secondly, maybe
3 doing some actual field experiments to think about the
4 causality issue again; and lastly, teasing apart
5 competing social effects, perhaps comparing different
6 kinds of retailers and seeing if we always have a
7 positive social influence story.

8 So thank you.

9 (Applause.)

10 MR. HOSKEN: Jon?

11 MR. SEATON: Right. Hello, I'm Jon Seaton from
12 Loughborough University in the U.K. Everyone has a bit
13 of difficulty with that name; sorry for it. I was once
14 introduced as Jon Seaton from Lowbrow University.

15 (Laughter.)

16 It has improved since then. And we're sort of
17 in the top ten, according to newspaper tables.

18 My co-authors are Paul Dobson, a lot of people
19 here will know him. He's a retail professor at
20 Loughborough Business School. Ratula is our PhD student,
21 so she won't get much credit but she did all the work.
22 So that's just how it goes.

23 Well, the material I'll cover today is familiar
24 to the people who attended the morning session. What I'm
25 going to do is go through the U.K. experience of the top

1 four supermarkets in terms of their pricing behavior.

2 These figures tell you roughly what it's like.
3 It's quite a big and lucrative industry. The top
4 supermarkets are Tesco, who you will be experiencing soon
5 in the U.S., although things might be different over
6 here; Sainsbury's, Asda, which is Wal-Mart, and Safeway.

7 But Safeway was merged with Morrison not so
8 long ago, and a lot of people have discussed that. We've
9 also heard a lot of people talking about is merger a good
10 thing? Does merger lower prices or raise prices? The
11 typical view is that with concentration going up, you
12 should get increasing prices in the industry. On a
13 lighter note, I was interviewed yesterday by your
14 officials at the airport and was asked, "What are you
15 doing here?" And I said, "I'm going to talk to people
16 about grocery retailing." "What does an English
17 professor -- what are you going to tell the Americans
18 about this?" Well, I couldn't answer that question. But
19 I hope I can today.

20 The next thing I have to talk about is
21 definitions, so I'm going to briefly talk about
22 definitions. We're talking about stores in excess of
23 1400 square meters, 15,000 square feet, in some of these
24 slides.

25 What we noticed over the three-year period that

1 we're looking at is that -- well, typically the industry
2 was polarized between high/low and EDLP. And it seems to
3 have shifted with the merger to more kind of value-led
4 behavior by all the four supermarkets, which is really
5 quite interesting.

6 You've seen the regulatory background already.
7 But again, the Competition Commission looked at the bids
8 by most of the supermarket chains to go after Safeway,
9 and it was Morrison who won, given that there were some
10 excellent divestments, which they did.

11 I should also say the Competition Commission
12 are reviewing the area as we talk about it -- in fact,
13 he's here in the audience reviewing it -- and as you can
14 see, the results will be out in 2008. So hopefully, what
15 we say here might be taken on board. I don't know, but I
16 think it should be interesting.

17 This is just a summary of the size of the
18 market for the different size stores. And you can see
19 that there does seem to be quite a lot of concentration
20 in the industry in terms of the 1,400 square meters and
21 2,300 square meters. Of course, it's mainly Tesco that
22 seems to be winning on that front.

23 If we take a slight time dimension, there are
24 better, more up-to-date about the reasonableness that we
25 can function at the moment. I think Tesco is now up to

1 about 34 percent. Sainsbury's is down to 16, Asda 16,
2 and Safeway is about 11 and Morrison's about 11 on this
3 one. So they have come down a bit, some of them.

4 Now the paper. What are we going to do about
5 the paper? About the paper, this is the form it's going
6 to take and I'm going to have to go through it fairly
7 quickly. It is mostly pretty pictures. In an earlier
8 version that we gave in Berlin, we had quite a lot of
9 econometrics in there. And unfortunately, the
10 econometrics take up about four slides for each
11 regression. So we're not going to do that today, you'll
12 be thankful for.

13 Initially I'm going to talk about modeling
14 issues, the data selection, and then we'll go through the
15 pretty pictures. And hopefully you'll see that there's
16 some interesting results there in terms of the
17 conversions of prices.

18 Well, this is the way we look at the data. And
19 I'll talk more about the data later. But essentially, it
20 is just the data on prices of supermarket goods for all
21 the four supermarkets.

22 And in a sense, there's nothing much you can do
23 with that sort of data because essentially, you're
24 tracking along with Heinz baked beans and the price is
25 pretty much the same. And then suddenly, oh, the price

1 goes up. And then you wait a few more weeks, and maybe
2 it drops down again.

3 So there's not really much happening in the
4 data. So we wanted to look at the price change event,
5 but then we wanted to look at the issues behind whether
6 the price change was dropping the price, raising the
7 price, and by how much.

8 Now, you can do this with sophisticated
9 econometric analysis, which we're not going to do today.
10 We're just going to look at the basics. This is the part
11 about the data. The nice thing about this data is that
12 it's actually produced for us by one of the supermarkets.
13 They actually finance an independent company to put
14 supermarket price data on the web for all the four
15 supermarkets -- Tesco, Sainsbury's, Safeway, Morrisons,
16 and also Wal-Mart.

17 There are initially about 4,000 products put on
18 the web when it first started up in 2003. This has now
19 progressed to 10,000 prices, 10,000 goods. So it's quite
20 a lot of data, and we've got this for three years. One
21 disappointing thing about the data is that it doesn't
22 include the multi-buys, the bog-offs, or these sorts of
23 offers. It is just the day-to-day prices.

24 This means overall when we filter the data for
25 missing observations, which there are quite a lot of

1 because sometimes they don't find the products in the
2 supermarkets, we ended up with 129 weeks of collected
3 data and we were able to get a nice clean panel of 539
4 products. So it is fairly selective from the original
5 sample. We're hoping to use sample selection techniques
6 later to examine it in much more detail at another time.

7 We split the data up into three periods
8 relating to pre-merger, the merger time, and then post-
9 merger to analyze what happens. I'll move on to this one
10 now.

11 Essentially, using the diagram we have before,
12 we can see that, as I said, there isn't much happening in
13 the data. Price changes don't happen very often. So if
14 you've got a Heinz tin of baked beans, they've got a 4
15 percent chance of moving in any one week.

16 There's more likelihood that the price will be
17 lowered than raised. The other thing is that if the
18 price is lowered, it's more likely to be 1p; if it's
19 raised, it's more likely to be about 10p.

20 This is summary statistics of the data by
21 aisle. This is how the data actually comes across, by
22 aisle, so it can take quite a lot of time to download it.
23 But as you can see, there is quite a lot of variation
24 between the products, and also quite a lot of variation
25 in the number of items we have per aisle, grocery being

1 the largest, and I think it's bakery where we only have
2 eleven items.

3 We're able to split it up, obviously, by the
4 types of goods, whether it's own brand or -- sorry, own
5 label or whatever. And you can see there all of the
6 different prices. The mode price for the whole sample
7 comes out as about 98 pence, but you can see from the
8 aisles that there doesn't seem to be a single kind of
9 price band. There isn't a \$1 product that you mostly get
10 around. It seems to jump around a bit, depending on the
11 aisle that you're in. And we'll see that when we look at
12 some of the diagrams.

13 Another thing to note is there's a lot of
14 variation in the prices. The higher price is £26, well
15 over \$50. And that's alcohol. Alcohol is -- that's the
16 extreme observation in our sample, as we'll see.

17 This is a time plot showing the average prices
18 measured in different ways -- means, quartiles, medians,
19 modes, over the whole time period. Now, there was
20 inflation over that time period of about 2 to 3 percent,
21 depending on how you measure it. But as you can see,
22 there's very little chain in the mean. That's the purple
23 line there. Nothing really seems to happen that much. A
24 few dips around about Christmas when there's a lot of
25 discounting for the alcohol in particular.

1 The mode skips around a lot. That's the
2 starred purple line that bobs around a lot. And again,
3 it shows that there isn't really a standard modal price
4 that you get that's commonly produced.

5 Now, this is the real important diagram. This
6 is average prices, where I've looked at each supermarket
7 separately and scaled it by the base price of Tesco in
8 the first week of our data set. So Tesco price at 100 in
9 the first week, as you can see, as to Wal-Mart a bit low.
10 But they tend to have pretty much the same prices most of
11 the time there. Their hovering around, yes, as to Wal-
12 Mart, is pretty much below. But interestingly enough,
13 they are very close together.

14 The important one, though, is Morrison, the
15 black line, which, as you can see, that big drop is when
16 the merger happened. So we did get a drop in average
17 prices. Also, you can see that Sainsbury's, the orange
18 line, has also dropped because of the merger. And it
19 seems to have stayed dropped; it bumped up a little bit,
20 but then later came down. So it does seem like we have,
21 to some extent, falling prices with merger.

22 We're now looking at price changes. And
23 there's quite a lot of variation there. The important
24 line I'm supposed to look at is the red one. That's a
25 moving average of price change. And there does seem a

1 dip post-merger. Very few price changes there; that's
2 price rises and falls. But it kind of goes back up to a
3 plateau later on, about the same level it was at.

4 Here we desegregate by price rise and price
5 fall. And there you can see that -- well, there are more
6 falls than rises, as we suggested earlier. But they seem
7 to both increase and decrease during the same time.
8 They're both down during the merger time, and then
9 crawled up after the merger. So it isn't as though one
10 is always coming down and one is always going up.
11 They're actually following each other.

12 In terms of the retailers who does it the most,
13 well, strangely enough, it's Tesco that's moving the
14 prices around a lot. Asda, as you might expect, is quite
15 low in moving prices because it's everyday low price so
16 it doesn't have to shift them about a great deal. But
17 it's Tesco that's moving them around a lot.

18 If we desegregate by retailer for net falls --
19 this is falls minus rises -- then you can see that yes,
20 there is some dissimilarity between the supermarkets, but
21 there are some similarities as well. And they do tend to
22 track each other a bit. But it's hard to absorb such a
23 complex diagram.

24 Magnitude of price change: Well, the penny
25 price change is the most common. Probably the most

1 expensive to do, but it's the most common. Tesco does
2 this the most, followed by Sainsbury's and Safeway-
3 Morrison's, then Asda. Oh, Asda is, sorry, the same as
4 Sainsbury's. Ten p, as we've said before, is the most
5 common price rise. But you do get, of course, 50p price
6 rises, pound price rises, that sort of thing. The price
7 change intensity also varies a bit between the retailers
8 as well.

9 All right. This is the cumulative frequencies
10 of the price falls. Now, the Safeway-Morrison is a bit
11 odd. They're very strange. They didn't really have the
12 1p price falls that the others had. But that has changed
13 post-merger. But you can see Tesco, the red line, a lot
14 of 1p price falls relative to the other supermarkets.

15 Price rises: Very few 1p price rises. It
16 jumps at 10. But again, another thing to note here is
17 that Safeway-Morrison's holds off their big price rises
18 to much greater numbers than 50 pence. It's about a
19 dollar.

20 This is net price falls, falls minus rises, for
21 10p or more changes and 9p or less changes. And you can
22 see there's quite a lot of difference, depending on the
23 range of price movement. The big price movements, the
24 net price falls of 10p, they tend to be rises because
25 they're negative. Remember, this is net falls. So when

1 you get a negative result, it's rises.

2 So you tend to get a lot of those post-merger.
3 There is a move up in October/November '05 which follows
4 the net price falls for the smaller price changes. So
5 there are some similarities, but for the most part, when
6 you get a big price change, it's a rise.

7 Now, this is probably a quite controversial
8 bit. This is where we talk about price alignments
9 between the supermarkets. And I'll get quickly onto the
10 diagrams here.

11 This is looking at all the supermarkets,
12 looking for -- for example, with the black line at the
13 bottom that's traced along, that's where they share the
14 same price with the black line. There's no price
15 difference. They have the same price on up to 30 percent
16 of the products towards the end, and hardly any of the
17 products at the beginning.

18 And it is this period where we get the merger
19 happening where we get a move towards closer price
20 tracking by these supermarkets. So again, a very, very
21 interesting result.

22 We can desegregate this by the supermarket
23 relationships and see what happens between them. So the
24 result between Tesco and Sainsbury's, again a big
25 discontinuity at the merger. A lot more price tracking

1 by both of them. They share about 40 percent of the
2 prices. And that seems to be increasing towards the end.

3 Tesco/Morrison took a bit of time, but
4 eventually we get a lot more prices that they have in
5 common, 50 percent now towards the end.

6 Sainsbury's/Morrison, much more of a change at
7 the beginning, up to 25 percent at the start post-merger,
8 up to 50 percent afterwards.

9 But that's the big one, isn't it? Tesco and
10 Asda are really chasing each other and always have done.
11 About 80 percent of the prices are exactly the same.

12 Now, we can look at product types and, very
13 briefly, I think here you can see the probability of a
14 price change is more likely in off-license. The British
15 are very attracted to low price alcohol -- I'm sure it
16 isn't so over here -- pet foods as well, if they remember
17 to feed the pet once they've drunk so much; and
18 beverages.

19 Percentage of price changes as rises were less
20 likely in health and beauty, but pretty much the same
21 elsewhere. Bakery is a bit of an oddity because we've
22 only got eleven of those. That's why that's a bit
23 extreme.

24 These are the types of variables we can look
25 at. But I'll jump quickly from that because we're not

1 going to look at it. We're going to look at leader/
2 follower behavior. And I think this is possibly the most
3 controversial out of all of the results that we find.

4 Here we're looking for who's chasing who, and
5 it's very interesting. There is asymmetric behavior.
6 They're not all following each other. Some people are
7 leaders and others are followers.

8 This chart is very complex to explain. But
9 essentially, the figure in the third column is looking at
10 price falls. And what I do is it's like an event study.
11 We pick a price change and track three weeks back and see
12 if the other supermarkets have changed their price given,
13 say, Tesco has changed their price. And we track forward
14 three weeks and see if they've changed the price
15 afterwards.

16 And we do a percentage calculation, and we find
17 out whether it was a leader or a follower. Obviously,
18 it's a follower if everyone has changed the price or most
19 have changed their price beforehand. It's a leader if
20 everyone changes the price afterwards.

21 And we get a rough statistic there. Obviously,
22 minus 100 means it's a follower, a perfect follower. We
23 don't really have any minus 100s there. We don't have
24 any plus 100s, which means a perfect leader. But we do
25 seem to have some indication that this is happening.

1 Now, we do need to have some sort of
2 statistical test of this, and we use a chi squared test
3 to test the uniformity of price rises before the even and
4 price rises, price changes, after the event. So the
5 numbers in red are statistically significant.

6 So, for example, Sainsbury's is at the top, the
7 second line, second row. They are a price follower on
8 falls, and they're a follower on rises. We'll summarize
9 some of that data later.

10 But we also desegregated the data pre-merger,
11 which is the 1s, merger the 2s, and the third period is
12 where that all merged. And you can see that the behavior
13 seems to have changed a bit.

14 In general, for a price rise, we find that
15 Tesco is a leader in price rising behavior. Sainsbury's
16 is a follower; that's why I've got an arrow pointing to
17 Sainsbury's from the fee rising. And Asda is a price
18 follower with rises, a very strong follower with price
19 rises. Morrison's doesn't seem to do anything.

20 In terms of price falls, Asda seems to be the
21 one who provokes that, and people tend to follow behind.
22 Sainsbury's is a follower in terms of price falls.

23 We can desegregate that further and see who
24 follows who. In terms of price rises, Tesco is leading
25 everyone. So it's leading Sainsbury's, but Sainsbury's

1 is leading Asda/Wal-Mart, Tesco leads Wal-Mart, and
2 Morrison's is led by Tesco and also leads Wal-Mart. So
3 Tesco seemed to have a prominent position, according to
4 this data, in leading the other supermarkets.

5 In terms of price falls, we can see Tesco has
6 an effect in lowering prices on Sainsbury's, but is
7 itself affected by Asda. Now, the thickness of the
8 arrows, I should say, shows the strength of the
9 relationship. So it's a much smaller, thinner
10 relationship, Asda affecting Tesco, but Tesco certainly
11 has a dominating effect on Sainsbury's. And Sainsbury's
12 has a small effect in making Morrison's lower prices.

13 I think this is my last slide, probably well
14 timed. Here I've plotted the follower on the lower half
15 of each of these graphs, and the upper part then is the
16 leader. The lighter colored purple is for raising
17 prices.

18 What we can see there, as we track through
19 time, Tesco appears to be a very strong leader in raising
20 prices. It sort of was a follower in prices until fairly
21 recently, and now it seems to be leading the price
22 reductions as well.

23 Sainsbury's, on the right-hand side, doesn't
24 really seem to be doing anything apart from following.
25 Morrison's, pretty much a follower in raising prices, but

1 now it looks like it may actually be having some impact
2 on lowering them. But that doesn't look so out of
3 kilter, that later date.

4 Most interestingly, Asda was always a very
5 strong follower in raising prices, and that still seems
6 to be true. It was also a very strong lowerer in prices.
7 It was a leader in lowering prices. And as you can see,
8 that strength of relationship seems to be dying through
9 time.

10 So it does seem to us from this data, a
11 tentative analysis that we don't want quoted anywhere
12 else for the moment, that Tesco seems to be really having
13 a powerful impact post-merger despite the fact that the
14 consumer has enjoyed dramatically reduced prices.

15 Okay. That's the end of it.

16 (Applause.)

17 MR. THOMADSEN: My slides don't seem to have
18 gotten on the computer, so I'll just talk from my notes.
19 I'm Raphael Thomadsen from UCLA.

20 This is a very interesting paper. It uses a
21 very interesting and creative data set, which is a data
22 set of price comparisons between Britain's top four
23 grocers. And basically, it's hundreds and hundreds, or
24 even more, thousands of items. So it's a very nice data
25 set.

1 The main question that they're asking is a
2 question that, if you're here at an FTC conference,
3 you're probably interested in, which is: What happens to
4 prices after a merger? That's pretty much the key
5 question.

6 And they note prices could go up or down. You
7 might think prices will go up after a merger because
8 higher market power means higher prices. But on the
9 other hand, there's significant economies of scale in the
10 grocery industry. Maybe prices will go down.

11 And in fact, what they find is they find that
12 the prices do go down. They decrease, and they decrease
13 and stay down for at least three years. So it's not some
14 sort of temporary decrease. It lasts at least three
15 years.

16 Now, the decrease happens mostly with Safeway-
17 Morrison's. So the company that merged is the one that
18 has the decrease in prices. It would be nice to actually
19 separate out Safeway and Morrison's to see a little bit
20 more of that interplay. But that's suggestive that maybe
21 the economies of scale are dominating.

22 I would be remiss not to note I have a paper in
23 the Rand 2005 that also notes that there's another reason
24 prices could go up after a merger that might apply here.
25 If you have two weaker firms which, by combining, become

1 a stronger firm, there can also be a demand effect, where
2 being a stronger competitor can pull down prices, too.
3 So there is a question whether it's a demand or a supply
4 effect.

5 But what is clear from the data is that prices
6 go down, and not only down in terms of average prices,
7 but they can look at item by item. And when I look at
8 these graphs, and I spent a lot of time poring through
9 these graphs, what you see is that around the time of the
10 merger, there are a lot of decreases in prices, large
11 decreases in prices for Morrison's. And then afterwards,
12 there's a pattern that pretty much lasts for three years.

13 And if you look at the differences in prices
14 item by item, it's really true that prices are dropping,
15 and they're dropping on the same items. It's not that
16 they're segmenting the market, where some people discount
17 beans, other people discount paper towels, and you get
18 about the same average prices. They're really matching
19 category by category. So that's a nice sort of a result
20 that they have.

21 They also talk about and find that in terms of
22 pricing patterns, you tend to have many, many small price
23 drops and relatively few but larger increases in prices.
24 I have a few comments on that.

25 The first thing is, I'm not sure if this is

1 related to the merger or not. It's something to keep in
2 mind. If you believe it's related to the merger, tie in
3 maybe more how it is. If it's not, maybe this should be
4 a separate paper. But it is an interesting question:
5 Why is it that prices are decreasing slowly but increase
6 quickly?

7 And you could imagine it's either a cycle of
8 promotions. There's many papers on gasoline that talk
9 about these similar sorts of effects in terms of cycles.
10 So there's a lot of places to look at where that is. The
11 big question in my mind is: Is it merger or is it just
12 actually a second paper on promotions?

13 Overall, this is still very preliminary work.
14 My biggest comments would be there's a lot of information
15 there, a lot of small details. I think the big thing to
16 tie together is what do we make of all of these details?
17 Maybe pull together a tighter story that's easier to take
18 away.

19 But overall, I like the paper. It's a good
20 paper. Thank you.

21 (Applause.)

22 MR. HOSKEN: So we'll take a ten-minute or so
23 break.

24 (A brief recess was taken.)

25 MR. ADAMS: I'm Chris Adams. I just want to

1 thank a couple of people. Marissa Crawford, who's
2 working out there. Chrystal Meadows, for helping
3 organize this. Dan Hosken, for giving me help and
4 advice.

5 So what we're going to do in this session is
6 talk about Wal-Mart, which Dave told us was pretty
7 important. And then we're also going to talk about some
8 interesting -- what I think are really interesting models
9 about how to analyze the grocery industry in a dynamic
10 context.

11 You might not see it, but I think these models
12 are going to have a pretty important role in the future,
13 or that's my guess. I think there's a long way to go,
14 but I think it's an interesting exercise.

15 So why don't we start off with Professor Holmes
16 from Minnesota.

17 MR. HOLMES: All right. So talk about
18 Wal-Mart. So it's already come up today. Wal-Mart has
19 revolutionized the process of getting goods from the
20 factory into people's homes. McKinsey, just a little
21 while back, in a study was giving them a big chunk of the
22 credit for -- you can see Wal-Mart in the productivity
23 numbers for the whole country, or at least for the retail
24 sector.

25 Hausman and Leibtag show some recent evidence

1 how this is getting passed along to consumers in the form
2 of supercenter food prices being 15 to 25 percent lower
3 than supermarkets.

4 Today I want to look at one aspect of
5 Wal-Mart's formula, that is, economies of density. And
6 what are they? Well, just cost savings from having
7 density, stores close each other saving the store money.

8 What are the sources? I think this has come up
9 already, this discussion today about logistics. But it's
10 obviously a lot easier to get the goods into the store if
11 they're right next to each other than if they're really
12 far apart. But they're also easier to manage if they're
13 closer together.

14 Now, what I want to -- the first thing I want
15 to hammer home to you is that Wal-Mart has always chosen
16 density in the United States, except for like Store No.
17 1. In 1962, it wasn't a very dense operation. They had
18 one store; that's the only one. But after that, they
19 always chose density.

20 So let me just show you the diffusion of
21 Wal-Mart's beginning in 1962. Let's see. So the blue
22 things are a distribution center. The red means a fresh
23 new store; then it turns into pink. They're always
24 picking density. They're always picking a store location
25 near where they've already got a base.

1 They don't just jump -- well, okay. They had
2 to jump a little bit over these states. Well, they had
3 to put a couple stores in. But there are hardly any
4 people who live in these states. But pretty much, to the
5 maximum extent possible, they always chose high density.

6 So what I want to show you is -- I'm going to
7 replay this whole thing. Starting in 1988, when we start
8 putting the first supercenter, which back then they were
9 basically just converting the old Wal-Marts and adding
10 the grocery store to it. More recently, they just are
11 building these things from scratch.

12 But we're going to replay the tape. Let's see.
13 And again, the distribution centers you see here are
14 dedicated supercenter distribution centers. But the same
15 thing. Again, you never put a distribution center far
16 from where you have a base if you already have
17 distribution -- you never put a supercenter far from
18 where you don't have -- from your other stores. So
19 that's what they did. They always chose density.

20 Now, what am I going to make of it? Well, how
21 do we quantify the benefits from density? Ideally, it
22 would be great to do some sort of thing where I got data
23 on the trucks' delivering to each store, drivers' time,
24 all that sort of thing. Wal-Mart is not going to give
25 that to me unless we bring in some sort of court order.

1 You can think a little bit -- I am a special
2 sworn employee for the census for some other project, and
3 I was sitting there with the census of retail trade. I
4 had all this information. And I was thinking, I would be
5 pretty tough-pressed even with all that information to do
6 anything to look at these benefits from density because I
7 wouldn't be picking up the movement of the trucks if I'm
8 looking at the information for a particular store. And
9 in any case, I would never be allowed to use it because
10 it would be disclosing information about Wal-Mart.

11 So I'm going to try a different approach that's
12 going to look at what Wal-Mart did and try to infer
13 something about what density might have been worth to
14 them.

15 So the idea is that there's a tradeoff between
16 benefits of density on the cost side and costs from
17 cannibalization of sales. So we can think about it.
18 Suppose you have two stores and they're 100 miles apart.
19 And you say, let's put them closer together. They'll be
20 easier to replenish.

21 Yes, put them together and together and
22 together. How about putting them right next door to each
23 other? They're going to be really easy to replenish.
24 Right? But of course they're going to steal sales from
25 each other.

1 So that's the idea. Now, what am I going to do
2 with this? Well, the first thing I'm going to do is I'm
3 going to estimate a demand model for Wal-Mart stores.
4 All right? I'm going to try to predict for any
5 configuration of where Wal-Mart's are what their sales
6 would be and what the operating profits would be.

7 (Pause)

8 I'm going to estimate a model of demand. So I
9 could feed this model wherever Wal-Mart wants to put its
10 stores, and I can predict what the sales are going to be
11 and operating profit. And I'm going to provide some
12 evidence of significant diminishing return for
13 cannibalization.

14 Wal-Mart is just jamming these stores next to
15 each other, and they're stealing sales from each other.
16 I'm going to put forth a dynamic model of Wal-Mart's site
17 selection problem and use some perturbation techniques to
18 put a lower bound on what the density economies are. All
19 right?

20 Basically, there's going to be a tradeoff.
21 Wal-Mart can put another store where it's already got a
22 bunch and steal some sales from existing stores, or go
23 out in California where it's not going to be there for 20
24 more years and have no cannibalization but be very far
25 from its base of density. All right?

1 And it's sometimes choosing to have the
2 cannibalized sales when it could go out there, and I'm
3 going to be backing out -- I'm going to be calling that
4 density economies. So basically what I'm doing is I'm
5 backing out a residual and I'm putting a label on it and
6 calling it density economies.

7 Now, other interpretations. All right? Well,
8 I've been talking about logistics, but you could also
9 point to some advertising, so forth. Fine. Let's fold
10 those things in. They're all economies.

11 Now, what's another thing, you might say?
12 Well, what about some sort of preemption motive, all
13 right, that I need to put an extra store in there and
14 keep Target or Kmart or something out. That's fine. All
15 right? I am well aware of that issue, and I'm thinking
16 hard about it. And future work, I want to get going on
17 that.

18 It's not obvious that it would cut this way.
19 Right? I mean, sure, Wal-Mart wants preemption benefits
20 and put where they already have. Or maybe they want to
21 extend their reach and prevent Kmart and Target from
22 getting to California first. All right?

23 So I would have been very concerned if, when I
24 looked at this map, I also plotted a map of Wal-Mart and
25 Kmart and Target. So Kmart started out of Michigan,

1 Target out of Minnesota. But they all have their little
2 fiefdoms. And when Wal-Mart got to the Minnesota border,
3 they stopped, and when they got to the Michigan border,
4 they stopped, because -- that's not what happened. All
5 right?

6 So the way I'm going to tackle this problem
7 is -- it might remind you of those economists at John
8 Rust's paper -- I think he's in our audience today --
9 about Harold Zurcher replacing his bus engines. It's a
10 famous paper in econometrics. And that's basically the
11 problem I'm looking at here. It's a decision theoretic.
12 Sam Walton is sitting there. Where to put his stores?
13 And that's what we're going to do today.

14 So here's the model. I'm going to have
15 discrete points on the plane. And what these little
16 points are, these little blue dots, they will be census
17 blockgroups. So I'm going to have a fine level of
18 geographic detail. And that's a very fine geographic
19 unit. There's about a thousand people in a census
20 blockgroup.

21 And there are going to be Wal-Mart's over the
22 landscape. In this little example here, we've got three
23 Wal-Mart's. And they're going to be competing with
24 themselves and with other retailers.

25 Besides this geography, the model is going to

1 have four key ingredients. The first of all will be a
2 model of sales. So I need for any configuration about
3 where I put these -- if you don't mind, I'm going to
4 point over here -- for any configuration about where the
5 Wal-Mart's are, I need to be able to predict what sales
6 will be.

7 And the sales in this Wal-Mart, of course, are
8 going to depend on whether this Wal-Mart is in existence
9 or not. Right? Because if this Wal-Mart wasn't there,
10 then maybe a big chunk of the customers would be coming
11 over here. But once there's a Wal-Mart there, then
12 that's not going to happen.

13 So I'm going to be front and center. The other
14 people working in this area, the economists, are looking
15 at a county and they're just assuming the county is the
16 market, and there's the one Wal-Mart and one Kmart and
17 they compete with each other but they don't compete with
18 the neighboring counties. But what will be front and
19 center on my analysis is the Wal-Mart's are going to be
20 competing with other Wal-Mart's. So that's the first
21 thing I need, is my model of sales.

22 Two, I'm going to have density economies. And
23 costs will be lower at a Wal-Mart if there are more Wal-
24 Mart stores nearby. So I'm just going to have some
25 measure of density at a particular location. So right

1 here, what's the density of Wal-Marts? Well, there's one
2 Wal-Mart there, but this one's not too far. This one is
3 maybe a little bit further. So I'm going to cook up some
4 measure of density that's going to take into account how
5 many Wal-Marts are nearby and how far they are.

6 I'm going to have some model of variable inputs
7 that we'll just skip now. I'm also going to have another
8 cost that's going to vary with population density. So
9 more dense areas are going to be good because you're
10 going to get more customers. And maybe you're going to
11 be near more Wal-Mart stores, which is good.

12 But there's also a bad part. Sam Walton wasn't
13 too keen about the labor markets in big cities. Right?
14 So Sam Walton is big on enough -- whatever, the Sam
15 Walton cheer, give me the W, give me an A, et cetera.
16 That went over in Arkansas and the Ozarks. You try to
17 bring that into New York City, it just doesn't work.

18 So I'm also having to model that population
19 density is kind of bad. So you want to be near stores,
20 other Wal-Mart stores, because on the cost side that's
21 good. But the actual people on the cost side is bad, but
22 of course selling to them on the demand side is good.

23 The problem that Wal-Mart is going to be
24 solving is pretty complicated. There's really four
25 pieces. Number one: How many new Wal-Marts and how many

1 new supercenters to open? Two: Where to put the Wal-
2 Marts? Where to put the supercenters? I've got no exit
3 here. That would really complicate my life if I had to
4 deal with exit. But fortunately for me, for my studying
5 Wal-Mart, they don't exit. I mean, there's never been an
6 exit of a supercenter, and there's maybe one a year
7 regular store shutdown.

8 Now, there are these empty carcass Wal-Marts.
9 What are they? They are just -- you build down the
10 street a bigger one. All right? What I mean by no exit
11 is they never leave a market. But they very frequently
12 upgrade and just walk down the street.

13 I just went through that: two, where to put
14 them. Three: How many distribution centers to open?
15 Four: Where to put them? My approach is I'm just going
16 to solve problem two, taking as given what they're doing
17 for the others.

18 So there's interesting things going on with the
19 capital markets for why Sam Walton in 1962 opened up one
20 store and it took two more years to open another one.
21 All right? We all understand the capital market stuff
22 going on there. I'm not going to try to explain why Wal-
23 Mart didn't just go out all at once, and why didn't they
24 just open 3,000 stores in 1962. All right? I'm going to
25 just take as given that they have a certain number of

1 stores to open, and my question is: Where do they put
2 them?

3 All right. Let's just skip all this technical
4 stuff.

5 The data that I'm going to bring to this
6 question is I've bought store-level data from Trade
7 Dimensions, which is an estimate of Wal-Mart's sales at
8 each store, all right, for a couple recent years. I have
9 the opening dates. I have this from Wal-Mart themselves.

10 November 2005 they're posting an Excel
11 spreadsheet on the web with the opening date of every
12 store. Grabbed it off there. A couple weeks later, they
13 deleted the last column. They still had the Excel sheet
14 on there, but the opening date of the store is gone.
15 Anyway, I got it.

16 (Laughter.)

17 The detailed demographic data. So you're going
18 to need to know that -- you saw the little blue dots.
19 Well, how many people are in each of those blue dots, and
20 what's their income and their demographics and so forth?
21 I'm using the rich census data.

22 Look, this exercise I'm doing, I'm going to be
23 solving basically Wal-Mart's problem from 1962, the
24 entire future expansion of the stores. I'm going to need
25 census data from many decades. So I'm going back to the

1 '80s, '90s, et cetera.

2 I'm going to bring in wages. I get estimates
3 of that. So location decision. Some locations are going
4 to have higher costs because of wages. I'm going to have
5 some estimates of property values, and so forth.

6 And here's a little tidbit I get from the
7 annual reports. All right? So fundamentally, this
8 analysis is I have to convince you that I have good
9 estimates of cannibalization. So I have this piece of
10 information from Wal-Mart that as they continue to add
11 new stores in the United States, "We do so with an
12 understanding that additional stores may take sales away
13 from existing units. We estimate that competitive store
14 sales in fiscal years 2004, 2003, 2002 were negatively
15 impacted by the opening of new stores by approximately
16 1 percent." All right. That's an estimate of
17 cannibalization. And my demand model better be
18 consistent with that if we're going to take at face value
19 what they're saying in these forms.

20 Particulars of demand: Consumers are spread
21 over these discrete locations, and they're going to
22 allocate spending to the general merchandise and
23 groceries and so forth. I'm going to have a model of how
24 we're going to allocate these across retail alternatives,
25 including an outside good, which would be shopping at

1 Target, Kmart, et cetera, and all the Wal-Mart's that are
2 within, say, 25 miles.

3 And I've got my consumers. They are like crows
4 in terms of the way they get to the store. So I know
5 earlier the speaker had the time distance. I'm actually
6 going back to 1962, and even that might have changed over
7 time as they change roads. And it gets pretty
8 complicated. So the way the crows have been flying has
9 been pretty consistent since '62 in the United States.
10 So that's what I'm doing.

11 And I'm going to fit the parameters to store-
12 level sales. So it's a little different. The home scan
13 data that was discussed earlier is pretty good stuff. So
14 that's fitting the consumer-level stuff. I'm
15 investigating, trying to get that. But to do what I'm
16 doing, I need to know exactly what blockgroup these
17 consumers are in, and I believe Hausman and these others
18 guys who've been using this data have it more in a metro
19 area. I don't even know if it would be able to be used
20 for my purpose; in any case, I don't have it.

21 It fits pretty well, this demand model. What
22 I'm going to show here is just the cannibalization rates.
23 So say I have a demand model. Right? What do I mean by
24 that? I can put any configuration of Wal-Mart stores
25 that I want, and I can predict what the sales would be at

1 each Wal-Mart.

2 So in particular, I can say, well, let's just
3 take the stores that were there in year 2004 and see what
4 their sales would be, and then add stores that were going
5 to be added in 2005, and ask how the existing stores were
6 negatively affected, and then take that as a percent.

7 I will call that the cannibalization percent.
8 Now, when I just estimate my model, I get pretty close to
9 what Wal-Mart actually reported. I get numbers like 1.5
10 or something. Wal-Mart is saying 1. So you might
11 think -- I mean, in the scheme of things, if you round
12 those numbers to 1, it's just about what Wal-Mart was
13 saying. But it's coming out a little bit higher. So
14 what I do is I re-estimate the model, constrain it so
15 that it exactly matches the report that the
16 cannibalization percent is 1 percent.

17 Now, that doesn't sound like a big number, but
18 it is a big number. If on average the cannibalization
19 was 1 percent, remember, in a given year, Wal-Mart is not
20 opening everywhere. They're opening in some parts, not
21 others. And so if their average is 1 percent across all
22 of their stores, that means that some of the stores that
23 are actually opening, it actually could be quite a big
24 number. And that's what I'm finding.

25 So let me just give you a table that

1 encapsulates the big idea, and we're going to skip all
2 the technical stuff. What I'm going to do here is I'm
3 just going to do this hypothetical. I'm going to take
4 every Wal-Mart store and I'm going to look at when it
5 opened, and I'm going to calculate what its profits would
6 have been if it were a stand-alone store. I'm just
7 talking about the profits of the store in terms of the
8 sales and variable costs of labor, et cetera, not taking
9 into account the distribution.

10 And then what I'm going to do is I'm going to
11 take -- there are 3,000 Wal-Marts. I'm going to break
12 the stores up into how long Wal-Mart has been in that
13 state when they come in. Are they one of the early
14 stores in the state or are they coming in when Wal-Mart
15 has already been there 20 years?

16 And the point I'm going to make with this table
17 is that when Wal-Mart is entering states that they've
18 been in there for 20 years, there is significant
19 cannibalization going on. So let's just see how we're
20 going to do this.

21 I'm finding that with my demand model, that if
22 you look at stores coming in, the first row here -- if
23 that's okay, I'm going to put come over here -- the first
24 row are stores that are the first stores in the state.
25 All right? And let me see. I'm making a correction here

1 for -- obviously, Wal-Mart's scope of products has
2 expanded since 1962. So I'm holding these things
3 hypothetically in 2005 -- not just 2005 dollars, but also
4 2005 product line, the fact that Wal-Mart sells a lot
5 more stuff now than they did in 1962, to try to make
6 things comparable.

7 So taking the demand model as it stands for
8 2006 and taking into account Wal-Mart's product mix as of
9 2006, the average -- and throwing out groceries now, so
10 we're just going into the general merchandise stuff --
11 the average store when it's a brand-new store in the
12 state, for those stores that were brand-new stores in the
13 state, the incremental sales were about \$40 million, \$38
14 million. And the incremental operating profit I'm
15 calculating at about \$3.55 million.

16 Now, if you look at stores that are entering
17 when Wal-Mart has already been there more than 20 years
18 in the state, I'm calculating incremental sales of only
19 \$30 million as opposed to 38, and incremental operating
20 profit is 2.44, so almost a million dollars less in
21 operating profit.

22 Now, it might be that Wal-Mart just -- when
23 it's entering these later states, it's just picking
24 really crummy locations. But that's not what's going on
25 because if you just were to look at the stand-alone

1 operating profit, you ask a hypothetical question, is
2 what if this were the only Wal-Mart, and so it's not --
3 nobody is stealing any of its sales. You would see that
4 the stand-alone and operating profit would be almost the
5 same, even for this bottom row.

6 Again, what is this? These are the first
7 stores in the state. Stores here include all the stores
8 that were opened in Arkansas after 1983. So this is when
9 Wal-Mart has already been in Arkansas for more than 20
10 years.

11 And what can we say about these kinds of
12 stores? Well, they make lower operating profit, but
13 they're closer to a distribution center. So I can ask,
14 when that store comes in, how close are you to a
15 distribution center? The first stores in the state are
16 350 miles away from a distribution center; the last
17 stores in the state are on the order of 90 miles.

18 So that's the game. The cost is you're giving
19 up operating problem, and here's the problem or here's
20 what's going on. Wal-Mart is actually sometimes choosing
21 this when they could do this. They're adding more stores
22 in Arkansas in the mid-'80s when they haven't even got to
23 California yet.

24 MR. ADAMS: Tom, you have about five minutes.

25 MR. HOLMES: Good. So from my method, I'm

1 inferring they were getting something for it. They must
2 have been saving -- the cost of running these operations
3 must have been so much lower to make it worth it for them
4 to do this.

5 So I do a similar thing -- this is a grocery
6 conference, right, so I'm supposed to be talking about
7 groceries. You can do the same kind of analysis just for
8 thinking of opening up the supercenter as a stand-alone
9 type of grocery operation, and you get very similar
10 numbers. When Wal-Mart has been there more than 16
11 years, the operating profit is substantially lower, on
12 the order of a million per store, but they are much
13 closer to the distribution centers, much closer to other
14 stores.

15 Now, I do some technical things with this,
16 basically trying to estimate a lower bound on how
17 important these savings must be. Let me just do some
18 experiments. I know no one is really talking about
19 busting up Wal-Mart right now. That's probably a good
20 thing. But we can just get some idea of the magnitudes
21 by doing some experiments.

22 And so what I'm going to do is I'm going to do
23 a couple kinds of experiments here. I'm going to be
24 splitting Wal-Mart into separate companies so that they
25 no longer can get the density benefits. And I'm also

1 just going to be pumping up density in certain areas, and
2 just to see how this affects their cost. And then I'm
3 going to take a ratio of these things to 1.3 percent of
4 sales, which is some estimate of Wal-Mart's distribution
5 cost.

6 So just to preview what's going to happen, my
7 bigger number is going to come from the groceries than
8 from the general merchandise. And the thing is, I'm
9 allowing for some diminishing returns of density. So
10 Wal-Mart is so dense that you could cut it in half and
11 it's still dense.

12 So I don't get that big of numbers. So this is
13 the percent of distribution costs, how it would be
14 adversely affected. Cutting Wal-Mart in half so that
15 every store is half as dense would only -- this is a
16 lower bound, but it's only 6.4 percent. That's because
17 it is so dense.

18 But of course, certain areas like North Dakota,
19 it's not very dense to begin with, and then these things
20 would be big numbers. Like 25 percent is a big number.
21 But most of the country, the numbers aren't big.

22 Let me just do the same experiment now with
23 groceries. And again, of course cutting density in North
24 Dakota is going to give you big numbers because it's not
25 very dense to begin with. But California -- and this was

1 data that was current as of January 2006; of course, it's
2 already out of date because Wal-Mart has already thrown
3 some more stores in there, more supercenters there -- but
4 as of January 2006, cutting density in California would
5 have pretty -- you'd get big numbers because it's not
6 that dense to begin with.

7 Given my estimates of how important density
8 must be, I get in terms of the distribution costs that
9 costs would be 20 percent higher if you cut it in half.
10 Or, alternatively, if California would get as dense as
11 Georgia, I'm estimating that distribution costs would
12 fall in the order of 50 percent in California -- or,
13 excuse me, 36 percent, this number right here.

14 So big numbers. But because they're -- people
15 may find it hard to believe, but Wal-Mart as of January
16 2006 still had room to grow. I mean, California was
17 under Wal-Mart, at least in terms of grocery stores.

18 That's all I have.

19 MR. ADAMS: Great. Thanks, Tom.

20 (Applause.)

21 MR. ADAMS: We have Brett Wendling, one of
22 FTC's Bureau of Economics new hires. Are you still new?

23 MR. WENDLING: Hi. I'm Brett Wendling, and I'm
24 going to discuss the paper that you just heard about,
25 "The Diffusion of Wal-Mart and Economies of Density," by

1 John Holmes.

2 MR. HOLMES: Tom.

3 (Laughter.)

4 MR. WENDLING: So the question that he's
5 looking at is he's trying to explain, well, how does Wal-
6 Mart choose the location of their stores when they're
7 facing these competing effects of cannibalization and
8 density economies, where the cannibalization is, if I
9 locate my stores close to another, they're likely to
10 cannibalize the sales. And therefore, I want to spread
11 my stores out. And the density economies are these
12 economies of scale of putting all the stores close to one
13 another. So that effect makes you want to put all the
14 stores close together.

15 He has store-level sales data for every
16 Wal-Mart in the country since '62 all the way up through
17 2005, where he knows the revenues at each store, the cost
18 of each store, and the location of all the stores.

19 And what he does is he uses the profits at each
20 store level to estimate the size of these density
21 economies. And that's what he's trying to get at. And
22 his basic finding is that these density economies are
23 important in determining store location. And he mentions
24 that, as an example, a specific store could save \$220,000
25 if they move closer to a regional distribution center of

1 100 miles.

2 So in the discussion of this paper, I think
3 that he could tie this literature to the urban literature
4 because one of the strengths of this paper is that these
5 agglomeration economies are important in many different
6 contexts. And in the urban literature in particular,
7 they're very interested in how location choice of
8 different individuals affects city formation.

9 And in that context, they have these
10 agglomeration economies, which are similar to his density
11 economies, that compete with property rents that are
12 analogous to his cannibalization, cannibalization effects
13 that compete with each other and explain city formation.

14 And they used similar mathematical techniques.
15 And he could relate his discussion to why the estimation
16 of these density economies are so important, not just in
17 his literature but for a long time in older urban
18 literature.

19 And in the estimation part of the paper, the
20 model, I believe, is a very impressive modeling
21 technique, and completely appropriate for the type of
22 analysis that he's performing. So I'm not going to spend
23 any time on it. Rather, I'm going to spend some time on
24 the data and some limitations of the data that I think he
25 could address.

1 So one aspect is that his location choice that
2 he's modeling is not fully observed. So Wal-Mart has
3 four different types of stores, and he's only observing
4 two of the store types. He doesn't observe Sam's Clubs
5 or Neighborhood Stores. And these types of stores may be
6 affecting his cannibalization or density economies. They
7 may not affect them. I don't think that they're --
8 there's a possibility. But I believe that you could have
9 some discussion about how the omission of those types of
10 stores affect your results.

11 What I think is a slightly more serious problem
12 is that the choice of Wal-Mart has a lot of product
13 heterogeneity, and that the products offered at each of
14 the stores are going to be related to the location choice
15 that he's interested in. And moreover, it's going to
16 affect the size of the profits, which again he's using to
17 estimate the size of these density economies and the size
18 of these cannibalization effects.

19 So, for example, Wal-Mart's choice of whether
20 to offer a snow blower may depend on whether the store is
21 in Minnesota or Florida. And the margins on snow blowers
22 may affect the profit results.

23 One way you could test whether this product
24 heterogeneity matters is maybe use a data set where
25 there's a lot less product heterogeneity at the store. I

1 thought potentially fast food firms, such as Raphael
2 Thomadsen used -- I think it was Burger King or
3 MacDonald's data in one of his papers.

4 Starbucks is another product that has -- these
5 stores have very similar location decisions as Wal-Mart
6 in that the cannibalization effect is fighting with these
7 distribution economies of locating close to one another.
8 But they're not going to suffer from the fact that
9 there's this endogenous product choice. Every Starbucks
10 I've walked into has the same product offering.

11 So in conclusion, I thought that the estimation
12 of the size and the effect of agglomeration economies, or
13 what he calls density economies, are important and
14 actually undersold because they're important in many
15 contexts, even beyond the ones that he described.

16 I think that the model that he provides is
17 really the workhorse of this paper, and it is very
18 impressively articulated throughout the paper. And it
19 provides a reasonable exposition for how the firm-
20 specific agglomeration economies are formed.

21 However, I'm concerned that the product
22 heterogeneity at Wal-Mart's may be affecting his profits
23 measure. And he could possibly test whether this is
24 important in his results by using a more homogenous firm.

25 All right. I hope that helps. Thank you.

1 MR. ADAMS: Great, Brett.

2 (Applause.)

3 MR. ADAMS: Next we have Arie Beresteanu from
4 Duke University.

5 MR. BERESTEANU: Thank you. This is a joint
6 work with Paul Ellickson from Duke. I think the
7 challenge of presenting a pretty technical paper in
8 20 minutes for a diverse audience, what I will doing in
9 the presentation, I will talk less about technical things
10 as much as I can, of course, and try to give you the big
11 picture of what we are trying to achieve, and talk a lot
12 about the technique that we are using, which is
13 relatively new, and the kind of use that you can make of
14 that technique and the kind of use that we are making for
15 that technique for our specific purposes.

16 So I probably should not talk about what's in
17 this slide much because I don't need to convince you that
18 retail is important, and retail has changed quite
19 dramatically in recent years, and then definitely in the
20 last few decades.

21 And what's more interesting for us, apart from
22 the fact that it's a very dynamic industry, is that it
23 presents several challenges for empirical work. And to
24 list a few of those challenges, here are the three that
25 came to our mind, is that they sell a vast array of

1 differentiated products; they operate multiple stores in
2 multiple locations in multiple markets; and they evolve
3 incrementally with population growth. So in the model
4 that we'll employ, we'll have to take into account those
5 considerations and many others as well.

6 We focus on supermarkets. And again,
7 supermarkets are a great example for retail for several
8 reasons, and present challenges as well. They sell a
9 reasonably well-defined basket of goods. They are mostly
10 regional in scope. They are arguably not so spatially
11 differentiated; and they compete in what we call natural
12 oligopolies.

13 The supermarket industry has always been
14 dominated by big box chains. And there is always a
15 constant tension between building a big store and having
16 to locate it far relatively to the center of population,
17 and doing the opposite, building relatively small stores
18 and being able to locate them close to the center of the
19 city or the MSA.

20 So another thing that we need to take into
21 account is that those existing incumbents in each market
22 face the threat of entry, even if that entry doesn't
23 actually happen, the first entry of bigger box chains and
24 supercenters, those potential entrants in many cases.

25 So what we do, we propose a dynamic structural

1 model of retail competition in which the following four
2 points are -- we take into account the following four
3 points.

4 So first of all, firms are chains with multiple
5 stores. So the entity, the decision-making entity, is a
6 chain of stores in a certain geographic market.

7 Market structure and chain size evolve over
8 time, so it's a dynamic model.

9 Firms are one of two types. So one of the
10 things that we'd like to look at or the focus of our
11 research here is the impact of supercenters on the
12 grocery or the supermarket industry. So there can be two
13 types of players in this model, in this game, and the
14 first one being the supermarket, the regular supermarket,
15 and the second one being the supercenters.

16 And firms compete in store density. So they
17 build more stores, trying to capture a bigger share of
18 the market, making higher profits, of course.

19 So we have an eleven-year panel of various
20 characteristics of those supermarkets and supercenters,
21 their market shares, and also we obtained prices for a
22 small subset of the supermarkets for a certain period of
23 time.

24 And what we do next is we estimate a dynamic
25 model of supermarket competition, and we evaluate

1 policies aimed at eliminating supercenters. So there are
2 several places suggesting to pass laws that will not
3 allow building the big box stores, and by that,
4 restricting entry of stores like Wal-Mart and
5 supercenters.

6 And another type of regulation that have been
7 discussed is increasing the cost of supercenters or
8 chains that operate supercenters. And that can be done
9 through making them pay health benefits for their
10 workers, and by that incurring higher cost and changing
11 the face of competition in that market.

12 Another thing that we are not thinking about at
13 the moment but potentially can be done or can be thought
14 about using the technique that I will talk about is some
15 merger analysis or post-merger analysis and things of
16 that sort. I'll try to point that out in some slides to
17 come.

18 So again, without getting into too much
19 technical details, what we do here, we propose a dynamic
20 oligopoly model that include differentiated products, the
21 products being a supermarket chain in a certain MSA; its
22 simultaneous entry and exit, or again that includes
23 simultaneous entry and exit. There is a continuous but
24 incremental investment or de-investment in your capacity,
25 meaning you can open stores. You can close stores. You

1 can, of course, do nothing.

2 And firm-specific cost and profit shocks are
3 also incorporated into the model. And another extremely
4 important aspect of retail competition is to take account
5 of population growth. And we know that population growth
6 is perhaps the most important thing that drives the
7 increase of number of -- total number of stores in a
8 certain market.

9 So we estimate a model, and I will talk about
10 it in some more details in a minute, using a two-step
11 technique. And for some reasons that I will not get
12 into, that technique is very well suited for the type of
13 model and the complexity of the model that we are facing
14 here.

15 So what we do here is that we look at a
16 discrete time model with infinite horizon. So the time
17 passes, one period, and then a second one, and a third
18 one, and so on and so forth to the infinite.

19 There are M geographic markets. Those will be
20 MSAs. In each market, there are several firms. There
21 don't have to be the same number of firms, of course, in
22 each market. And there are two type of players that I
23 was mentioning before. And there will be in each time
24 period two potential entrants, one of each type.

25 So the game will be played the following. In a

1 certain time period, the existing incumbents, existing
2 chains, can do one of the following things. They can
3 increase the number of stores -- one store, two stores,
4 three stores, and so on. They can do nothing. They can
5 reduce the number of stores -- close one store, two
6 stores, and so on. Or they can exit altogether from the
7 market. So that's the set of choices faced by
8 incumbents.

9 Also, there are potential entrants. Potential
10 entrants can decide to enter, and if they decide to
11 enter, they can open one store, two stores, three stores.
12 They decide on their initial number of stores. And they
13 can decide not to enter, of course.

14 So each player, each chain, is characterized by
15 the following three variables. First of all is the
16 number of stores that they operate, or the number of
17 stores per capita, if you want to take into account
18 population; the type, meaning are they a supermarket or a
19 supercenter, and that is fixed -- they don't switch from
20 one type to another; and the third variable describes
21 their perceived quality.

22 Now, without getting into too much details
23 again how we calculate or estimate the perceived quality,
24 we start by doing a demand estimation. And from that
25 demand estimation step, we extract that variable. Now,

1 what the firms are interested is to maximize, of course,
2 their present value of the stream of profits.

3 Now, this equation one is perhaps the one that
4 describes or summarizes the core of the technique. But
5 let me take a step aside from the slide and describe what
6 we are doing.

7 So what we are doing is we are utilizing a
8 device which proceeds in three steps, actually. The
9 first step will be to lay down the foundation of this
10 device, which will include demand estimation. Second
11 would be profit estimation, profit function estimation.
12 And the third element of that first step will be the
13 reaction function.

14 What is a reaction function? So one of the
15 players is looking at the market in which he or she --
16 they operate, and to see how many players they are
17 playing against. What are the number of the stores?
18 What are the type? What are the perceived quality, and
19 so on and so forth.

20 And based on what they observe and the
21 knowledge that there are potential entrants and so on and
22 so forth, they make a decision what to do next. Should I
23 close stores? Should I open stores? Should I exit
24 altogether? Should I do nothing? So they basically form
25 a reaction function. Tell me what I'm facing. I'll tell

1 you what is the choice that I am going to make. That's
2 that first step of this operation.

3 Having that first step, we are able to
4 basically simulate forward what will the market be next
5 step. So we start from some starting point. We have
6 that many players, that quality, that quantities. So we
7 know what each player is going to do. We make them do
8 that, the optimal thing that they chose to do. And then
9 we can move to the second step, knowing again, each one,
10 how many stores they will have if they exit, if they
11 enter, and so on and so forth. And we can continue that
12 forward.

13 Now, let's say -- so the missing parts of what
14 I described is what are the costs that they are paying in
15 order to do what they are deciding to do? What is the
16 cost of opening a store? What is the amount of money
17 that you potentially get by selling off one of the stores
18 that you are closing? What is the cost of entering the
19 market? What is the payback for shutting down the
20 operation and exiting?

21 Those costs we need to somehow get from the
22 second step of that operation. And that step relies on
23 this equation No. 1. That equation says the following:
24 They are playing the optimal thing. So if all my
25 competitors are going to play their current strategies --

1 they will react the way I estimated they are going to
2 react -- and I'm the only one who's going to deviate from
3 that optimal strategy, I have to extract less profit in
4 the future because I'm doing something which is sub-
5 optimal, at least weakly.

6 So what I'm going to do in the -- what we are
7 going to do in the second step is to make use of that
8 equation and see what are the cost parameters that
9 rationalize this equation that must be right. And after
10 doing that, we are able to estimate the cost parameters.

11 Now, after those two steps, basically I have
12 the complete description of the game played and the
13 payoffs, payoffs and costs or net payoffs for the
14 players. Now I can go to the third step, which will be
15 simulate some counterfactuals: What would happen if I
16 don't allow supercenters at all, there will be only
17 supermarkets playing? What will happen if I take those
18 costs that I estimated and I increase them for these type
19 of players and make the game more even between the
20 players?

21 And another thing can be also, what will happen
22 if instead of having four players in the market, I will
23 have just three? I will take one or two players and
24 merge them together, and there will be three players, one
25 of them bigger or the sum of the two previous ones. So

1 that's another thing that we can do.

2 So that operation that I just described is from
3 a recent paper just published by Bajari, Benkard, and
4 Levin, often referred to as BBL, the initials of those
5 authors. And the first step and the second step, I just
6 described with words.

7 So here are some statistics about the data. I
8 won't talk a lot about them. We have data on
9 supercenters and supermarkets in several markets. And
10 those vary a lot. I mean, the supercenters are bigger.
11 And again, I'm not going to repeat.

12 The other thing that you should look at is the
13 basket, the price of the basket. And you can see that,
14 roughly speaking, the supercenters are cheaper by about
15 15 percent. So they are farther but cheaper.

16 So question two describes the demand estimation
17 that we conduct. One of the variables here, $\sin J$, but
18 that's the perceived qualities that we estimate from that
19 equation. And those estimates, again without getting
20 into too much details, make a lot of sense. You see that
21 price affects negatively demand, and other things that
22 should affect quality will do so.

23 The second part of that first step is to
24 estimate their policy function, their exit decision,
25 their entry decision, their investment decision, both of

1 the new entrants and those of the incumbents. Again, I'm
2 not going to talk about those numbers, but they're all
3 the right sign and make a lot of sense.

4 That's not -- I mean, that's something that we
5 should just be happy about because then when you
6 simulate -- okay, that's the same thing for supercenters.
7 When we estimate or when we simulate that model, that
8 second step, that we run a lot of counterfactuals, what
9 would -- that firm will deviate from its optimal
10 strategy. What will that firm deviate from its optimal
11 strategy, and by that, getting enough information to pin
12 down what are the cost parameters.

13 That operation will make sense because we are
14 estimating -- we are using those estimates from the first
15 step in order to do so, and they make sense themselves.

16 So I talked about, I think -- so let me just
17 show, rough out how those forward simulations look like
18 in practice. So you see in the first panel of this graph
19 a lot of snakes. Each snake, each color, represent a
20 firm. On the left axis, the Y axis, is their density,
21 number of stores, number of stores per capita. So there
22 are small firms, big firms.

23 What we see at point zero, it's the starting
24 point of that simulation. And then we know each player,
25 what that player is going to play, and we can proceed to

1 the period number one, two, three, four. And here there
2 are 100 periods being played.

3 The one firm that we call it firm 1, that
4 there's a blue line with circles on it, is the firm that
5 we are going to follow. So that firm at this graph is
6 doing what it's supposed to do. It doesn't deviate from
7 the optimal strategy. So that's what it would look like
8 in this specific simulation. That firm survived all
9 hundred periods and was doing pretty well. That's just
10 one scenario.

11 Here is one that we go and make that firm do
12 something which is not optimal. For this specific
13 situation, it happened that that firm was selling off a
14 lot of stores, and then eventually, around period 15, was
15 exiting altogether.

16 Now, if we had the right cost parameters, then
17 if we take present value of their profits in this graph
18 versus what they would get in that graph, that should
19 have given them higher profits.

20 So the cost parameter that would rationalize
21 that, that's what we are after in this step. And we get
22 that by doing a lot of those trials. What if we start
23 from this starting point, and we take that firm, make
24 that firm change by that much, it's optimal, and then get
25 less, and so on and so forth. And we get enough

1 restrictions on the parameters such that we get the cost
2 parameters hopefully right.

3 So we get from those estimates the marginal
4 cause of positive investment. And we have also squared
5 the marginal cost of negative investment, and the square
6 of that, both for supermarkets and supercenters.
7 Obviously, they are different. And they're also what you
8 get if you exit. So if you sell off your operation, you
9 get some money out of that, and those estimates reflect
10 that.

11 So what we can do -- so let me just go back to
12 those pictures and try to describe what we can do with
13 that technique. As I said, one thing you can do is after
14 you have the cost parameters and you know everything they
15 should know about the games or their optimal strategies,
16 the payoff functions of that game, you can then estimate
17 what will be the impact of all sort of policies.

18 So let's take out one type of player, not allow
19 supercenters to open stores in a certain market. How
20 will that market look like in a hundred years or a
21 hundred periods of time, or less, whatever your horizon.
22 And that can be looked at from several angles. What
23 would be the type of competition? How many stores will
24 be in that market? What will be (heart) prices then and
25 customer surplus, total welfare, and so on and so forth.

1 That's one scenario that you can think about simulating.

2 Another scenario that you can think about
3 simulating is taking those parameters, and if the cost of
4 operating is precise, at least, lower for supercenters,
5 let's increase that and make it even. And now the
6 competition will change again, could, and we can use what
7 we estimated or bigger than our estimators to simulate
8 what will be again the market composition in several
9 periods ahead, what will be the consumer surplus prices,
10 and so on and so forth.

11 And as I mentioned before, you can think about
12 an exercise which will be -- let's say this is an actual
13 market, and this is the starting point for, let's say,
14 Durham, North Carolina. And let's say we allow two firms
15 that now exist in -- well, we take the green line and the
16 purple line and you make one firm out of it.

17 And we change the starting point to a starting
18 point where we have one firm less. And one of those
19 firms is just a sum of the currently existing firms. And
20 let's simulate the market forward and see what happens
21 again -- prices, competition, consumer surplus, and so on
22 and so forth.

23 So let me conclude by saying that we provide a
24 simple model of dynamic competition among supermarkets.
25 And we take into account several key and important

1 features of that market. And that operation, that
2 two-step or three-step operation that I was describing,
3 is going to give you a meaningful answer only if you
4 really take into account the important features of the
5 market that you are looking at.

6 And we think that we are doing that. And then,
7 again, the next step will be to look at several
8 counterfactuals of the kind that I have described.

9 MR. ADAMS: Great. Thanks, Arie.

10 (Applause.)

11 MR. ADAMS: To discuss, we have Adam Copeland
12 from the Bureau of Economic Analysis.

13 MR. COPELAND: Thank you for inviting me here.
14 It's been very interesting. Let me just say these are my
15 own view, and not the views of the BEA or the director of
16 the BEA.

17 So let me start with a quick summary. So the
18 main question they're trying to get at, within the retail
19 grocery sector, what would be the impact of banning
20 supercenters on consumer welfare? And we can also get
21 out things like market structure and profits.

22 So we've all read about this in the news, about
23 certain -- I think it's mainly smaller towns that are
24 thinking about trying to ban supercenters because they're
25 worried about the impact on Main Street. And so their

1 methodology, which he portrayed quite well, is BBL, which
2 is the Bajari, Benkard, and Levin approach, which is one
3 of these latest industrial organization techniques that's
4 actually perfectly suited for answering these kind of
5 questions.

6 You have these complicated dynamic problems
7 that, five years ago, we wouldn't have been able to
8 answer. But given these latest computational techniques,
9 we can now solve these models and figure out exactly how
10 this industry will evolve, who will exit, who will enter,
11 and things like that.

12 And the results are, well, it's still coming
13 along. We have these initial parameter estimates. They
14 seem reasonable. So do the counterfactuals. But it
15 looks like it's going in the right direction. They are
16 just going to have to finish it up.

17 So I guess these comments here I have are just
18 pretty general comments, and they're basically going to
19 be about how, when they flesh out this paper and put in
20 all the details, what things I think they should talk
21 about because right now in the paper they just really
22 talk about the technique and the data. So this is more
23 just filling stuff in.

24 So the first thing is that we saw in the
25 previous paper by Tom Holmes that a lot of the entry

1 decisions for Wal-Mart seem to be spatially related work.
2 If a Wal-Mart is in a nearby city, it's more likely to
3 open up in this city.

4 And this current paper, the way it works is you
5 just look at each city by itself. So there's no spatial
6 dimensions where a Wal-Mart in Baltimore is going to
7 affect a Wal-Mart opening in D.C. So they should talk
8 about this. It would actually be really innovative if
9 you put it into the model, but I think that action might
10 be quite hard.

11 Now, two and three are just more about taking
12 the model to this particular industry and making sure
13 that you sell the paper and this is really capturing
14 what's going on. And one thing that was in my mind was
15 about the fact that supercenters sell more than just
16 groceries. So it turns out -- I've been told that they
17 actually sell a lot of groceries. But I kept wondering
18 about are decisions to open or invest in supercenters
19 really dictated by grocery sales?

20 So I know -- and in the paper, they do have two
21 different formats. So the entry decisions for
22 supercenters are different than the entry decisions for
23 supermarkets. But I still think at least more
24 explanation needs to be needed about, well, supercenters
25 also sell a bunch of non-grocery-store items, and how are

1 we accounting for that, or how does it affect our
2 estimates? I think you're going to do fine. You just
3 need to explain it a little bit more.

4 Then the third question gets at -- the third
5 point gets at the main question of the paper: What
6 happens when you ban a supercenter? And what I think
7 needs to be talked about more is jurisdictions justify
8 these bans based on the fact that these supercenters are
9 going to wipe out a bunch of stores, grocery stores but
10 also hardware stores and bike stores and stuff like that.

11 So you want to go back and say, look. We're
12 going to estimate what happens to consumer demand when a
13 supercenter gets banned. It obviously is going to affect
14 a lot more than a grocery store. So you just need to
15 talk about how your model is going to talk about an
16 overall effect, or maybe you just need to say, look,
17 we're just looking at groceries. But there needs to be
18 some sort of context here about what exactly a model does
19 talk about and what it can say and what maybe it's
20 missing.

21 Now, I had another page of comments that were
22 more detailed things about the demand estimation, but
23 actually, I want to talk about something else given what
24 I've heard today.

25 And what I really want to emphasize is the

1 potential of this technique that they're using here. And
2 I want to say this is such an interesting paper because
3 it's part of a small and growing literature that's trying
4 to solve or trying to model how industries evolve. And
5 this is a very difficult thing to do. And it takes a lot
6 of time and a lot of effort.

7 And I think it's going to be particularly
8 interesting for people like the FTC or people who work in
9 courtrooms for the FTC because it can answer a lot of
10 questions that were brought up this morning. I mean,
11 people got up here in the morning and talked about how
12 this is a dynamic industry, and how the current analysis
13 really misses that. They've talked about how exit can be
14 beneficial because the really crappy grocery stores are
15 closing down.

16 There's a really interesting story about
17 Kroger, how in anticipation of Wal-Mart entering, they
18 cut prices and they invested in their stores. And then
19 the kind of model for that in here can answer those
20 questions and can rationalize them.

21 So I think there's a lot of potential for these
22 kind of models to help people at the FTC and help people
23 at law firms who advise the FTC to think about what's
24 going to happen with mergers. And so I think it's really
25 encouraging.

1 In the academic literature, this tool is fast
2 becoming or already has become a standard tool for
3 analyzing these kind of things. And I think it's really
4 encouraging to the FTC -- it's really encouraging to me
5 that the FTC is already thinking about learning about
6 these techniques and investing in them.

7 So those are my comments, and thank you very
8 much.

9 MR. ADAMS: Great. Thanks.

10 (Applause.)

11 MR. ADAMS: We're going to move straight on to
12 the next session, if we can find Michael. Yes. He stood
13 up. And we're going to have Dennis Carlton, Joe Simons,
14 and Tim Brennan coming up.

15 MR. SALINGER: Well, I'll just pick up where
16 Adam left off. We've got a really simple problem at the
17 FTC when grocery store mergers are proposed. We just
18 have to figure out whether prices are going to go up.
19 And if they are, then we need to try to block it or seek
20 some modification; and if they're not, we should let the
21 deal go through.

22 And the question is: How should we do that?
23 Jim Fishkin did a really nice job of describing how
24 traditionally the Commission has done that. But it's
25 subject to criticism, and it's subject to the criticism

1 that Debbie and Chris talked about. They said that this
2 is a dynamic industry, and that -- and as was documented
3 by Paul in his historical overview of the industry that
4 we started with.

5 And so the question is whether the guidelines
6 approach that we've traditionally used captures the
7 dynamics of the industry, or whether, as Chris said, it's
8 a Procrustean bed. So we have a really distinguished
9 panel to answer that, or to -- well, to comment on that
10 question.

11 So we'll begin on my right with Dennis Carlton.
12 Dennis Carlton is one of the great industrial economists
13 of our age. He is currently the Deputy Assistant
14 Attorney General at the Justice Department. He's a
15 professor -- he's on leave from the University of
16 Chicago, where he's been a professor for many years.

17 He is the author of the leading textbook in
18 industrial economics. And he was recently on the
19 Antitrust Modernization Commission. And, I don't know,
20 what else? What other great things should I say? I'll
21 just leave it at that.

22 MR. CARLTON: Thank you. It's a pleasure to be
23 here. And I also compliment the FTC for organizing a
24 conference that I think really focuses attention, as Bill
25 Kovacic was saying at lunch, on research methods and

1 trying to figure out if the research methods we currently
2 use to analyze antitrust questions at the agencies can be
3 improved, and also that it's very good every once in a
4 while to take a time out and look back and say, is what
5 we're doing correct?

6 I think all of the papers today, which I wasn't
7 able to sit through all of them but I did read through
8 all that were available, were excellent. And I think
9 what they highlight is the development of new
10 sophisticated techniques that allow us not only just to
11 understand static pricing games, but much more
12 complicated games over time.

13 Now, on the one hand, that's a tremendous
14 benefit because we are studying now how industries
15 evolve. On the other hand, I think you have to keep
16 paramount in your mind whether the questions that are
17 being answered, which are based on structural modeling
18 which give you deep insight into the industry, are the
19 types of models that can answer the type of questions
20 that are posed to an antitrust agency that often, as
21 Michael said, is asked the question: Within a two-year
22 period, are prices going to go up? So let me just try
23 and explain that a little bit.

24 The issues that were outlined by the speakers
25 that I think distinguish what's going on in the grocery

1 industry from what I'll also characterize as other
2 industries, but especially the grocery store industry,
3 are the following.

4 One, we have stores selling overlapping product
5 lines. A huge variety of products in a superstore; they
6 overlap in part with other types of retail
7 establishments. We know that these superstores have or
8 achieve economies of scope by having these multiple
9 products under one roof.

10 We saw on the cost side that they -- and that's
11 on the demand side, the economies of scope. We saw on
12 the cost side that there are economies of density. And
13 although it wasn't talked about explicitly, sort of
14 implicitly, we know there are these changing technologies
15 as logistics are improving and as information
16 technologies are getting better and better. So that's
17 the characteristics.

18 The decision variables we have we think are
19 pricing. Well, we heard something about the difference
20 between everyday low pricing and having sales.
21 Oftentimes, we ignore that, or that sometimes can be
22 ignored, and that can lead to improper estimation of
23 demand elasticities, especially in a dynamic context
24 where inventories can be stored. And I've often thought
25 that problem hasn't received enough attention.

1 It also means, by the way, that when you're
2 thinking about competition between two stores, if most of
3 the time the price is high but there's a white sale ever
4 year in August or whenever it is and most of the stuff is
5 sold in August, that's when you want to really be
6 modeling competition and looking at the effect of a
7 merger.

8 There wasn't all that much on product choice,
9 although implicitly. So in addition to pricing, there's
10 product choice. What do I want to have in my store?
11 What brands do I want to have in my store? What range of
12 products do I want in my store? What store brands do I
13 want in my store? And that's an important strategic
14 variable as well as how you want to promote and advertise
15 and get people into your store.

16 We heard a lot about dynamics. And what's
17 important and what was stressed in several of the papers
18 was entry. And what entry involves is a strategic
19 decision not only when to enter but where to enter and
20 how strategically your decision about both when and where
21 to enter will affect what your rivals do.

22 There wasn't too much talk given about what
23 game is being played. Usually in static games we always
24 assume it's sort of a Bertrand game because we're just
25 looking at prices. But I'll just make the following

1 point.

2 When we do merger simulations, we typically
3 solve a Bertrand game, although we don't have to and we
4 could do much better than just assuming they're playing
5 static Bertrand as an approximation. But let's stick
6 with Bertrand.

7 It could also be the case that in a static
8 game, we analyze the optimal choice of some other
9 variables, like the quality of the product, the range of
10 the products. And if you think about what some of these
11 dynamic models are doing, they've enlarged the strategy
12 space.

13 Now, it's true some of the choice variables are
14 in the future, so you've got index them with time. But
15 let's forget about the time dimension for a second. Just
16 imagine it's a quality variable or a range of product
17 variable. That's a decision variable.

18 Now, if you think about it, there are a lot of
19 complications when you do merger simulation. When you do
20 merger simulation, you have to estimate demand curves,
21 which can -- we kind of get that right as long as we are
22 using the right price to the consumer and as long as
23 we've properly modeled whether there is market power at
24 the level of the store. And if we haven't done that
25 right, we can even get our demand estimates screwed up.

1 But then we do merger simulation. I've not
2 really seen, although conceptually it's easy to figure
3 out how to do it, merger simulations, even static merger
4 simulations, in which you're not only choosing price, but
5 you're choosing these other quality variables. And that
6 just makes the model more complicated.

7 So if you have misgivings about merger
8 simulation, even though I think it's a very helpful
9 technique for having you figure out what the implications
10 of demand estimates are, if you start putting in these
11 other product characteristics and you start doing merger
12 simulation, I just want to point out that has not yet
13 become the standard type of merger simulation that people
14 do.

15 And why? Because it's complicated and we're
16 not sure how robust it is. Now, I think it's the right
17 research direction to go in. But the reason I raise this
18 is because that is a step short of doing the more
19 complicated dynamic models.

20 Now, once you start doing these more
21 complicated dynamic models, I think you should recognize
22 a few things. First, it's absolutely the right way to
23 understand the industry. Understanding how it's going to
24 evolve; understanding the size distribution of firms,
25 which is something industry organization economists

1 should spend more time on but don't.

2 And the fact, though, that it's evolving over
3 time means you have to ask yourself the question: How
4 long are these estimates good for, and how accurate are
5 they in the future? So let's just take something like
6 entry over time.

7 Well, as the entry -- as I was sitting, the
8 last speaker said, I can simulate this out a hundred
9 years. Well, that's certainly forward-looking, I agree.
10 And I think it's very desirable to get an idea of how an
11 industry is going to evolve.

12 For the questions that antitrust officials and
13 agencies are faced with, if you are basing things on
14 what's going to happen much beyond the two-year horizon,
15 you have to be pretty comfortable that you're making
16 decisions based on variables that you have some
17 confidence in.

18 Now, I've always thought the reason you focus
19 on two years -- we focus on, I guess; I'm a "we" now --
20 focus on two years in prices is because we feel more
21 comfortable doing that. And we're a little less
22 comfortable making these predictions of entry when entry
23 are going to occur periods down the road. Doesn't mean
24 that's the right thing to do, but I think we need more
25 experience to see how reliable these models are in

1 predicting entry decisions.

2 Now, to go back to the technology changing, I
3 think the fact technologies are changing means that these
4 strategies of entry and how industries are going to
5 evolve over time are important to nail down. But
6 whenever technologies are changing, whether it's in the
7 grocery store industry or any industry, you have a hard
8 problem.

9 While making a study of the toy industry, we
10 had this characteristic that when Wal-Mart entered an
11 area, if it was first store in the area after, say, Toys
12 "R" Us or it was the biggest competitor to Toys "R" Us,
13 if it was either a Wal-Mart or a target, it had some
14 effect on price -- not a huge effect, necessarily, but
15 some effect.

16 So the question is, how could you model that?
17 Well, one thing that I did, I noticed, is there were
18 parts of the country where the technology had been
19 implemented; if you think about it as technological
20 change, entry is an entry of a new technology.

21 You could look at parts of the country where
22 the technology had actually changed, and then you could
23 use that as a basis to predict what's going to happen in
24 those areas of the country that hadn't yet. That strikes
25 me as something I could get some comfort in doing.

1 When you have giant technological change but
2 you don't have observations yet of how one area is going
3 to behave relative to another because one has incurred
4 the change and one has not, I think you have a greater
5 uncertainty in your productions.

6 It's kind of like two firms merging, and the
7 argument is going to be, well, we're going to get a lot
8 more R&D. And my view is that's a very hard case when
9 it's about new technologies and the development of new
10 technologies, or even how new technologies play out in
11 inducing entry into the future.

12 So then I guess the bottom line where I come
13 out is that I think some of these techniques, focusing on
14 dynamics, focusing on location as entry, focusing on
15 density as a key variable, are all very important and
16 necessary to understand how the industry behaves. It's
17 what I would call doing structural modeling, which I
18 think is really key to be able to answer fundamental
19 questions that you couldn't answer using the standard
20 reduced form technique, in which you're just trying to
21 explain price on various variables, including number of
22 firms.

23 On the other hand, for an antitrust agency,
24 sometimes it's a combination of both techniques that I
25 think will best answer the question. Reduced forms, if

1 you can do them correctly, and that is that you really
2 are able to treat certain types of entry as exogenous, at
3 least over certain periods of time, or there are some
4 natural experiments in which the number of firms do
5 change so that you can really see what happens to price,
6 those strike me still as very valuable experiments that
7 give you information, especially in the short run, which
8 may be the productive horizon over which we have the
9 greatest confidence.

10 So I think these are important new techniques
11 we've heard about. I'm sure we'll use them. I hope we
12 use them in conjunction with the other techniques that we
13 commonly use. Thank you.

14 MR. SALINGER: Thanks.

15 Our next speaker is Joe Simons. He's the co-
16 chair of the antitrust group at Paul Weiss. Previously
17 he was the director of the Bureau of Competition here at
18 the FTC. And he's well-known for his contribution to our
19 understanding of critical loss.

20 Did you coin the term?

21 MR. SIMONS: Yes.

22 MR. SALINGER: And he coined the term "critical
23 loss."

24 MR. SIMONS: Yes. I wrote the article with
25 Barry Harris. I had to drag Barry into writing the

1 article. It was kind of a funny thing. I think a lot of
2 people didn't really understand what it was for quite a
3 while afterwards, even. So it's really interesting to
4 see what's happened to it over the years.

5 Thanks, Mike, and I'll just echo Dennis and say
6 I think this is extremely important to engage in this
7 kind of exercise. And of course, when you follow Dennis
8 Carlton, it's impossible to follow. So usually what you
9 can just say is, I agree with Dennis.

10 MR. CARLTON: I've never heard you say that.

11 MR. SIMONS: Which I pretty much do.

12 (Laughter.)

13 MR. SIMONS: Anyway, so just sitting in this
14 conference today, I can just see this thing progressing
15 on two different levels. So on one level, you have kind
16 of the more theoretic and also, then, quantitative
17 economic approach that was characterized the last two
18 panels.

19 And then you have kind of the in-the-trenches
20 approaches, as Michael referred to it this morning, which
21 involved some folks who have spent a lot of time dealing
22 with real transactions at the FTC. So that's Jim
23 Fishkin, Debbie Feinstein, and Chris MacAvoy.

24 And so I thought maybe it would be useful if I
25 commented on that to start with. If you sat here and you

1 listened to the three of them, Jim on one side, who was
2 basically the one prosecuting or investigating those
3 transactions, and Debbie and Chris on the other,
4 representing the companies, the merging parties, you'd
5 think they're at completely different ends of the
6 spectrum. My feeling about what they said is I tend to
7 agree with both of them. How could that be?

8 Debbie and Chris said that the FTC relied too
9 much on structure for their tastes. And if you went back
10 and you looked at the data that was released a few years
11 ago, you'll see that the data shows that the FTC engaged
12 in enforcement actions at lower levels of concentration
13 in the grocery area, and the oil industry, too, than it
14 did with respect to other areas of the economy.

15 And I think they would view that as
16 confirmation that their intuition from their own dealings
17 with the Commission is correct. And it may very well be
18 correct.

19 And they also talked about market definition
20 and the Commission tending to focus really for a long
21 time on what they viewed as more of a narrow market
22 definition, just the big box supermarkets and tending to
23 exclude club stores, convenience stores, and mass
24 merchants.

25 Now, Jim stood up and said that he looked at

1 all this stuff, that the other people at the Commission
2 looked at it carefully, and that the Commissioners looked
3 at it carefully every time a transaction came up. And
4 there were lots of transactions.

5 And having been here myself at two different
6 points in time in the late '80s and then again a few
7 years ago, I agree with Jim. Every time one of the
8 supermarket transactions came up when I was here, it was
9 looked at extremely closely. There were arguments
10 internally about what the market definition should be.
11 And there were arguments internally about what was the
12 implication of the concentration level of any particular
13 transaction.

14 I think what happened, though, inside the
15 Commission with respect to supermarket transactions is
16 that it lagged behind in terms of the analysis that you
17 tend to see with respect to other parts of the economy.
18 You see more quantitative analysis, more simulations, and
19 my own thing that's near and dear to my heart, you see
20 more use of critical loss.

21 And you really don't see that, at least in my
22 experience, or haven't seen that -- I haven't seen one of
23 these transactions in a few years -- but you really don't
24 see that in the context of a supermarket transaction.

25 So you get into these situations where you have

1 two people who are arguing on either side of the Credit
2 Suisse. One of them says, you know, you look at Kroger
3 and you look at -- I don't know who the other one was;
4 Safeway? No, it wasn't Safeway -- Winn Dixie, and you
5 say, these guys are very close in product space. Yes,
6 they're both mainstream, but they're kind of at the lower
7 end of mainstream. And a merger of those two entities
8 we're worried about.

9 So that's kind of a theory. It gets at the
10 unilateral issue. But you look at documents really
11 carefully. Who do they price check? How often do they
12 price check? Yes, maybe they look at club stores a
13 little bit, but not too much.

14 So the staff is doing a lot of work. They're
15 looking at a lot of documentation. They're talking to a
16 lot of people in the industry. But what they're doing
17 is, in kind of a loose way, they're doing an analysis.

18 It's not very -- I don't really want to say
19 it's not very rigorous; it's rigorous in a sense, but
20 it's not rigorous in another sense, as opposed to a
21 situation where you're either doing a merger simulation
22 or you're doing a critical loss analysis where whatever
23 you think of either of those types of techniques, you
24 actually have to specify assumptions. Right?

25 You have to say, here's what I'm assuming.

1 Here's the facts I'm relying on. Given that, here's what
2 the outcome is. The critical loss is exceeded. It's
3 not -- the merger simulation shows a price increase, or
4 it doesn't. In either case, you have assumptions that
5 are clearly spelled out.

6 When you do what the staff was doing
7 previously, you've got two people talking to each other,
8 debating with each other. But the assumptions are never
9 spelled out. They never talk about exactly, well, gee,
10 yes, they're close. They have the same similar formats.
11 They have a core of customers. But how big is the core?
12 How much of the margin would switch? They never get into
13 a discussion of that type of a thing.

14 And so what ends up happening is it's not very
15 satisfying, particularly for the people on the outside
16 whose transaction is going to get challenged. And so
17 what they draw from that experience is, I think, that
18 structure is really important, and particularly because,
19 over time, the experience is different with respect to
20 other industries.

21 So I think one thing that would be really a
22 very good development here is that the grocery industry
23 gets the same type of analysis applied to it that the
24 Commission and the DOJ routinely apply to other
25 industries.

1 And then I'd, these techniques that were
2 discussed today, I've never seen them before. But they
3 look very promising, too. And given what's going on in
4 terms of the dynamic changes in this business, something
5 like that would be really terrific if that could be
6 developed as well.

7 And then the other thing I just wanted to say
8 was that in terms of -- particularly in an industry where
9 there's a lot of change, and where what you can see --
10 Wal-Mart really exposes these efficiencies that come from
11 density and distribution. It's almost like an airline
12 hub. You add another route to an existing hub, it's much
13 cheaper, that type of thing, and how that occurs over
14 time.

15 One suggestion that I would have for look at
16 that would be to think about the efficiencies and also
17 the potential anticompetitive effects in a risk-adjusted
18 way, and then present-valued, in the sense that what are
19 the chances that the efficiencies are going to be
20 realized, over what period of time? How much are they
21 likely to affect the price or not? Another question is,
22 do we care or not whether they affect the price or not?

23 And then what are the chances that there's
24 really going to be a price effect, and over what period
25 of time? This industry strikes me as one in particular

1 where, yes, you may not get entry in a year or two, but
2 in many parts of this country, you're going to get entry
3 at some point.

4 And so if the price goes up for some period of
5 time, the question is: How long is it likely to exist?
6 And weigh that against the efficiencies that the
7 transaction achieves and what the likelihood is that they
8 will be achieved.

9 MR. SALINGER: Great. Thanks.

10 Our final speaker is Tim Brennan. He's a
11 professor at the University of Maryland, Baltimore
12 County. He recently finished a stint as the T.D.
13 MacDonald Chair in Industrial Economics at the
14 Competition Bureau in Canada. He has had a wide variety
15 of government jobs, and has long been a thoughtful
16 observer on antitrust issues. So Tim.

17 MR. BRENNAN: Thanks a lot, Mike. Thanks to
18 Mike and Chris for inviting me here. It's a real honor
19 to be here.

20 Because everything I know about the economics
21 of the grocery sector I've learned since 9:15 this
22 morning, and since I'm the only thing standing between
23 now and everybody going out, having a few beers, and
24 making up your own John Holmes and Wal-Mart jokes, I will
25 try to be brief.

1 Coming back to 30,000 feet, I suppose, to some
2 extent and coming to the question about can antitrust be
3 forward-looking, I want to talk about that, in general,
4 very briefly, and then apply some things, some
5 considerations for that, to the grocery sector.

6 First, of the three areas of antitrust, mergers
7 is the one that should be the most forward-looking. It's
8 designed to be that way. You've got pre-merger
9 notification. You're looking at the prospect of price
10 increases, asking counterfactuals and market definitions
11 and so on.

12 And also it's probably the grocery sector which
13 is most responsible for the main empirical innovations
14 and merger evaluation, namely, everything you can do with
15 scanner data and actually getting people to consider the
16 idea of dropping market definition altogether and going
17 straight to a competitive effects analysis.

18 So this ought to be the most promising sector.
19 But as people have pointed out, there are a number of
20 problems. Let me go through them.

21 First, something that I don't think has come up
22 today is that to some extent, this is a legal question,
23 not an economic question. Plaintiffs bear burdens of
24 proof. And if the situation is changing very rapidly,
25 that can be a problem.

1 And just to give a non-grocery example, shortly
2 after the Telecommunications Act was passed, the Justice
3 Department had to consider what to do about the Bell
4 Atlantic Nynex acquisition. And at the time, there was a
5 concern that because these adjacent major telephone
6 companies, they might be competing with each other.

7 Now, how that was all going to play out, nobody
8 knew. But the point is at the time, nobody knew. But if
9 someone thought that it was a problem, what were they
10 going to do? There was no information, no track record.
11 There's just a difficulty.

12 So when you have these dynamic considerations,
13 one thing to ask is: What's it going to take to convince
14 a judge to block something if you think that there's a
15 problem?

16 A second consideration is how well does the
17 process handle innovation? I'm a little pessimistic
18 about that partly, or maybe largely, because of the
19 Microsoft case, which I've looked at to some extent. One
20 of the things that troubled me about the case as it was
21 carried out, not so much whether the case itself was a
22 good idea in some larger sense, was when you called the
23 relevant market in Microsoft Intel-based PC operating
24 systems, when the target, Netscape, was never going to be
25 an Intel-based PC operating system, there's something

1 about that that says, we have to use markets that are
2 defined today. We can't use markets the way they would
3 be defined in the future. That apparently is a problem.

4 So if we're looking at something that today
5 we're calling supermarkets when really it is something
6 else in the future that is different from supermarkets,
7 maybe in some sense does this indicate that we're stuck?

8 A third thing is: What's the role of
9 innovation here? There's a general presumption, I think,
10 or an instinct that some how innovation makes mergers
11 more benign, that, well, okay, these guys are going to be
12 big, but something else is going to happen someplace.

13 But there's also a possibility that mergers can
14 make two people who were in separate markets now relevant
15 competitors in the future. To take the Microsoft example
16 again, I often wondered sort of hypothetically, suppose
17 Microsoft had never developed Internet Explorer and
18 decided to just buy Netscape in 1996 or something? If
19 you think the Microsoft case was a good idea, you presume
20 it would have wanted to block that merger. On what basis
21 would you have done so? They are not anywhere near
22 anybody in the same market.

23 And so here I wonder where suppose Wal-Mart had
24 bought Safeway in 1985 or something. Would that have
25 been a problem? What would somebody do? Wal-Mart is

1 saying, well, there's going to be these things called
2 superstores someday or supercenters someday. What are
3 people going to do about that?

4 Fourth on the list is something that Dave
5 Scheffman pointed out, is this notion of using snapshots
6 to talk about competitive effects. One has got to be
7 careful here about taking these static pictures, and a
8 lot of analysis we've seen today is a way to get around
9 this problem.

10 But looking at what people are doing as a
11 snapshot and saying, well, gee, these must compete with
12 this because people are going here and they're going here
13 and they're going there, a related -- a similar sort of
14 consideration has come up in telecommunications
15 deregulation.

16 When I was in Canada, that was a hot topic. It
17 still is a hot topic. And one of the arguments that came
18 up is, well, wireless is increasingly in the market for
19 local telephone service, competing with wirelines. How
20 do we know? Because the number of people who are
21 dropping their wireline service and going just wireless
22 is growing.

23 Well, there's an aphorism in the
24 telecommunications industry, apparently, is that wireless
25 is replacing wireline one funeral at a time. But just

1 because the market is shrinking because people like my
2 dad are never going to get a cell phone, and eventually
3 they're going to disappear, and students at UMBC are
4 never going to get a wireline phone, that doesn't mean
5 that in any given moment wireless constrains the price of
6 wireline.

7 And the same would be true here. Just because
8 people are doing lots of different things, the question
9 is, as Dennis has pointed out and Joe and others during
10 the course of the day, is what's the marginal effect if
11 you're worried about what might be the effect of a merger
12 for antitrust purposes.

13 A lot of what people talked about today is
14 efficiencies. Joe just mentioned this. I know Dennis is
15 extremely concerned about this. Is this going to play
16 out differently if you do a consumer welfare standard
17 versus a total welfare standard? Like Dennis, I'm a
18 total welfare person, somewhat instinctively. But in
19 terms of how that plays out in practice, how is that
20 going to work?

21 On the models that people have mentioned,
22 they're out there. They're very sophisticated. We've
23 learned a lot from them. My concern for antitrust cases
24 is what happens when they're competing? We've heard some
25 great ones here. What happens when someone else comes up

1 with a great one, and this one says, after a very long,
2 complicated story, the price goes up, and then the other
3 one says, after an extremely long, complicated story, the
4 price goes down? What's the poor judge going to do with
5 those?

6 So that's that. Just two final points. One is
7 that a lot of the considerations we've talked about today
8 apply outside the merger context, I think. In
9 particular, there are a lot of concerns involving this
10 sector that involve things like tying up shelf space so
11 people can't get in, these sorts of soda stories and
12 things like that.

13 And to me, a lot of that comes down to
14 essentially the same questions about market definition
15 and grocery sector as what we've been talking about with
16 mergers because if someone has these exclusive contracts
17 with supermarkets, grocery sellers, whatever their A, B,
18 and C, that's only harmful if D, E, and F type stores
19 aren't substitutes.

20 If they are, then it's not a problem. So the
21 kinds of things we've been talking about here today,
22 questions we've been raising are not restricted to the
23 merger context.

24 Finally, one takeaway from some of these papers
25 or some of the speeches today has been, I sort of wonder

1 whether despite all these complications, maybe a good
2 rule for this sector would be that if there's a Wal-Mart
3 within 25 miles, there's no problem.

4 I'm a big advocate of simple rules. Maybe
5 that's not such a bad idea. If that were the rule, that
6 might take a pretty big chunk out of the incomes of some
7 of the people in this room. And I'll leave it to you to
8 decide whether that enhances social welfare or not.
9 Thank you.

10 (Applause.)

11 MR. SALINGER: Well, to bring the day to a
12 close, I'd like to give you a choice of two questions to
13 answer, and ask each of our panelists to answer at least
14 one of the two, which is: If there's one lesson that the
15 FTC can learn that would help us do the merger review
16 better, what would be the one piece of advice, the one
17 takeaway, we could take from today?

18 Or alternatively, what research question -- if
19 you could give advice to a researcher as to a research
20 question to answer that will help us do things better in
21 the future, what would you do?

22 I should say that was a completely unfair thing
23 to do to these panelists because I gave them no warning I
24 was going to do that. Any takers? You can decline if
25 you say it's unfair.

1 MR. CARLTON: What I should have said when I
2 started my comments was start with a disclaimer that
3 these are my views and not those of the Department of
4 Justice. And God only knows how I'll answer this
5 question.

6 Well, I would say two things. One is I think
7 our reliance on market definition can be helpful in many
8 cases to making sure you don't do things that are
9 illogical. But especially when an industry is changing
10 and when you have this overlap, I think looking at direct
11 competitive effects is quite important. At least, I
12 would try and put more reliance on that.

13 As far as research questions, I think the right
14 question is asking whether the concentration that occurs
15 when some of these technology change wind up lowering
16 prices. I think there's pretty convincing evidence now
17 that when Wal-Mart goes in an area, prices can often fall
18 significantly. And I think that tells you a lot.

19 What I noticed from my work in the toy industry
20 was that when there was one big competitor against, say,
21 Toys "R" Us, prices went down -- not all that much,
22 surprisingly, but they went down a little bit. But then
23 when you had other big competitors, big box competitors
24 come in, it ceased going down.

25 So that I think the important research question

1 is really to try and focus on what the antitrust
2 authorities need to answer, that is: What's the price
3 effect in the short run? I think on the entry score,
4 which some of these dynamic models properly address, one
5 of the things that comes out of these models is the
6 duration until the time of next entry.

7 And that's something I would pay attention to.
8 And that's kind of a -- it's implicit in some of the
9 models, but actually you can do some interesting analysis
10 on durations, likelihood of entry, and things like that.
11 And it would be very interesting to see how that squares
12 with our usual notions in the merger guidelines of when
13 someone is going to come in.

14 And if someone is going to come in, obviously
15 within two years it's within the guidelines. But suppose
16 someone in these dynamic models is going to come in in
17 year three. If you look at how these models work, that
18 can have a large influence on behavior in year two. And
19 maybe we should be paying some attention to that also.

20 MR. SALINGER: Joe?

21 MR. SIMONS: I'll stick with the lessons. So a
22 few lessons. One is that I think it's pretty clear from
23 what was going on today, a decision to challenge a
24 supermarket merger of any kind of size is not a no-risk
25 proposition. Given what's going with Wal-Mart and the

1 other players who are getting big for largely the same
2 reasons, these things have significant efficiencies. And
3 you want to be careful not to get in the way if you don't
4 have to.

5 Also, one of the points raised today was -- and
6 this has kind of been borne out by the FTC's experience
7 dealing with divestitures of supermarkets -- these assets
8 deteriorate very quickly. When consumers know that the
9 stores are for sale, the half-life shrinks dramatically
10 for these stores. And so getting through the process
11 quickly is really, really important in this business.

12 The second lesson would be focus on the margin.
13 Yes, they may be close in product space, but the
14 important thing is focus on the margin. How big is the
15 margin? What's going to happen?

16 And then I agree again with Dennis in terms of
17 let's really pay attention to the competitive effects.
18 And conceivably, given the data that's available in this
19 business, you might not really need to do too much of a
20 rigorous market definition. Rather, you could focus more
21 on the competitive effects.

22 MR. SALINGER: Tim?

23 MR. BRENNAN: Sure. The only thing I really
24 could say -- because again, I'm not an expert in the
25 grocery sector -- would be to come back to the first

1 thing I mentioned, which is: How do we prime the
2 judicial system that has to resolve these things to deal
3 with the fact that we may have to make decisions under
4 great uncertainty, if in fact this is that innovative an
5 industry?

6 What should the burdens of proof look like?
7 Should we begin to look at questions along those lines?
8 I don't know enough about the grocery sector to know
9 whether it's more innovative than telecommunications or a
10 whole lot of other things out there, where people have to
11 worry about these sorts of questions as well.

12 But the thing that has troubled me, as you
13 could tell from my comments, in a lot of other sectors
14 and troubles me from what we've heard today is: How are
15 we going to get a handle on this?

16 And given the enormous complexity of the
17 empirical work in these things, and I think the
18 inevitable speculation that's going to take place if this
19 is that innovative an industry, I think leads us to a
20 situation where either we're not going to be able to do
21 very much except in situations where there really isn't
22 that much innovation going on and we can make pretty
23 confident predictions; or we're going to have to get
24 people to accept the fact that we're taking risks.

25 MR. SALINGER: Great. Well, I'd like to close

1 by reiterating the thanks that I've mentioned this
2 morning. So thank you again to the Chairman's office,
3 and also to Commissioner Kovacic, for their tremendous
4 support for the importance of running a day like today.
5 But especially to Chris Adams, who did a tremendous
6 amount of work to pull this off. So thank you all for
7 coming.

8 (Whereupon, at 4:40 p.m., the conference was
9 concluded.)

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