# Market Inquiry into classified directory advertising services

## Working paper on Competition

This paper was prepared before the Competition Commission's provisional findings and reflects the Commission's thinking at the time it was prepared. The Commission's latest thinking will be reflected in its provisional findings to be published shortly.

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## Introduction

1. Classified directory[1] providers operate in a two-sided market in which they compete both for advertisers and users. This paper examines the nature and intensity of both these aspects of competition. We consider that the provision of classified directory advertising services (CDAS) in printed directories with a set of characteristics that includes strong brand image, high levels of usage and comprehensive business listings forms a relevant economic product market. Yell, Thomson and BT publish such directories. Certain other directories, notably that of Kingston in Kingston-upon-Hull and those of Trinity Mirror in parts of Scotland are comparable to the directories published by Yell, Thomson and BT.

2. The characteristics of the directories discussed in this paper are outlined in Table 1 and discussed further in paragraphs 167 to 171.

[1]In line with our terms of reference, we use the term ‘classified directories’ to refer to printed classified directories.

TABLE 1 **Directory characteristics**

| *Directory* | *Yellow Pages* | *Thomson Local* | *The Phone Book* | *The One* | *Hull Colour Pages* |
|---|---|---|---|---|---|
| Directory provider | Yell Group Plc | Thomson (owned by SEAT) | BT Directories, part of BT Group | Trinity Mirror | Kingston Communications |
| Number of directories | 102 | 173 | 171 | 4* | 1 |
| Geographic UK coverage (%) | 100 | 50† | Substantially 100 | n/a | n/a |
| Population UK coverage (%) | 100 | 90‡ | 100 | n/a | n/a |
| Business AZ | No | Yes, with advertising | Yes, with advertising | Yes, without advertising | n/a |
| Residential AZ section | No | No | Yes§ | No | No |
| Size of directory | A4 | 'Renaissance'¶ | A4 | 'Renaissance' | A4 |
| Local information | Yes | Yes# | Yes | Yes | Yes |
| Maps | Yes | Yes | No | No | No |
| Number of classifications | 2,344 | 1,851 | 1,503 | Up to 900 | 1,024 |

*Source*: Directory providers.

*Trinity Mirror has published, or plans to publish, directories covering five different areas between 2004 and 2006. In 2004 it published two directories; in 2005, four, and in 2006, four.
† Approximate figure, provided by Thomson.
‡ Approximate figure provided by Thomson. Thomson covers all the main areas of UK population except Northern Ireland, Hull and parts of North East England and Scotland.
§ The BT residential AZ section contains some advertising.
¶ This is a non industry-standard term used by Thomson. (Renaissance = 270 x 178 mm, A4 = 297 x 210 mm).
#'Localplus'.

## Competition for advertisers

3. This section analyses the ways in which classified directory providers compete for advertisers by improving the value[2] of their products relative to one another. It also examines the strength of competition and the level of switching between directory providers in recent years.

### *Pricing: policies and trends*

4. We have examined the pricing policies of the classified directory providers included within our market definition; this has included a study of rate card determination and

[2]In this paper, we use the term 'value' to refer to an advertiser's valuation of an advertisement, net of price. Increasing the value of an advertisement may be achieved by improving certain aspects of the advertisement (for example, the number of business leads it generates) or by decreasing the price of the advertisement.

discounting policies. We have also studied realized prices[3] and the revenues of directory providers over time and the relative movements in prices and revenues over time in order to analyse how pricing and price competition operate in this market.

*Pricing policies*

5. The prices of classified directory providers' advertisements are determined by a combination of a rate card rate and discounts from that rate card rate.[4] The factors influencing rate card rates and discount policies vary according to the provider.

6. Following a Monopolies and Mergers Commission inquiry in 1996,[5] BT (which then owned the *Yellow Pages* business) gave undertakings under section 88 of the Fair Trading Act 1973. These undertakings were reviewed by the OFT and tightened in 2001. Following this review, BT sold the whole of the *Yellow Pages* business to a consortium of investment funds called Castaim Limited which subsequently became Yell Ltd. Castaim agreed to comply with the undertakings that BT had given to the Secretary of State. We refer to these as the 'Yell undertakings'.

7. The Yell undertakings relate to a number of areas including the prices to be charged to advertisers—on the basis of a like-for-like comparison, starting from the base level of prices in effect as at 1 December 2001, Yell's rate card prices for advertisements in classified directories have been required to decline, relative to the RPI, by at least 6 per cent each year.[6] The undertakings contain a "good faith" provision whereby Yell must "have regard…to the objective" of the pricing obligations, namely to ensure that on the basis of a like-for-like comparison, prices paid for advertisements in its classified directories decline by at least 6 per cent in each year relative to the RPI.

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[3] Throughout we use 'rate' to refer to rate card prices, and 'price' to refer to realized prices, ie the price after any discount.
[4] Certain types of advertisement, often placed in premium position such as the spine of a directory, are sold through an auction process by some providers.
[5] *Classified directory advertising services*, HMSO, Cm 3171, March 1996.
[6] Rate card rates were capped at the lower of *(a)* the applicable rate for the same category of advertisement as set out in the December 2001 rate card, and *(b)* the immediately preceding rate adjusted by a factor of RPI–6 per cent.

8. Yell publishes a rate card specifying the rate for each product[7] in each of its directories. Yell's rates vary according to the size of the advertisement, the colour option selected and the geographic region the directory covers. Yell's rates vary proportionately with the size of an advertisement: doubling the size of an advertisement doubles the rate. Rates increase less than proportionately with guaranteed minimum circulation (GMC) so that advertisements in directories with large GMC may be cheaper in terms of cost per thousand GMC than those in small GMC directories. Yell offers monochrome (mono) and colour advertising; mono rates form the basis of all rates since colour rates are calculated using a mono rate (based on the size of the advertisement) and a colour premium. Yell offers various discount schemes. These are notified to the OFT, but do not appear to be published in the rate card. Yell has told us that its sales teams explain the various discount schemes to customers. Yell does not engage in individual price negotiations.[8]

9. Thomson uses rate cards and discounts to determine the prices of its advertisements; these rate cards are for internal use and are not published. Thomson has three different types of rate card: [Excised]. Thomson has been offering full colour products since 1999; [excised]. Thomson also offers various discount schemes[excised].

10. BT's prices are also set using an internal rate card. BT set its quarter-column rates to be [excised]. BT's rates for larger advertisements are [excised]. BT introduced colour in 2005 and in the 2005/2006 publishing cycle colour and artwork[9] were offered at the same rate as a standard mono advertisement. [Excised]. BT offers various discount schemes.

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[7] Some products are not on the rate card. Filler and spine products are sold using an auction process.
[8] Yell told us that the effect of the undertakings is to prohibit individual price negotiations because all rates and discounts for advertisements in each directory must be notified to the OFT in advance.
[9] Yell artwork charges range from £25 to £70.

11. Trinity Mirror uses rate cards to determine the prices of advertisements in *The One*; these rate cards are not published but are made available to advertisers. Rates are based [excised]

12. Kingston Communications uses internal rate cards when selling advertising in its *Hull Colour Pages*. Rate card rates are determined by factors including the cost of production, historical rates, local market conditions, product enhancements and margin objectives.

*Discounting*

13. Yell has, since 2000/01, offered discounts to new and renewing advertisers, and to existing advertisers who increase their advertising expenditure. Yell introduced a 'tier'-based discount system in 2004/05; the discount 'tier' (Bronze, Silver or Gold) a classification is placed in determines the discount a new advertiser placing an advertisement in that classification receives.[10] [Excised]. New advertisements placed in Bronze classifications receive a 40 per cent discount from the rate card, those in Silver classifications a 30 per cent discount, those in Gold classifications receive no discount. [Excised.] Advertisements in insurance classifications are assigned to a special insurance tier; new insurance advertisers receive no discount. [Excised.] Table 2 shows the numbers of classifications, share of revenue and average discount in each tier in 2004/05.

[10]Discounts to new customers are available on certain advertisement sizes only. Discounts are available to new advertisements of 30mm, 45mm and quarter column.

TABLE 2 **Yell advertisement tiers, all advertisers,* 2004/05**

| *Discount tier* | *Number of classifications* | *Share of revenues (%)* | *Average discount over gross revenue*† (%) |
|---|---|---|---|
| Gold‡ | [excised] | | |
| Silver | | | |
| Bronze | | | |
| Unclassified | | | |

*Source:* Yell cross section data.

*Though tiers are used to determine the discounts of new and first-year renewal advertisers only, all classifications and all advertisements are placed in a tier. The revenue and discount figures represent all advertisements, ie advertisements placed by new, renewing and existing customers.
†The average discount calculations presented in the table exclude the value of Yell's composite rates.
‡[Excised] has been included in Gold.

14. Yell's renewing[11] and existing[12] advertisers are also eligible for discounts. Advertisers in their second year qualify for a 20 per cent repeat purchase discount or a buy-one-get-one-free offer on certain advertisement sizes. Advertisers in their second or subsequent year who decide to purchase a more expensive advertisement receive a 'Move-Up' discount of 20 per cent of the increase in advertising expenditure. The Move-Up discount does not apply to the colour premium.

15. Yell also offers a 'composite' rate to advertisers who purchase advertisements in directories that have been 'rescoped' from one directory to two or more.[13] The composite rate, which is a single rate for purchasing an advertisement of the same size in each rescoped directory in a rescoped area, is no higher than the rate for a single advertisement in a directory before the rescope. Our analysis of rescoping is presented in a separate section below. If Yell were not to offer its composite rate, rates for purchasing advertisements covering the original directory area would rise following a rescope. We consider that increasing the prices required to obtain advertising covering a particular geographic area in this way would be a breach of the good faith provisions in the undertakings. Therefore, while the composite rate is not specifically required by the undertakings, in our view the composite rate enables

[11]Renewing advertisers are those who are advertising for the second year since starting advertising with Yell.

Yell to comply with the good faith provisions. In the remainder of this paper our references to 'discounts' generally exclude the composite rate except where otherwise stated.

16. We have analysed the data on Yell's discounts in the 2004/05 publishing year. Excluding the composite rate, [excised] per cent of Yell's advertisements in revenue terms received some form of discount.[14] The average price paid for a non-discounted advertisement was £[excised] while the average net revenue for a discounted advertisement was £[excised]; the average discount per discounted advertisement was £[excised] or [excised] per cent[15] The average discount per advertiser buying a discounted advertisement was [excised] per cent. For new advertisers, discounted advertisements are cheaper than non-discounted advertisements since the Move-In discount (that is, the discount for new customers) lowers the prices of advertisements. For existing[16] advertisers, the average revenue per advertisement for non-discounted advertisements was [excised] the average revenue per discounted advertisement; this may be explained by the Move-Up discount(that is, the discount for existing advertisers who are buying more expensive advertisements): advertisers choose more expensive advertisements which are then discounted by 20 per cent (but still cost more than the original advertisement).

17. Yell told us that its Move-In, First-Year Renewal and Move-Up discount schemes are applied nationally and are used to reduce prices in response to increasing competition. The discount schemes offered have changed over time, and the discounts offered within schemes have also changed. Yell discounts over time, at an aggregate level, are shown in Table 3. Including the composite rate, Yell has offered an increasing amount of discounts over time, since Yell's rescoping has meant an

[12]Existing (or older) advertisers are those who have been advertising with Yell for more than two years.
[13]Rescoping is discussed further below.
[14]The remaining [excised] per cent of Yell's advertisements (by revenue) were sold at the rate card rate or at the composite rate.

increase in the availability of the composite rate. Excluding the composite rate, the total discount granted from rate card prices [excised]. The average discount per advertisement[17] and per advertiser[18] fell in both absolute and percentage terms between 2001/02 and 2004/05.

TABLE 3 **Yell discounts over time**

| *Year* | *2001/02* | *2002/03* | *2003/04* | *2004/05* |
|---|---|---|---|---|
| Total Yell discount from rate card (£m) | [excised] | | | |
| Composite percentage of total (%) | | | | |
| Value of non composite offer discounts (£m) | | | | |
| Discount per advertisement (£)† | | | | |
| Discount per advertiser (£)‡ | | | | |
| Net revenue per advertisement (£) | | | | |
| Net revenue per advertiser (£) | | | | |
| Percentage discount per advertisement (%)§ | | | | |
| Percentage discount per advertiser (%)¶ | | | | |

*Source: Yell; CC calculations.*

*[excised]
†Excluding composite rate.
‡Excluding composite rate.
§The percentage discount per advertisement (all advertisements).
¶The percentage discount per advertiser (all advertisers).

18. These aggregate trends shown in Table 3 may mask differences in the discounts received by different types of Yell advertiser. Recent changes in Yell discounts have included an amendment of the discount to new advertisers, which was reduced from 50 per cent to 40 per cent in the 2003/04 publishing cycle. From May 2005, the First-Year Renewal discount was increased, offering a 25 per cent (previously 20 per cent) price reduction from rate card. The Move-Up discount was reduced from 30 per cent

[15] Excluding the value of the composite rate.
[16] Advertisers who have been with Yell for two or more years.
[17] Average discount per total number of advertisements; this will be lower than the average discount per advertisement receiving a discount.
[18] Average discount per total number of advertisers; this will be lower than the average discount per advertiser receiving a discount.

to 20 per cent in 2002/03. Yell does not apply discounts to particular geographic locations.[19]

TABLE 4 **Yell, Thomson, BT discount schemes over time**

| *Directory publisher* | *Type of customer** | *2000†* | *2001* | *2002* | *2003* | *2004* | *2005* |
|---|---|---|---|---|---|---|---|
| Yell | New | [excised] | | | | | |
| | Renewing | | | | | | |
| | Existing | | | | | | |
| Thomson | New | | | | [excised] | | |
| | Renewing | | | | | | |
| | Existing | | | | | | |
| BT | New | BT started selling classified advertising in October 2002 | | - | [excised] | | |
| | Renewing/ existing | | | | | | |

*Source: Yell; Thomson; BT.*

*New customers are those advertising for the first year. Renewing customers are those who advertised in the previous and current year. Existing customers are those that have been previously advertising for two or more years. ie are going into their third or more year of advertising.
†Discount schemes are apply over publishing cycles. Thomson's publishing cycle follows the calendar year. Yell and BT's publishing cycle run from April to March; for these directory publishers year numbers refer to the first year in a publishing cycle.
‡[excised]

19. Thomson uses discounts [excised]

TABLE 5 **Thomson discretionary discount, 2001 to 2005***

| *Year* | *[excised]* |
|---|---|
| 2001 | |
| 2002 | |
| 2003 | |
| 2004 | |
| 2005 | |

Source: Thomson.

[19]The composite rate does apply to particular geographic locations.

20. BT has used a range of discount schemes in order to attract advertisers. As with Yell and Thomson, these have been targeted at new and renewing advertisers and those advertisers increasing expenditure.[Excised]

21. Trinity Mirror told the CC that its objective is to achieve rate card rates for its *The One* directories.[Excised]

22. Kingston Communication offers discounts in its *Hull Colour Pages* [excised]: first time buyers receive a discount of [excised] per cent in order to encourage them to trial advertising; advertisers who increase expenditure receive an 'Upsell' discount of [excised] per cent of the increase in expenditure and there are discounts for advertisers who take out identical advertisements in multiple classifications. Advertisers prepared to pre-pay for their advertisement receive a [excised] per cent discount. Kingston told us that its discounts were subject to change and negotiation.

*Price and revenue trends*

23. We have analysed the pricing and revenues of the directory providers between 1999 and 2005.[20] The prices reported in our pricing studies are realized prices[21] and so price changes can represent both changes in rates and in discounts. Table 6 presents some of the results from our pricing studies; full calculations are presented in Appendices 1, 2 and 3.

[20]Trinity Mirror and BT were not present in 1999: BT has been selling classified advertising since October 2002; Trinity Mirror's *The One* has been present since 2004.
[21]Prices net of any discount from the rate card.

TABLE 6 **CC pricing and revenues studies**

| *Directory provider* | *Year** | *1999/2000* | *2000/01* | *2001/02* | *2002/03* | *2003/04* | *2004/05* | *2005/06* |
|---|---|---|---|---|---|---|---|---|
| Yell<br>Thomson<br>BT | Number of advertisements | [excised] | | | | | | |
| Yell<br>Thomson<br>BT | Number of advertisers | | | | | | | |
| Yell<br>Thomson<br>BT | Revenue (£millions) | | | | | | | |
| Yell<br>Thomson<br>BT | Average revenue per advertisement (£) | | | | | | | |
| Yell<br>Thomson<br>BT | Average revenue per advertiser(£) | | | | | | | |
| Yell<br>Thomson<br>BT | Average number of adverts per advertiser | | | | | | | |
| Yell†<br>Thomson<br>BT | Average advertisement size (columns) | | | | | | | |
| Yell‡<br>Thomson<br>BT | Percentage of revenue from colour ads | | | | | | | |

*Source*: Parties; CC calculations.

*'Year' refers to Yell and BT publishing cycles. Thomson's publishing cycle follows the calendar year; Thomson data for a calendar year is presented in the column for the Yell and BT cycle commencing in that year.
†These figures are based on the time-series data set for Yell which covers around 92 per cent of *Yellow Pages* revenues.
‡These figures are based on the time-series data set for Yell which covers around 92 per cent of *Yellow Pages* revenues.

24. Our analysis of *Yellow Pages* pricing and revenues (covering the publishing cycles 1999/00 to 2004/05) is included as Appendix 1. Yell's revenues from *Yellow Pages* classified advertising have [excised] per cent[22] over the period. [Excised] average revenues per advertisement [excised], the average revenue per advertiser has [excised]. There have been trends towards a greater number of advertisements per advertiser and a greater usage of colour: average advertisements per advertiser [excised], colour penetration [excised] of advertisements and [excised] of revenues. The average advertisement size in Yell directories was stable, though this may mask

increased sizes in certain classifications. The number of Yell advertisers has increased; this fact, coupled with the stable revenue per advertiser, explains Yell's overall increase in revenue.

25. Our analysis of Thomson's pricing and revenues (1999 to 2005) is included as Appendix 2. Thomson's revenues from classified advertising [excised] per cent[23] over the period. Average revenues per advertisement fell, while the average revenue per advertiser was broadly stable. There have been trends towards a greater number of advertisements per advertiser, a greater usage of colour and increased advertisement size: [excised]. There may have been a more marked trend toward colour usage and increased size of advertisements in certain classifications. The number of Thomson advertisers has increased; this, coupled with [excised], explains Thomson's overall increase in revenue.

26. BT started selling classified directory advertising in October 2002. Three directories were published in 2002/03, 111 directories in 2003/04, and 171 directories, covering substantially the whole of the UK, in 2004/05. The data on BT are for too short a period to identify meaningful trends. Our analysis of BT prices and revenues is presented in Appendix 3. Between 2003/04 and 2005/06, BT revenues from classified advertising grew from £[excised] million to £[excised] million. BT's average price per advertisement was broadly stable; its average revenue per advertiser [excised]. The average number of advertisements per advertiser [excised] and the average size of an advertisement in columns [excised]. BT introduced colour in 2005/06 but has been temporarily offering colour at no additional premium to monochrome advertising.[24]

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[22]In nominal terms.
[23]In nominal terms.
[24]For its display advertisement products; 25mm and Super Bold entries are not available in colour.

27. We have not conducted a detailed analysis of Trinity Mirror's pricing and revenues. Trinity Mirror received £[excised] revenue from classified advertising in 2004 in its Glasgow and Edinburgh directories; the revenue for its four[25] directories published in 2005 was £[excised].

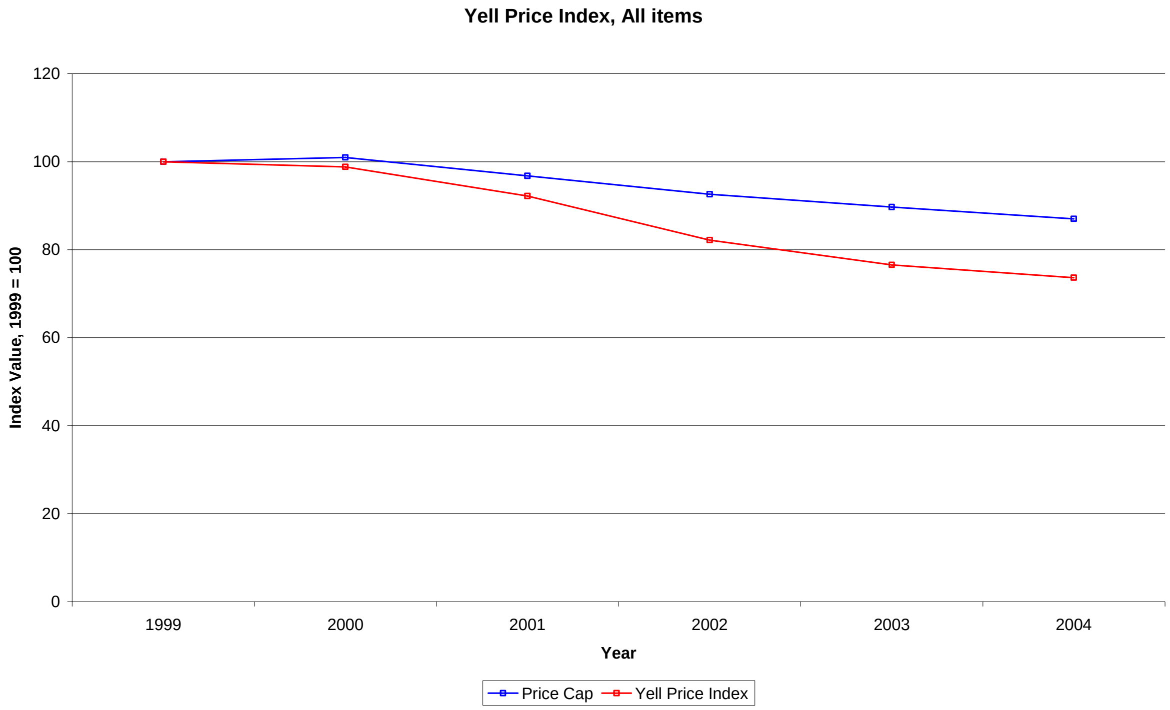
28. We have not conducted a detailed analysis of the pricing and revenues in the *Hull Colour Pages* but have examined material submitted by Kingston. Kingston's revenues from classified advertising [excised] per cent over the period 2000 to 2005. Kingston's number of advertisers rose and the [excised]. Kingston attributes some of this [excised] to the colour advertisements it has have been offering since 1998.

29. We have calculated price indices for Yell and Thomson; the Yell price index is presented at Appendix 4 and the Thomson index at Appendix 5. The price indices show the average price change an advertiser buying the same advertisement (or bundle of advertisements) in consecutive years would face. The price indices therefore provide an average trend which is helpful in understanding the overall pattern of price changes. However, the price indices represent average changes and so patterns of price changes in certain classifications and for certain types of advertiser may be hidden. There is also evidence that advertisers often do not buy the same advertisements in consecutive years; the price indices are therefore a poor indicator of the amounts paid in consecutive years by individual advertisers. Yell has rescoped[26] directories during the period of analysis; the implications for the price index are discussed below.

[25]Lanarkshire, Ayrshire, Edinburgh and Fife. No edition of the Glasgow directory was published in 2005.

FIGURE 1

## Yell price index




*Source:* Yell; CC calculations.

TABLE 7 **Yell price index and the price cap index**

| | *1999/00* | *2000/01* | *2001/02* | *2002/03* | *2003/04* | *2004/05* |
|---|---|---|---|---|---|---|
| Price cap index | 100 | 101 | 96.8 | 92.6 | 89.7 | 87 |
| Yell price index | 100 | 98.8 | 92.2 | 82.2 | 76.5 | 73.7 |
| Year-on-year change in Yell price index (%) | | –1 | –7 | –11 | –7 | –4 |
| Difference between change Yell price index and change in price cap (%) | | –2 | –3 | –7 | –4 | –1 |

*Source: Yell; CC calculations.*

FIGURE 2

## Thomson price index

[excised]

[26]Rescoping is described below.

*Source: Thomson and CC calculations.*

TABLE 8 **Thomson price index and the price cap index**

| | *1999* | *2000* | *2001* | *2002* | *2003* | *2004* | *2005* |
|---|---|---|---|---|---|---|---|
| Price cap index | [excised] | | | | | | |
| Thomson price index | | | | | | | |
| Year-on-year change in index | | | | | | | |
| Difference between change in index and change in price cap | | | | | | | |

*Source: Thomson; CC calculations.*

30. Both the Yell and Thomson price indices fell by more than the annual reduction[27] that applied to Yell's rate card rates. The Thomson's price index has fallen faster than Yell's price index suggesting a reduction in the relative prices of Thomson advertisements. Both the Yell and Thomson price indices fell markedly in 2002, the year in which BT started selling classified advertising. The relatively large reduction in 2002 may be due to a number of factors, including the entry of BT. Yell rates fall at the rate required by the undertakings, though discounting polices mean realized prices fell faster than the minimum rate.[28] Thomson's price reduction in 2002 may have been due to the [excised], rather than due to BT's entry.

31. Yell's rate cards rates have fallen exactly at the minimum rate implied by the price cap, and therefore the fact that the Yell price index has fallen faster than the price cap is explained by the discounts granted by Yell. The overall level of discount is affected both by the discount schemes in place and the make-up of Yell's advertiser base—since new advertisers receive discounts, increasing the number of new advertisers will tend to increase the level of discounts.

[27]RPI–2 between 1999/2000 and 2000/2001 and RPI–6 between 2001/2002 and 2004/05.
[28]Yell's discounting policies mean that the price index will fall faster than the price cap index when Yell *(a)* attracts new customers, and *(b)* when Yell's customers 'move up' to more expensive advertisement types.

32. The introduction of new products may lead to price indices falling faster than the price cap implied index. New sizes, shapes and positions may be introduced at a high rate which can then be reduced over time in line with the price cap and by discounting.

33. Our price indices treat rescoped[29] directories as new products[30]; price changes are therefore not calculated between advertisements sold in directories pre- and post-rescope. For this reason, rescoping has no direct effect on the CC's price indices. Rescoping has two effects on rates: first, rates fall because rates are driven by GMC and splitting or downscoping a book results in a lower GMC in the new books; second, rescoping increases the rate per thousand GMC because the fall in rates is less than proportional to the fall in GMC following a rescope.

34. Rescoping, by reducing a directory's GMC and increasing the focus of that GMC, may improve the quality of Yell's product, especially from the point of view of advertisers who choose to place an advertisement in only one directory. Rescoping is discussed further below. As stated above, the Yell price index does not track price changes between books pre- and post-rescope; it has been constructed to only track price changes between advertisements in directories that cover essentially the same geographic area in two consecutive years. While the price index shows that there have been reductions in Yell's prices for advertisements of a given GMC, there may also have been improvements in the overall targeting of Yell GMC due to rescoping that it does not reflect.

[29]Rescoping is described in a separate section below.
[30]Price indices are used to measure changes in the prices of comparable products. Due to the change in directories that occurs with rescoping, we do not consider it appropriate to calculate price changes between pre- and post-rescope directories in our price indices.

### *Switching and the substitutability of CDAS products*

35. The extent to which advertisers switch between CDAS providers is one indicator of the strength of competition in the market. Advertiser switching, in response to changes in the price or attractiveness of rival CDAS products would provide evidence both of the substitutability of CDAS products and of advertisers' responsiveness to price (or attractiveness) differentials. Though evidence of switching would suggest a competitive market, an absence of switching would not necessarily imply a lack of competition in the market: for example, if price cuts are made and matched by different providers little switching would be likely to occur, even though price competition would be strong. Switching behaviour is also a source of evidence on the impact of BT's entry to the market. Evidence on switching comes from aggregate level data; from the BMRB survey carried out for this investigation and published on our website; and from Yell market research, databases and surveys.

36. The CC's price indices for Thomson and Yell show Thomson's prices fell, on average, at a faster rate than Yell's during the period of analysis; this implies a reduction in the relative prices of Thomson's advertisements (and hence an increase in the relative price of Yell advertisements). Given these relative price changes, shifts in expenditure away from Yell and towards Thomson might be expected. However, the stability in Thomson and Yell's market shares over time (until BT's entry) suggests that advertisers have not been switching between Yell and Thomson at an aggregate level. Some possible and mutually compatible explanations for this lack of switching are that the increases in Yell's relative prices (decreases in Thomson's relative prices) have been offset by corresponding improvements in Yell's relative quality so that there has been little change in the relative net value[31] of

[31]We would expect advertisers to make their expenditure decision between Yell and Thomson based on the price and quality (in terms of some measure of expected leads per advertisement) of these directory providers' products. The net value of an advertisement will increase with quality and decrease with price. This raises the possibility that if a directory provider's relative prices rise, but this price rise is accompanied by a relative quality increase, the relative net value of its service to advertisers may be unaffected.

advertisements in the two books, that Yell and Thomson's products are not seen as close substitutes by some advertisers, that advertisers do not respond quickly to price changes and that Thomson has had to cut prices in response to Yell's rescoping activity.[32]

37. We analysed changes in Yell, Thomson and BT's advertiser bases over time. Table 9 shows the numbers of new and retained advertisers and retention rates for the major directories.

TABLE 9 **New advertisers, retained advertisers and retention rates**

| *Number of new advertisers per year* | *1999* | *2000* | *2001* | *2002* | *2003* | *2004* | *2005* |
|---|---|---|---|---|---|---|---|
| | [excised ] | | | | | | |
| Yell | | | | | | | |
| Thomson | | | | | | | |
| BT | | | | | | | |
| *Number of retained advertisers per year* | | | | | | | |
| Yell† | | | | | | | |
| Thomson | | | | | | | |
| BT | | | | | | | |
| *Retention rates‡ (%)* | | | | | | | |
| Yell | | | | | | | |
| Thomso | | | | | | | |
| BT | | | | | | | |

*Source:* BT ,Thomson and Yell.

*Figures are not available prior to 2002/03 due to change in Yell's IT systems.
†Yell figures include Business Pages as well as *Yellow Pages*.
‡(Number of existing advertisers in year 1/ Total number of advertisers in year 0) ×100.

38. It appears that Yell's introduction of new advertiser discounts in 2000 may have temporarily affected Thomson's ability to attract new advertisers, although Thomson's new advertiser numbers have increased [excised] in 2002 to 2004. Yell attracted increasing numbers of new advertisers in 2002 and 2003. In 2004, there was a [excised] per cent drop in the number of new advertisers attracted by Yell,

[32]The Yell price index does not reflect price changes due to rescoping. Thomson's price index (since there have been no substantive rescopes) analyses all price changes and so will reflect any changes due to Thomson's reaction to rescoping.

which suggests that BT's entry may have had an impact on Yell's ability to attract new advertisers.

39. The number of advertisers retained by Yell and Thomson have increased between 2002 and 2005; this is set out in Table 9. If advertisers switch all their expenditure regularly then they will not become 'existing' from the point of view of a particular directory provider. This means that even if a growing number of advertisers are using CDAS, total switching will prevent the 'existing' advertiser base from increasing. The increase in Yell and Thomson's 'existing' advertiser base suggests a low degree of total switching between directory providers; it seems that switching, when it occurs, is likely to be partial rather than total.

40. The number of 'existing' advertisers present in Yell and Thomson's directories does not appear to have been affected significantly by BT's entry. BT entered with low relative prices; we might expect some switching to BT in this case if BT was seen as a substitute to Yell and Thomson. The absence of an effect on Yell and Thomson's existing customer numbers suggests that BT was not seen as a strong enough substitute for advertisers to stop advertising in Yell and Thomson by these advertisers at the time. This does not preclude the possibility that there was partial switching or rebalancing of expenditure by advertisers since this would not affect the number of existing advertisers. Partial switching is discussed further below.

41. Yell told us that the pattern of existing customer switching [excised]. Yell provided the CC with data showing that the percentage of new advertisers [excised].

42. The main directory providers use advertiser retention rates—the percentage of advertisers who retain a presence in a directory after advertising in it in a previous year—as a key performance indicator. Changes in retention rates could indicate

changes in the degree of competition in the market; in a highly competitive market exhibiting a high degree of complete advertiser switching, retention rates would tend to be low. A drop in retention rates does not necessarily imply an increase in competition, however—new advertisers tend to have lower retention rates and so if a business becomes more successful in attracting a large number of new advertisers it is likely to see its retention rates fall.

43. BT told us that its success was demonstrated by the fact that Yell's retention rates had fallen during the period when BT was entering; Table 9 shows that Yell retention rates fell from [excised] to [excised] per cent between 2003 and 2005. During this period, Yell also increased the number of new advertisers in its directories; this may have contributed to the decline in retention rates for the reason noted above.

44. Yell also provided data showing that [excised]. Figure 3 shows [excised].

FIGURE 3

[excised]

*Source: Yell.*

45. Our analysis of the data provided by Thomson shows that [excised].

46. Switching may occur without giving rise to reductions in advertiser numbers if advertisers reduce expenditure in a directory in order to increase expenditure in another, rather than moving all expenditure to an alternative directory. Thus the absence of large shifts in advertiser numbers does not necessarily imply an absence of switching. The classified directory market is characterised by 'multi-sourcing'—many advertisers purchase advertising from several different CDAS providers. Our BMRB survey showed that about half (46 per cent) of current CDAS advertisers only

use one directory supplier, and the other half use two suppliers or more (35 per cent use two and 17 per cent use three suppliers). In particular, very few advertisers do not advertise in Yell: our survey suggests that 93 per cent of all current CDAS advertisers with the three main directories advertise in Yell, and therefore it is more likely that these would only switch part of their expenditure in response to BT's entry or other competition, rather than completely switch away from Yell.

47. Multi-sourcing[33] means that partial switching may not be reflected in retention rates or in advertiser base changes, but in a fall in advertiser spending. Table 10 shows changes in expenditure per advertiser, depending on the status of the advertiser. Average expenditure per Yell advertiser has remained broadly stable over time; [excised]. If we only look at expenditure per 'retained' advertiser, [excised]; this does not suggest that advertisers have been shifting expenditure away from Yell and Thomson and into BT. Our AIA study, carried out for this investigation and published on the CC's website, suggested that, currently, advertisers have been trying out or testing BT rather than switching to BT; the data on expenditure per advertiser confirms this.

TABLE 10 **Average expenditure per advertiser**

| | *1999* | *2000* | *2001* | *2002* | *2003* | *2004* |
|---|---|---|---|---|---|---|
| *Average expenditure per advertiser (£)* | | | | | | |
| Yell | [excised] | | | | | |
| Thomson | | | | | | |
| BT | | | | | | |
| *Average expenditure per retained advertiser(£)* | | | | | | |
| Yell | [excised] | | | | | |
| Thomson (includes first year renewing advertisers) | | | | | | |
| BT | | | | | | |

*Source:* BT, Thomson and Yell.

[33]Discussed above. 46 per cent of advertisers in the BMRB survey used only one directory provider, others used two or more.

48. The BMRB survey asked respondents whether they had decreased expenditure in the past three years, and, if so, whether they had switched that expenditure to another CDAS provider.[34] By focusing on decreases in expenditure, the BMRB survey covered both total switching and partial switching. In general, this showed that 17 per cent of all current CDAS advertisers who had reduced expenditure with one directory had switched that expenditure to another directory in the past three years, representing 7 per cent of all current CDAS advertisers. Table 11 shows that the 17 per cent of *Yellow Pages* advertisers who decreased expenditure with *Yellow Pages* were more likely to have switched to BT (12 per cent) than to Thomson (4 per cent). The 21 per cent of Thomson advertisers that had decreased expenditure with Thomson were more likely to have switched to Yell (12 per cent) than to BT (9 per cent).[35] In both cases, switching to BT was higher than would be suggested by market shares.

TABLE 11 **Switching (total and partial) within CDAS in past three years**

*per cent*

| | *Directories in which spending was reduced in last three years* | | | | | |
|---|---|---|---|---|---|---|
| Directory switched to | *Yellow Pages* | *Business Pages* | *Thomson Local* | *BT Phone Book* | *Others* | *Total* |
| *Yellow Pages* | 1* | 11 | 12 | 10 | 15 | 5 |
| *Thomson Local* | 4 | 0 | 0 | 0 | 0 | 3 |
| BT *Phone Book* | 12 | 6 | 9 | 5** | 3 | 10 |
| Base | 459 | 18 | 155 | 77 | 40 | 596 |

*Source*: BMRB, CC calculations.

*This figure is correctly reported from the BMRB survey; this advertiser may have switched expenditure between Yell classifications or from Yell's Business Pages to *Yellow Pages*.
**This figure is correctly reported from the BMRB survey; these advertisers may have switched expenditure between BT classifications or from the A–Z sections to the classified sections of *The Phone Book.*

49. Large advertisers were more likely than smaller advertisers to have reduced expenditure with a directory in the past three years (47 per cent of national

[34] Or to other media—the data on switching to other media was analysed in the CC's market definition working paper.
[35] The sample sizes of those advertisers reducing expenditure and switching to other CDAS are small.

advertisers against 35 per cent of local advertisers). Larger advertisers were also more likely to have switched their expenditure to another directory (20 per cent of national advertisers decreasing expenditure, against 15 per cent of local advertisers), and in particular to BT (12 per cent of national advertisers against 7 per cent of local advertisers).

50. The BMRB survey suggests that BT is taking a slightly higher proportion of advertisers from Thomson than it is from Yell, compared to those directory providers' market shares. According to the survey, out of a total of 60 advertisers who increased expenditure with BT by switching from other directory providers, 55 (80 per cent) advertisers decreased their expenditure with Yell and 14 (20 per cent) decreased their expenditure with Thomson. If BT attracted expenditure from advertisers using its rival national directories in proportion to market shares, this would imply BT taking about 15 per cent from Thomson and 85 per cent from Yell.

51. The relatively small sample of advertisers who had switched between directories were asked the reasons for switching; responses are presented in Table 12. As might be expected, the main reasons mentioned related to the net value of advertising in terms of price or response to advertising. A lower price was more important for advertisers who switched to BT (41 per cent) and to Thomson (33 per cent) than for advertisers who switched to Yell (14 per cent), whereas a higher response to advertising was the most important reason for advertisers switching to *Yellow Pages* (62 per cent).

TABLE 12 **Reasons for switching advertising between classified directories (total and partial switching)**

| | | | *per cent* |
|---|---|---|---|
| | *Switched to Yellow Pages (29)* | *Switched to Thomson Local (18)* | *Switched to BT (58)* |
| Alternative directory provider offered lower price | 14 | 33 | 41 |
| Alternative directory provider offered colour or higher quality reproduction | 7 | 17 | 10 |
| Alternative directory provider offered higher quality of response to advertising | 62 | 28 | 19 |
| Alternative directory provider offered advertising on the Internet | 14 | 6 | 7 |
| Alternative directory provider covered larger geographical areas | 21 | 6 | 21 |
| Alternative directory provider covered smaller geographical areas | 3 | 33 | 9 |
| None of these reasons | 3 | 11 | 5 |
| Other answers | 28 | 33 | 36 |

*Source:* BMRB.

*Notes:*
1. Base: All national/regional/local classified directory advertisers who switched advertising expenditure to another directory (99)
2. Multiple response: percentages for all responses sum to more than 100 per cent.

52. The BMRB survey also asked advertisers whether they had increased expenditure with a directory over the past three years. From the responses to these questions, it is possible to calculate how each directory provider obtained increases in expenditure; this is shown in Table 13. Only a small proportion of advertisers who increased expenditure with Yell (either existing advertisers spending more or new advertisers) did so by switching expenditure from another directory (7 per cent).

53. The fact that in our sample only a small proportion of advertisers had increased expenditure with Yell by switching spend from other CDAS providers could be seen as an indication that Yell's discount schemes have had more impact on attracting advertisers new to classified directories than they have had on switching. Using discounts to attract advertisers new to classified advertising may be evidence of

competition since the advertisers new to CDAS that Yell has been able to attract using discounts might otherwise have used another provider.

54. The proportion of advertisers who switched expenditure from other CDAS providers in order to increase expenditure with BT was higher (33 per cent). These cases indicate that BT's entry has had an impact on competition in the market since advertisers have switched expenditure to the (lower priced) new BT directory. The remaining 67 per cent of advertisers had started using BT by increasing overall classified directory expenditure, suggesting that for some advertisers, BT is currently a complementary product or a product being trialled.

TABLE 13 **Increased directory expenditure**

| | *By switching expenditure from another directory* (%)* | *By increasing CDAS expenditure*† (%) | *Total number of customers* |
|---|---|---|---|
| *Yellow Pages* | 7 | 93 | 421 |
| BT | 33 | 67 | 180 |
| *Thomson Local* | 14 | 86 | 133 |

*From answers to the questions: Did you decrease your expenditure on a directory and where did you switch the expenditure to?
†From the answers to the question: Did you increase your expenditure on a directory and did you switch the expenditure from another directory?

55. In addition to the CC's BMRB survey, the CC has been supplied with evidence taken out by FDS on behalf of Yell.[36] The FDS survey, commissioned in late 2005, analysed the advertising media used by advertisers who were lapsed (had stopped using Yell pages) had reduced expenditure with Yell, and those advertisers regarded as 'prospect' advertisers.

56. Nationally, [excised] per cent of Yell customers that bought advertising in a Yell directory in 2004/05 did not do so in 2005/06; these advertisers are defined by FDS as 'lapsed'. FDS surveyed [excised] lapsed advertisers and split these into groups based on their location and the tier (Gold, Silver or Bronze) that their classification was assigned to. Weighting for the sampling of various groups the FDS survey

[36]The FDS survey was supplied by Yell during the investigation.

suggests that of lapsed advertisers, [excised] per cent were still using advertisements in BT's directories, [excised] per cent were still using advertisements in Thomson's directories and [excised] per cent were still using other local directories. This would suggest that of all Yell's advertisers in 2004/05, [excised] per cent stopped using Yell and continued to use BT, [excised] per cent stopped using Yell and continued to use Thomson, and [excised] per cent lapsed and continued to use other local directories.

57. Of those advertisers who had purchased advertisements in 2004/05, [excised] per cent had decreased their expenditure in 2005/06. FDS surveyed [excised] of these advertisers. [Excised] per cent were also using advertisements in BT's directories, [excised] per cent were also using advertisements in Thomson's directories and [excised] per cent were also using other local directories. This would suggest that of all Yell's advertisers in 2004/05, [excised] per cent reduced expenditure with Yell while continuing to advertise with BT, [excised] per cent reduced expenditure with Yell while continuing to advertise with Thomson, and [excised] per cent reduced expenditure with Yell while continuing to advertise in local directories.

58. Yell also supplied us with a study of advertisers in [excised] that was designed to analyse the effects of the entry of BT. The study compared the presence of individual advertisers in the Yell 2004/05 and 2005/06 directories[37] and the BT 2005/06 directory.[38] Of the new[39] advertisers present in 2005/06, [excised] per cent were only in BT, [excised] per cent were only in Yell and [excised] per cent were in both BT and Yell. If this study was representative of other directory areas, it would suggest that [excised].

[37] [excised]

[38] [excised]

[39] [excised] advertisers that had not been present in the Yell 2004/05 directory. Of these, [excised] in BT only, [excised] in Yell only, [excised] in both BT and Yell.

59. Yell's [excised] study also showed that of BT's advertisers [excised] per cent were new[40] advertisers in BT only, [excised] per cent were in both BT and Yell, and [excised] per cent had switched (total switching) to BT from Yell. The [excised] advertisers (representing [excised] per cent of BT's total advertisers) who had switched from Yell represented [excised] per cent of Yell's advertisers.[41]

60. Yell provided us with information [excised]. This information, which is similar to the [excised] study, is presented in Tables 14 and 15.

TABLE 14 **[excised]**

*Source: Yell.*

[40]Not in Yell's 2004/05 directory.
[41]Yell had [excised] of advertisers in 2004/05. Of these, [excised] were not present in 2005/06 but were present in BT in 2005/06.

TABLE 15 **[excised]**

*Source:*

61. [Excised.]

62. [Excised.]

63. Yell also provided us with research into its lapsed advertisers [excised]. The study focused on the 2005/6 advertising expenditure of advertisers that had been in the 2004/05 directory, but not in the 2005/06 directory. Of these lapsed advertisers, [excised] per cent had classified advertisements with Thomson and [excised] per cent had classified advertisements with BT. In total, [excised] per cent of lapsed advertisers were using some form of print advertising, including newspapers and local directories. This study suggests that Yell may be losing some advertisers to BT and Thomson, however the [excised] lapsed advertisers represent [excised] per cent of Yell's total advertisers.[42] So the percentage of total advertisers that were lapsed Yell advertisers and now advertising with BT and Thomson was [excised] per cent,[43]

64. Yell provided us with a number of other studies of lapsed advertisers showing switching patterns between *Yellow Pages* and other printed CDAS and classified

media. Two of these studies distinguish between advertisers switching to BT and advertisers switching to Thomson. Research amongst advertisers who had stopped advertising in the [excised] *Yellow Pages* area showed that [excised] per cent of lapsed advertisers used their budget to advertise elsewhere, mainly the local press ([excised] per cent), websites ([excised] per cent) and other printed directories ([excised] per cent). The proportion switching to Thomson was [excised] per cent) than the proportion switching to the BT *Phone Book* ([excised] per cent); however, the survey was undertaken in August 2004 and therefore in the early stages of BT's entry. This study suggests that Yell may be losing some advertisers to BT and Thomson. [Excised] per cent of Yell's advertisers in [excised] lapsed.[44] Using the survey results above, this would imply that the total proportion of advertisers in [excised] having completely switched to Thomson or BT in 2004 was around [excised] per cent.[45] As discussed above, this research only looks at lapsed advertisers while most switching between Yell and other directories is likely to be by rebalancing overall CDAS expenditure between providers, rather than ceasing to advertise with Yell completely. Moreover, Yell told us that this type of study will underestimate switching because of the length of the publishing cycle meaning that an advertiser ceasing to advertise with Yell will not necessarily be able to switch immediately to another directory.[46]

65. Research commissioned by Yell relating to the advertisers who had decreased or stopped advertising in the [excised] *Yellow Pages* following the rescope showed that, at the time of the survey (September 2004), [excised] per cent switched this expenditure elsewhere, mainly to local papers ([excised] per cent of those who decreased and [excised] per cent of those who stopped advertising), other directories ([excised] per cent of those who decreased and [excised] per cent of those who

[42] Yell had [excised] advertisers [excised] .
[43] Using the [excised] per cent estimate for the number of lapsed as a percentage of the total.
[44] Total advertisers = [excised]; lapsed advertisers =[excised].

stopped advertising) and the Internet, including Yell.com ([excised] per cent of those who decreased and [excised] per cent of those who stopped advertising). The proportions switching to BT's classified directory were [excised] the proportions switching to Thomson: [excised] per cent of those decreasing advertising switched to BT and [excised] per cent to Thomson; [excised] per cent of those stopping advertising switched to BT and [excised] per cent to Thomson.

66. Kingston told us that, since the entry of Yell,[47] [excised] of its national advertisers had moved all or part of their spending to Yell. Kingston considers that for these advertisers, an important characteristic of classified directories is the ability to provide national coverage.

67. Kingston also told us that there are some national advertisers who will always advertise in all the available classified directories. This suggests that for some CDAS advertisers the different directories represent complementary products rather than substitutes.

68. Trinity Mirror told us that, [excised].

*Summary: switching and substitution*

69. The evidence analysed to date suggests that:

*(a)* Advertisers' demand for CDAS is characterised by multi-sourcing by a large number of advertisers; switching can be 'partial' or full.

*(b)* Overall, though there have been changes in the relative prices of CDAS products, there has been no corresponding shift in relative expenditure. This may be due to offsetting changes in non-price aspects of advertising, a lack of responsiveness

[45]From the survey, [excised] per cent were using Thomson or BT (Thomson [excised] per cent, BT [excised] per cent). {excised] per cent of the [excised] per cent that lapsed = [excised] per cent.
[46]The directory publishing cycle is typically a year long; cycles vary by directory and are not aligned across providers.
[47]Yell entered via a rescoping of the Hull & East Riding *Yellow Pages.*

to prices and/or the fact that CDAS products are seen as complements by some advertisers.

*(c)* Yell has experienced declining retention rates. Plausible and compatible explanations are that this is due to an increase in switching and an increase in the number of new classified advertisers.[48] Thomson's retention rates [excised].

*(d)* Survey evidence indicates that switching behaviour varies by advertiser type, with larger advertisers being more prone to switch than smaller advertisers.

*(e)* The surveys commissioned by the CC and Yell's surveys indicate a degree of switching between CDAS providers. Overall, BT appears to provide an alternative to Yell for a larger number of advertisers than Thomson does.

*(f)* The main reasons for switching relate to the net value of advertising in terms of the price of advertisements or the response to advertising.

*(g)* [Excised.]

*(h)* Though the surveys suggest a degree of partial switching between directories, the average revenue per advertiser has remained stable for [excised] Yell [excised] since BT's entry. This suggests that a large number of those advertisers using BT are currently making additional CDAS expenditure rather than switching expenditure from Yell or Thomson.

### *Price competition*

70. We have studied realized prices in the market in order to analyse whether the pricing behaviour of classified directory providers is indicative of price competition and the extent to which rival classified directory providers constrain one another's pricing decisions.

[48] New advertisers tend to have lower retention rates.

71. Thomson told us that [excised] Yell has been reducing its rate card rates in line with the price cap [excised] . An implication of Thomson's strategy is that any price cap applied to Yell also constrains Thomson's prices.

72. Thomson told us that the price cap, Yell's pricing, new entry and the increased importance of online searches have been the reasons for the decline in Thomson's prices. Thomson's [excised] suggest that the RPI price cap on Yell impacts on all the providers in the CDAS market.

73. Thomson has [excised]

74. The breakdown of Thomson's sales by rate card type has changed in recent years. [Excised.] The increase in importance of [excised] (who are also very important to Yell) suggests that Yell and Thomson's advertiser bases, in terms of the type of advertiser present in the directories, has become more similar over time. The increasing similarity in advertiser base suggests that Yell and Thomson may have become closer substitutes for some advertisers.

75. The fact that BT's strategy in terms of pricing and discounting policies has been constructed with reference to Yell suggests that Yell exerts a current constraint on BT's pricing. [Excised.]

76. It has been suggested to us[49] that the localized scoping of BT's directories means that BT and Thomson are one another's closest competitor. Though the CC recognizes that there are differences in the directories offered by Yell, Thomson and BT, our evidence is that all three directory providers offer a similar service to a similar

[49]By one of the parties.

set of advertisers. Evidence from the BMRB survey[50] suggests that advertisers using *Yellow Pages* as their main directory would be equally likely to use BT or Thomson, should Yell become unavailable; advertisers using BT as their main directory were much more likely to use Yell than Thomson should BT be unavailable. Furthermore, the CC considers that the similarity of the product offered in terms of the UK coverage the directories provide, the dimension of the directory and the classification systems used in the directories, may suggest that BT's closest competitor is Yell.[51]

77. BT's re-entry at prices that were competitive with respect to Yell [excised].

78. [Excised.] Classified directory providers compete for the advertising budgets of firms and so the timing of sales cycles can be important. Thomson told us that [excised].

79. BT's [excised] suggest that Thomson is seen as an aggressive competitor in terms of pricing. However, [excised] Yell is seen as the main competitor; this suggests that Yell provides a stronger price constraint on BT than Thomson.

80. The evidence above suggests that the prices of BT and Thomson are constrained by those of Yell. We have also sought evidence that Yell's rates and realized prices are constrained by Thomson and BT. Since 92.5 per cent of the advertisers in our BMRB survey used the *Yellow Pages* and Yell has around 75 per cent of the revenues in this market, the determinants of Yell's pricing have been a key question for this inquiry.

81. Yell told us that competition in the market is intense. Yell argued that there is no scope for price increases since prices are constrained by competitive forces. The

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[50]See BMRB report, Table 5.12, page 33.

[51]Both provide 100 per cent geographic coverage, both are A4 size, the classification systems used are very similar (and somewhat different from Thomson)

CC's analysis of Yell's 2004/05 sales showed,[52] however, that [excised] per cent of the advertisements sold in that year were sold at the rate card rate.[53] In some areas, following rescoping, Yell has set its rates at levels that are lower than the maximum permitted by applying the rescoping formula contained in the undertakings. An example of this was the rescoping in [excised], this is discussed below. Adjusting for the areas where rates are below the maximum level permitted by the Yell undertakings, [excised] per cent[54] of advertisements were sold at rate card prices that were equal to the maximum permitted by the undertakings.

82. We considered the possibility that Yell's rate card rates, which are often set at a level determined by the undertakings, might also be the rates that Yell would find optimal in the absence of the undertakings for the [excised] per cent of its advertisements sold at non-discounted prices, equal to rates set at the maximum level permitted by the undertakings. We considered this to be unlikely for two reasons.

83. First, Yell told us that if the price cap had not been in place, [excised]. Second, if current rate cards rates were also the rates Yell would find optimal in the absence of the undertakings, this would suggest that Yell's optimal prices for each advertisement had been decreasing at RPI–6 per cent for the past four years. Whilst we accept that Yell's optimal prices may have fallen in real terms, the changes in market conditions do not appear to have been so great as to suggest that the optimal prices would fall by around 25 per cent[55] in real terms over this period.

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[52]See Table 2 in Appendix 6 .
[53]Out of a total of [excised] advertisements, [excised] were sold without discount (excluding composite rate).
[54][excised] per cent receive no discount from rate cards that are set at the maximum level permitted by the undertakings; [excised] per cent pay composite rates. In those areas, following rescoping, where individual rate cards are set below the maximum level permitted by the undertakings, the composite rate is set at the maximum level that enables Yell to comply with the good faith agreement contained in the undertakings.
[55]The price cap since 1999 has implied four years of RPI–6, and three years of RPI–2. The compounded price reduction required by the undertakings was 25 per cent.

84. The fact that the majority of Yell's advertisements are sold at prices that are equal to the maximum allowed by the undertakings, suggests that the undertakings, rather than effective competition, was the binding constraint on Yell's prices for a significant number of advertisements in 2004/05.

85. Advertisements sold at a discount from the rate card are sold at prices influenced by both market forces and the undertakings. We have examined the [excised] per cent of advertisements that were sold at rates below the maximum permitted by the undertakings in the 2004/05 publishing cycle in order to analyse the market forces (demand factors or competitors' prices) which constrained these prices. The analysis of Yell's discounts presented at Appendix 6 shows that, in revenue terms, most of the discounts apply to Yell's [excised] advertisements, and that quarter-, half- and full-page advertisements (which receive [excised] from BT, between [excised] and [excised] per cent) [excised] attracted [excised] per cent discounts, on average, in 2004/05. The application of discounts to [excised] products, combined with Yell's linear rate card, means that the realized prices per centimetre squared of Yell advertisements [excised] with the size of the advertisement purchased. [Excised].

86. We analysed the characteristics of Yell, Thomson and BT advertisers, in order to identify those advertisers who tend to pay the lowest prices and those who tend to pay the highest prices. This analysis is shown at Appendix 7.

87. Many advertisers who use CDAS buy more than one advertisement in a single directory. Since advertisers purchasing multiple ads may purchase one at the full rate card rate and one at a discounted price, the proportion of advertisers who receive a discount on one or more of their advertisements exceeds the proportion of

advertisements that were sold at a discount. Table 16 shows the extent of multiple purchasing.[56]

TABLE 16 **Advertisers and advertisements**

| | *Yell* | *Thomson* | *BT* |
|---|---|---|---|
| Year | [excised] | | |
| Number of advertisements | | | |
| Number of advertisers | | | |
| Average number of advertisements per advertiser | | | |

*Source: Parties; CC calculations.*

88. The discussion of discounts above examined the number of advertisements receiving a discount; we have also examined discounts granted to advertisers. In 2004/05, Yell discounted its rate card prices by a total of £[excised] million (excluding the composite rate). [excised] per cent were discounts to new[57] advertisers, [excised] per cent were discounts to renewing[58] advertisers and [excised] per cent were discounts to existing[59] advertisers. In total, [excised] per cent of Yell's advertisers received some kind of discount from the rate card in 2004/05.[60] Table 17 shows which advertisers tended to receive discounts from the rate card. [Excised] of new and renewing advertisers received a discount ([excised] per cent of new advertisers and [excised] of renewing advertisers). Discounts to new and renewing advertisers also tended to be [excised] : the average discount over gross revenue per new advertiser receiving a discount was [excised] per cent, and [excised] per cent for renewing advertisers. However only [excised] per cent of existing advertisers received a discount, and discounts to existing advertisers were [excised]: the average discount over gross revenue per existing advertiser receiving a discount was [excised] per cent.

[56]This information is also presented in Appendices 1, 2 and 3.
[57]Advertisers advertising in Yell for the first time.
[58]Advertisers renewing their advertising for the first year, ie placing an advertisement in the previous and current year.
[59]Advertisers who had been advertising with Yell for two or more years.
[60]Excluding the composite rate. There were [excised] advertisers, [excised] or [excised] per cent of these received a discount.

TABLE 17 **Yell discounts by advertiser type**

| | *Number* | *Revenue (£ million)* | *Revenue per advertiser (£)* | *Total discount (£ million)* | *Total % discount over gross revenue* | *Average % discount per advertiser* | *Median % discount per advertiser* |
|---|---|---|---|---|---|---|---|
| *New advertiser* | | | | | | | |
| Discount | [excised] | | | | | | |
| No discount | | | | | | | |
| All new advertisers | | | | | | | |
| *Renewing advertiser* | | | | | | | |
| Discount | | | | | | | |
| No discount | | | | | | | |
| All renewing | | | | | | | |
| *Existing advertiser* | | | | | | | |
| Discount | | | | | | | |
| No discount | | | | | | | |
| All existing | | | | | | | |

*Source:* CC, based on Yell cross-section data for 2004/05.

89. Yell's existing advertisers that received a Move-Up discount tended to be [excised] The same was true for renewing advertisers receiving a discount. New advertisers that received a discount tended to be [excised].

90. Large Move-In discounts to new advertisers and Move-Up discounts to existing advertisers could be an indicator of intense competition; the purpose of these discounts may be to capture other providers' advertisers by inducing them to switch expenditure either partially or totally. Discounts to new advertisers may also be a strategy to attract advertisers new to CDAS in order to increase penetration, in which case they might not have an impact on switching. As mentioned above, though competition for advertisers new to CDAS does not cause switching, or rivals to lose current advertisers, it may be evidence of competition: the advertisers new to classified advertising that a directory publisher attracts are also the potential new advertisers of its competitors.

91. The explanation that Yell has given of its new advertiser discounts suggests that the main aim of these discounts is to attract new advertisers to CDAS, rather than to capture other providers' advertisers: for instance, the choice between Gold, Bronze

and Silver is [excised], and does not appear to be linked to classifications where competition from other CDAS providers, or the other media, is intense. When BT entered, Yell's perception was that [excised] (these are Gold classifications), meaning that classifications in which competition from BT was intense were receiving [excised] discounts ([excised] classifications receive the [excised] discounts) than other classifications.

92. Yell stated that the [excised], and that most new advertisers would be [excised]; Yell added that its penetration[61] of UK businesses was only around 20 per cent. It estimated that about [excised] per cent of new advertisers came from Thomson, [excised] per cent were previous Yell advertisers who had lapsed, and about [excised] were brand new to CDAS. The results of the BMRB survey (see Table 13) [excised] that most advertisers who had increased expenditure with Yell in the past three years had done so by increasing their total CDAS expenditure (93 per cent), rather than by switching expenditure from another directory (7 per cent).

93. In addition, [excised] does not suggest that Yell's introduction of new advertiser discounts and move-up discounts in 2001 has had an impact on [excised] .

94. The analysis of Thomson's pricing to different advertiser types, set out in Appendix 7, shows that [excised].

95. As noted above Yell's rate card pricing strategy, combined with its discounts, mean that its prices per centimetre squared increase with the size of advertisements, [excised] Yell did not respond to [excised], suggesting that BT's prices, at least for some advertisement types, do not currently constrain Yell's.

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[61] The percentage of UK businesses using Yell; around 80 per cent of UK businesses do not advertise with Yell.

*Rescoping and price competition*

96. The CC's analysis of rescoping as non-price competition is presented in a separate section below. Yell's rescoping is also discussed in Appendix 8. This section analyses the price effects of rescoping.

97. Following a rescope, the maximum rates that Yell is permitted to charge are calculated using a formula specified in the undertakings. The formula takes as its base the rate for quarter-column advertisements; the maximum quarter-column rate in the new edition is calculated as the average of the quarter-column rate on the five directories whose GMC is immediately above, and the five directories whose GMC is immediately below, the new directory's GMC. The formula does not take into account Yell's rate in the pre-rescope area.

98. Yell have provided evidence that shows that, out of the 57 post-rescope areas between 1999 and 2005, Yell set rates below the regulatory maximum in [excised] areas. This implies that, even when advertisers are currently paying the non-discounted rate card rates in these areas, it would have been possible for Yell to have charged higher prices if Yell had not made this decision.

99. Table 18 shows that in [excised] out of the [excised] areas where Yell set prices below the regulatory maximum, the rate set by Yell was [excised] per cent or less below the regulatory maximum (in [excised] areas, the difference was [excised]). In another [excised] areas, the rate was set between [excised] and [excised] per cent of the maximum.

TABLE 18 **Yell pricing in rescoped directories**

| *Difference between maximum authorized and rate card* | *Number of areas* |
|---|---|
| [excised] | |
| All | |

*Source:* *Yell; CC calculations.*

100. Rescoping will only be successful and increase revenues if new customers start advertising with Yell after the rescope. It is clear that the level of pre-rescope rates imposes a constraint on the level of post-rescope rates. Indeed, if post-rescope rates are equal, or close to, pre-rescope rates, this is unlikely to attract new advertisers since they would be paying the same amount, or slightly less, for a much smaller coverage area.

101. We have analysed the post-rescope rates charged by Yell (Table 19). We have found that there is a strong relationship between post-rescope rates and pre-rescoped rates. Yell appears to set post-rescope rates around [excised] per cent below pre-rescoped rates. There are a number of areas where the regulatory formula would result in rates only just below the pre-rescope rates, and [excised]. When the regulatory formula results in rates lower than [excised] per cent of the pre-rescope rates, Yell has generally set rates at the maximum authorized or just below the maximum.

.

TABLE 19 **Yell pre- and post-rescope pricing by directory, quarter-column advertisements**

| | *Pre-rescope rate* | *Regulatory maximum* | *Effective rate* | *Difference between max rate and pre-rescope rate (%)* | *Difference between effective rate and max rate (%)* | *Difference between pre-rescope rate and effective rate (%)* |
|---|---|---|---|---|---|---|

[excised]

*Source:* *Yell; CC calculations.*

102. Figure 4 illustrates the fact that directories where rates were set below the maximum authorized tend to be those in which the rates prior to rescoping were relatively low compared to the average for a given level of circulation, and therefore areas in which the rescoping formula would result in maximum rates which are high compared to the pre-rescope rates.

FIGURE 4

**[excised]**

*Source:Yell; CC calculations.*

103. This suggests to us that one reason for Yell setting prices below the maximum permitted by the undertakings in many areas is that while Yell seems to aim to set post-rescope rates that are around [excised] per cent below pre-rescope rates, the regulatory formula does not take into account pre-rescope rates in order to determine post-rescope rates and can produce maximum permitted rates that, if adopted, would entail very steep increases in price per GMC in rescoped directories.

*Localized competition, Scottish Central Belt*

104. The competitive situation in directories covering the Scottish Central Belt may be different from that in the rest of the UK due to the presence of *The One* directory, published by Trinity Mirror. Increased competition could result from the competitive conduct of Trinity Mirror itself or from the competitive reactions of other directory providers to the presence of Trinity Mirror.

105. The product characteristics of Trinity Mirror's directories suggest that its closest competitor may be Thomson. The coverage (in terms of GMC) of the directories provided by Trinity Mirror is similar to that of Thomson's directories and this coverage is focused on similar geographic regions: [excised] Thomson targets [excised]. The directories offered by Trinity Mirror have the same dimensions as those offered by Thomson, both being slightly smaller than BT and Yell directories.[62]

106. There is evidence that suggests competition between Trinity Mirror and Thomson may constrain both of these directory provider's prices. [Excised] . The nature of Thomson's rate card strategies and discount schemes—which are less constrained than Yell's since Thomson is not subject to undertakings—means that Thomson is able to react to localized changes in competitive conditions. Trinity Mirror told us that, [excised] This would suggest Thomson's advertising prices place a constraint on Trinity Mirror's prices.

107. Trinity Mirror told us that [excised]

108. Trinity Mirror told us that [excised] .

109. The prices of advertisements in Yell's rescoped directories for Glasgow may have been constrained by the additional competitive pressure caused by the presence of Trinity Mirror. When Yell rescoped its Glasgow directory in 2004/05 it departed from the maximum rates determined by the OFT formula[63] and offered lower rates. Yell told us that in Glasgow South, the OFT formula would have allowed a £645 quarter-column rate whereas Yell set the rate at £540; in Glasgow North, the formula allowed a rate of £507, Yell set the rate at £480.

[62] *The One* and *Thomson Local* are 27 x 17.5cm. *Yellow Pages* and *The Phone Book* are A4 (29.7 x 21.0cm)
[63] The undertakings formula determining the rates in rescoped directories is set out above, paragraph 97.

*Localized competition, Kingston-Upon-Hull*

110. Kingston-Upon-Hull is the only area in which Yell is not the leading classified directory provider. The competitive situation in Kingston-Upon-Hull may therefore be different from that in the rest of the UK due to the presence of an alternative leading provider, Kingston Communications' *Hull Colour Pages*. Yell entered the Hull area in March 2005 by rescoping its York directory[64] and started selling advertising in August 2004; BT covers roughly half of the greater Hull area with its 'Scarborough and Yorkshire Coast' directory, Thomson does not currently publish a directory for the Hull area.

111. The *Hull Colour Pages* is an established product and has the high usage and advertising content required to compete as a major classified directory in the Hull area. Kingston Communications told the CC that its revenues from CDAS had risen by [excised] per cent in the last five years. Currently, [excised] per cent of businesses within its core target market (Hull-based small local businesses) pay for advertising within *Hull Colour Pages*. Yell told us that in its first year in Hull [excised]; Yell also told us that [excised]. It therefore seems possible that in the immediate future, Yell pricing to local advertisers in Hull will be constrained by the prices in the *Hull Colour Pages* due to the local incumbency of this directory.

112. Yell told us that in the Hull and East Yorkshire 2006 directory there were [excised] customers who were located in the area covered by the *Hull Colour Pages*. There were [excised] advertisers based elsewhere in the UK that bought advertisements in the Hull and East Yorkshire *Yellow Pages*.

[64] The York *Yellow Pages* was split to create two new directories—Hull and East Yorkshire (which covers Kingston upon Hull) and York, Harrogate and Scarborough.

113. Despite the short period that Yell has been in the market, Kingston has already lost the business of some large national advertisers. Kingston told us that at least [excised] advertisers had moved all their expenditure from its directory to Yell's. Though it is possible to obtain nationwide coverage using a combination of Yell, BT and Kingston directories, Yell and BT are the only directory providers that offer advertisers substantially complete nationwide coverage. National advertisers may find services which allow them to purchase nationwide coverage from one provider attractive.[65] Kingston appears to have found it difficult to retain the business of these types of advertiser; this may be due to its inability to offer nationwide coverage. As a consequence, *Hull Colour Pages* may provide less of a constraint on Yell's prices to national advertisers than to local advertisers in this region.

114. Kingston told us that its pricing was largely comparable to Yell's; it thought that comparable advertising in Yell was less expensive at the entry level and for certain types of businesses to which Yell had offered discounts. Yell told the CC that it had been able to attract advertisers to the *Yellow Pages* in Hull. However, further evidence submitted by Yell suggests that [excised]. Given Yell's [excised], it seems possible that while Kingston's prices to large national advertisers may be constrained by Yell's in this region, its prices to local advertisers may not be.

115. Rather than immediately cutting prices on Yell entry, Kingston had invested in increased marketing in order to retain its advertisers. Kingston is particularly worried that some users may feel that the *Yellow Pages* and the *Hull Colour Pages* are in fact the same directory, since it suspected that some advertisers had disposed of their copy of the *Hull Colour Pages* directory by mistake, thinking that the Yell directory had replaced it.

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[65] The desire of national advertisers for a minimum level of coverage across the country was suggested to us by one party.

*Summary price competition for advertisers*

116. This section has analysed price competition and in particular the presence of pricing constraints. Pricing constraints that exist between CDAS providers may run in both directions between providers; this may be the case even though CDAS providers' prices are not equal. For example, an established provider may be able to charge a premium, though the presence of an alternative directory constrains the level of this premium. An 'alternative' directory may, at the same time and for the same set of products, be constrained by the established provider since if its prices rise towards the established provider's prices, its advertisers would be likely to switch to the established product. The evidence on price competition suggests that:

*(a)* Thomson's pricing is constrained by Yell's: Thomson [excised] has reduced prices to remain competitive to Yell. Thomson may also be constrained by BT and by *The One* in Scotland.

*(b)* BT's pricing is constrained by Yell's: BT's current pricing and discount strategy has been set to allow it to offer prices that are lower than Yell's.

*(c)* Trinity Mirror's pricing is constrained by Thomson's and Yell's; [excised].

*(d)* Kingston Communications' pricing to large national advertisers may be constrained by Yell; its pricing to Hull-based local businesses may be less constrained.

*(e)* For [excised] per cent of Yell's advertisement prices in 2004/05 the binding constraint was the undertakings, rather than its competitors' prices.

*(f)* For [excised] per cent of Yell's advertisement prices in 2004/05 market forces provided the binding constraint on prices.

*(g)* Yell's rescoping activity has resulted in rates that are set below the maximum level permitted by the undertakings for those advertisers who purchase in one post-rescope book. Though one reason for this reduction in prices below those permitted by the undertakings may be competitive pressure; another possible

explanation is that the formula that sets the maximum permitted post-rescope price ignores pre-rescope prices, while Yell appears to take them into account.

117. The evidence examined to date suggests that some price competition has occurred in the market; some prices have been cut and some price cuts have been responded to. However, the binding pricing constraints that appear to be present in the market differ between directory providers: while there is evidence that producers other than Yell constrain one another and evidence that Yell's prices constrain other producers, [excised] per cent of Yell's advertisements in 2004/05 were sold at a rate effectively determined by the Yell undertakings, rather than by competitive forces.

118. Yell's advertisement prices are influenced by both market forces and the Yell undertakings. For [excised] per cent of Yell's advertisement prices, the binding constraint is the undertakings rather than market forces. In the absence of the undertakings, these advertisement prices would be constrained at some level by market forces (either due to demand falling as a result of price increases, or as a result of competition); however, the fact these prices are in effect determined by the undertakings suggests that market forces provide a weaker constraint on them than the undertakings. This raises the possibility that for at least some advertisements, price constraints on Yell are weak and operate at a level that would allow Yell to charge higher prices absent the undertakings.

### *Non-price competition for advertisers*

119. Evidence from Yell, Thomson and Kingston Communications suggests that CDAS providers might compete in other ways than by cutting prices. Yell notes the increasing competition in the CDAS market in [excised]. Its response is to [excised] '; we note that [excised] to counter increased competition. Though Thomson [excised] , it may compete with other directory providers through non-price means. For example,

Thomson's reaction to Trinity Mirror's entry was [excised]. Finally, while Kingston noted that its advertising was more expensive than Yell's for many advertisement sizes, it responded by increasing its marketing expenditure rather than by cutting prices. This section considers the evidence on non-price competition.

*Raising value through increasing usage*

120. Classified directory providers can increase the value of advertisements in their directories without changing the prices of advertisements by improving the usage of their directory. Increased usage, both in terms of quantity and quality, results in more value, in terms of leads, as a result of advertising. Therefore competing for usage is a way to compete for advertisers; this reflects the two-sided nature of the market. Competition for users is discussed in a separate section below.

*Rescoping*

121. Rescoping is a process whereby the boundaries of a directory's distribution area are changed. Yell and BT have engaged in significant rescoping exercises in recent years; Thomson has engaged in some very limited rescoping exercises. Classified directory producers have told the CC that rescoping is a natural process that any directory provider should undertake as the 'relevance' of a directory's footprint changes over time. Directory providers aim to offer their advertisers an area of coverage that best represents the location of users of their service; as population densities, shopping patterns and travel routes change, the optimal scope of a directory changes. Since altering the scope of a directory can change the value of advertising in that directory and the degree of differentiation between competing directories, rescoping can be used as a competitive tool.

122. Two distinct types of rescoping have been used by classified directory providers. Some rescopes alter the boundaries of a directory, changing the GMC it provides to

advertisers a little but keeping the overall distribution roughly the same. Other types of rescope are used to split directories; these rescopes (sometimes referred to as downscopes) divide a directory into two or more smaller directories with corresponding reductions in GMC.

123. Yell engaged in 27 rescopings between publishing years 2000/01 and 2005/06. Of these, 26 were ‘downscopings’ which resulted in an additional 26 Yell directories as directories were split. Another rescope involved splitting the York directory into two smaller directories and extending the coverage of one of these directories to include Hull. In 2004/05, 12 Yell rescopings occurred: Yell went from two to four directories around Glasgow and from two to three directories around Edinburgh; Yell also downscoped the five London directories.

124. Yell’s rescoping activity is analysed in Appendix 8. Rescoping reduces the price paid for individual advertisements while increasing the price paid per GMC. Advertisers who purchase advertisements in both directories both pre- and post-rescope see no change in the price, or price per GMC, of their advertising due to the composite rate.[66] Advertisers choosing to advertise in only one of the two rescoped directories may regard the smaller directory as a better option (despite an increased price per GMC) if the area that the directory now covers is more relevant to their business.[67]

125. Evidence submitted to us during the investigation showed that the growth rate of advertisers has been higher in rescoped directories than in non-rescoped directories. This may be due to increased retention rates or to an increased rate of new advertiser acquisition, or a combination of these factors. Since rescoping results in lower rates to advertise in individual directories, it may attract businesses into classified directories by reducing the entry-level advertisement price.

126. Yell's rescoping activity has meant its directories have become closer in GMC and geographic terms to Thomson and BT's directories. [Excised.]. Thomson has not downscoped in the last ten years and feels that it has [excised]. Thomson's scoping is seen as a key differentiating factor; since Yell has reduced the degree of differentiation, competition between Yell and Thomson may intensify.

127. BT has not downscoped any directory since it has entered the CDAS market, [excised].

128. Though rescoping delivers lower prices to advertisers, it also reduces the GMC, and hence may reduce the number of potential leads,[68] which advertisements in a single directory may generate. In most cases, following a rescope, price per GMC rises. However, Yell's composite rate ensures that the advertisers can obtain coverage of the original area for the same price per GMC. Rescoping may therefore offer those advertisers who require a more focused geographic coverage a more relevant product while the composite rate ensures that advertisers satisfied with the previous directory coverage do not lose out.

*Reorganization of classifications*

129. Parties have also told us that they reorganize classifications in order to provide more relevant positioning for their advertisers; placing advertisements in a position or order that makes it more likely that users will find the advertisement they are looking for improves classified directories service to both users and advertisers. Classification reorganizations are made in a number of ways: for example, in some cases classifications are renamed, in others, large classifications that include two or more distinct types of advertiser are split up.

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[66]The composite rate is described above.
[67]In this case, price per 'relevant GMC' would fall.
[68]Prior to the rescoping, some advertisers may generate leads from a smaller geographic area than that covered by the directory; for these advertisers rescoping may not reduce the number of potential leads generated.

130. The implications of classification reorganization for advertisers are not entirely clear. If classifications are reorganized in a way that increases users' ability to find the service they require, the leads generated from advertising may rise. Some advertisers may also experience an increase in their 'share-of-voice' in a newly-created classification. However, other advertisers may feel that both the classifications are relevant to them and that splitting the old classification forces them to place extra advertisements (and therefore increase expenditure) in order to achieve the same number of leads from advertising.

131. The evidence on advertisers' perceptions of classification reorganization is also mixed. While Yell told us that classification reorganization was driven by [excised], some respondents to our AIA study of large advertisers felt that they had to increase expenditure following the splitting of classifications;[69] we were also told by some large insurers[70] that changes in classification may lead to increased advertising costs. Classification reorganizations that succeed in improving the relevance of classifications and making directories easier to use may benefit advertisers by increasing the usage of directories. Evidence from Yell and our study therefore suggests that classification reorganization may be both a way of increasing the share of voice of some advertisers and of generating extra revenue from advertisers.

*Offering additional services to CDAS advertisers*

132. Classified directory providers can increase the value of the service they provide their advertisers without reducing prices by offering other complementary services with classified advertisements. Examples of such services are online advertisements and advertisements in other non-classified (A–Z) sections of the directory.

[69] AIA survey, page 23 and 24.
[70] *CC Summary of evidence from Insurance Companies*, page 1. [www.competition-commission.org.uk/inquiries/ref2005/classdirec/third_party_submissions.htm](www.competition-commission.org.uk/inquiries/ref2005/classdirec/third_party_submissions.htm)

133. Yell does not sell its online and paper directory products as a package. The *Yellow Pages* contains neither business A–Z nor residential A–Z listings.

134. Thomson offers a package of classified, business A–Z and Internet advertising; this advertising is both sold and priced as a package. Advertisers can opt for an individual classified or online advertisement at a reduced price. Advertisers in the classified section receive a free listing in the business A–Z; the business A–Z contains advertising and some packages of classified and A–Z advertising are sold.

135. BT offers [excised].

136. BT's directory also includes a residential A–Z section which contains, at the bottom of some pages, some banner advertising. On some occasions, residential A–Z advertising is sold at the same time as classified advertising, though advertisements are not priced as a package. Given that BT is the only directory provider able, without considerable investment in business contact data, to offer a service comprising residential A–Z advertising and classified advertising; this may confer special advantages on BT which might distort competition and we are considering this possibility.

137. Kingston Communications does provide an online business directory, but this service is charged separately from its print classified product.

138. Trinity Mirror [excised] .

139. Yell do not offer additional services of the types discussed above with their classified advertising, nor do Kingston Communications. BT, Thomson and Trinity Mirror—the non-market leading directories in all areas where they are present—may feel that

offering additional services allows them to increase the attractiveness of their directories without having to cut prices further.

140. A separate rationale for bundling, not examined here, is that bundling may help classified directory providers increase the advertising on their online directories and so contribute to the virtuous circle that is present in that market.

*Product innovations*

141. Classified directory providers have told us that increasing the value of advertising through innovation has been an important strategy when operating in this market. Innovations mentioned have included the introduction of colour advertising, ratings systems, simplifying advertisement purchasing processes and improving pricing systems.

142. All the classified directory providers have mentioned the development of colour advertising as an innovation. Kingston was the first directory provider to offer full colour, introducing it in 1998; it was followed by Thomson in 1999, Yell in 1999/2000 and BT in 2004. Trinity Mirror's *The One* is a full-colour publication. Colour advertising may increase the prominence that an advertisement has and increase an advertiser's share of voice. Provision of colour may therefore increase the value of an advertisement by providing more leads due to the increased visibility of the advertisements. Colour advertisements may also improve the perceived quality of a directory by users and increase usage.

143. However, any increases in quality due to colour advertising have been accompanied by increases in prices—colour advertisements are charged at a premium over mono advertisements in all classified directories except BT.[71] It therefore seems likely that

[71][Excised].

the introduction of colour has been both a way of improving the share of voice of some advertisers and of increasing advertising revenue.

144. Yell told us that it worked with trade associations to verify that advertisers using trade association logos are bona fide members in order to reduce the misuse of such logos by rogue traders. [Excised.].

145. Some classified directory providers have sought to clarify the leads generated by classified advertisements by providing metered phones with unique telephone numbers. This type of innovation is designed to remove some uncertainty about the value of a CDAS advertisement and, if successful, may enable providers to grow the market through proving the value of classified products. For risk-averse businesses, the elimination of some uncertainty about user response to advertising may increase the value of advertising. Metered phones may also help classified directory providers communicate the value of advertising more clearly.

146. Yell told the CC that [excised] . Yell also told the CC that the undertakings limited [excised] pricing initiatives. [Excised]. While this proposed innovation does not appear to contribute to the current competitiveness of the market, the pressure to innovate, and to assist advertisers to assess the value of their advertisements, may be a result of competition in the market.

147. Classified directory providers also mentioned a number of other innovations. These included online advertisement purchasing and design services (YellDirect), enhanced navigation features, such as special colouring of classifications and adding tabs to sections (Thomson and Yell) and including local information and other guides (ThomLocal, NHS Direct guide).

*Summary: non-price competition for advertisers*

148. The evidence presented to the CC suggests that there has been non-price competition for advertisers. Rescoping, reorganization of classifications, bundling, quality of service improvements and other innovations all appear to be ways that CDAS providers can improve the value of their product to advertisers.

149. Competition for users is an important form of non-price competition for advertisers and is discussed separately in the next section.

## Competition for users

150. Advertisers need to ensure that their advertisements deliver leads; leads are generated as a result of usage. Competition for users is the other half of the 'virtuous circle' that classified directory providers try to develop in this two-sided market. In the discussion of competition for advertisers above, we noted that an important way to compete for advertising expenditure was by competing for usage. The corollary of this is that one of the most important ways a CDAS provider can increase usage is by providing a directory with a good range of advertisements in every classification, so competing for advertisers is an important way of competing for users. Competition for users is discussed in this section.

151. There is evidence that the relationship between usage of a directory and the advertising in a directory is not a direct relationship. Thomson told us [excised].

### *Competition for users is non-price competition*

152. Directories are distributed free to users so increasing the usage of directories through price competition is not possible. Non-price competitive strategies that classified directory providers employ to increase usage include advertising, product differentiation and offering additional services (bundling) with their directory.

### *Usage trends*

153. Yell provided data on usage of its directory and of other directories; this was presented in the CC's working paper on market definition. Yell tracks usage of its own and other CDAS providers' products in its Regular User Study in terms of 'million of uses per month'. Figure 5 summarizes the usage trends from the Yell survey between June 2000 and March 2005. Yell told us that the best way to compare usage over time was to use a MAT (moving annual total) measure, in order to account for seasonality of usage.

FIGURE 5

[excised]

Source: Yell.

154. According to Yell's regular user study, usage (measured using MATs of millions of uses per month) of *Yellow Pages* has declined by around [excised] per cent between June 2000 and March 2005. Usage of *Thomson Local* has [excised]. Usage of *The Phone Book* has also [excised] according to this study; however this includes [excised] .

155. Yell told us that the latest figures showed that usage of *Yellow Pages* had [excised] since March 2005: on a MAT basis, usage of *Yellow Pages* at the end of the third quarter of 2005/06 was [excised] million uses per month, compared to [excised] million for the end of the third quarter of 2004/05. Yell also told us that its figures showed that usage of *The Phone Book* classified listings had [excised] in the same period.

156. BT also tracks usage of classified directories as part of the BT Tracker Survey. The BT Tracker Survey started in January 2005 so full comparisons with Yell's survey are

not possible. According to the BT Tracker Survey, the percentage of UK adults regularly using BT's classified directory has increased over the 13 months from January 2005. The number of uses per month of both BT's classified directory and classified directories [excised].

TABLE 20 **BT data: percentage of all UK adults regularly using classified directories**

*per cent*

| *Regular usage* | *2005* | | | | | | | | | | | | *2006* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Jan* | *Feb* | *Mar* | *Apr* | *May* | *Jun* | *Jul* | *Aug* | *Sep* | *Oct* | *Nov* | *Dec* | *Jan* |
| Yellow Pages | [excised] | | | | | | | | | | | | |
| Thomson Local | | | | | | | | | | | | | |
| BT Classified | | | | | | | | | | | | | |

*Source:* BT.

TABLE 21 **BT data: average number of searches per month**

*'000s*

| | *2005* | | | |
|---|---|---|---|---|
| | *Jan to June* | *Jan to Oct* | *Jan to Dec* | *% increase Jan to Dec* |
| Yellow Pages | [excised] | | | |
| Thomson Local | | | | |
| BT Classified | | | | |
| Total | | | | |

*Source:* BT.

157. The figures from the BT tracker survey suggest [excised] over the past year, in terms of number of searches per month, unlike Yell's regular study which suggests a [excised] in Yell usage. However part of this difference may be due to the seasonality in use of classified directories ([excised] and therefore some increases may be due to seasonality).

158. Thomson told us that it believed that usage of printed classified directories had [excised]; Table 22 shows CDAS providers' advertising expenditure over time.

Thomson also compiles a usage survey, according to which usage of Thomson directories has [excised].

### *Advertising for users*

159. National advertising campaigns are highly visible to both advertisers and users alike. Competing for users through advertising is a way of signalling to advertisers that usage of a directory will be high; similarly, users may believe that highly-advertised directories will contain a comprehensive selection of advertisements.

160. Yell, Thomson and BT all have national or near-national advertising strategies. They use a combination of television, radio and poster advertising to promote awareness and usage of their directories. All three national classified directory providers have increased their advertising expenditure in recent years. Table 22 shows advertising expenditure, by directory provider.

TABLE 22 **Advertising expenditure by Classified Directory providers ('000s)**

| | *1999/00* | *2000/01* | *2001/02* | *2002/03* | *2003/04* | *2004/05* | *2005/06* |
|---|---|---|---|---|---|---|---|
| Yell (whole business , ie including CDAS, Yell.com and 118 247) | [excised] | | | | | | |
| Yell (CDAS) | | | | | | | |
| Thomson | | | | | | | |
| BT (CDAS) | | | | | | | |

*Source:* Yell, Thomson, BT.

*Estimate.

161. Competition for users through advertising may increase the value of classified advertisements to advertisers; by increasing the usage of its directories a classified directory provider increases the probability of leads arising from advertising and so the number of leads per advertisement is likely to rise.

162. There is some evidence that the usage of an individual provider's classified directory responds to advertising. Yell provided a chart based on its Regular User Study that

showed [excised]; Yell told us that [excised]. Thomson told us that its advertising was aimed at securing a share of the existing level of CDAS usage and reminding people of its differentiated product positioning. BT told us [excised].

163. There is limited evidence that the total usage of classified directories responds to usage advertising. For example, Yell's User Survey shows [excised]. However, it is possible that the [excised]. BT told us that the increased marketing expenditure by Thomson and Yell since BT's entry had led to an increase in the general awareness of classified directories. Thomson told us [excised].

164. Trinity Mirror has used advertising in the *Scottish Daily Record* to promote awareness of *The One* directory. Trinity Mirror told us [excised].

165. Kingston told us that it had recently experienced intensive advertising by Yell in Hull. Yell used local press, radio and advertising hoardings to promote the newly rescoped York directory now covering the Hull area.

166. The evidence on advertising and usage suggests that competition through advertising for users has not delivered large increases in usage. [Excised.].

### *Differentiation of Products*

167. The characteristics of the products were summarized in Table 1 (see paragraph 2).

168. The three national offerings are differentiated in terms of the geographic coverage of the UK and their GMC. Yell published 102 directories in 2004/05, covering the whole of the UK. Thomson published 173 directories in 2005 but has a smaller circulation and geographic coverage than the other directories. BT published 171 directories in

2005/06[72] and has a typical footprint between that of Yell and Thomson, since BT's directories cover substantially the whole of the UK.

169. Yell and BT's directories are A4-size directories; Thomson[73] and Trinity Mirror Directories are the smaller 'renaissance' dimensions.

170. The degree of editorial and non-advertising content present varies widely by classified directory. Non-advertising content includes A–Z sections, maps, guides, health advice; A–Z sections (particularly residential) are discussed below. Trinity Mirror's directories contain by far the most editorial content—this is a key differentiating factor for its directory which, in its recent editions, contains a special food section containing articles and reviews.

171. While the directories are clearly differentiated the key product characteristic—the provision of advertisements classified by the product offered by the advertiser—is the same in all directories. The scoping of a directory appears to be a key characteristic of directories; Yell's downscoping strategy means that differentiation in scope has decreased in the CDAS market. Though classified directory providers have invested in other forms of differentiation, the increased differentiation of directories does not appear to have significantly increased usage. Increased differentiation, like advertising, may have helped to retard the reduction in the usage of classified directories highlighted by Yell's user survey.

### *Offering additional services to CDAS users*

172. An additional differentiating factor between the directories is BT's provision of a residential A–Z listing with *The Phone Book*. BT's provision of its A–Z residential

[72] BT publishes directories covering 171 different localities. In 2005/06 four of these directories were published twice so that the total number of published directories for 2005/06 was 175.

listings in the same publication as its classified directory may be an important factor for two reasons: Firstly, the A–Z section has significant value to users and has a high level of usage; secondly, a residential A–Z section is unavailable to other directory providers without considerable investment in business contact data[74].

*Summary: competition for users*

173. The evidence presented to the CC to date suggests that CDAS providers compete for users through advertising and product differentiation. Advertising by CDAS providers has increased in recent years and particularly since the entry of BT. Certain aspects of differentiation have increased; differentiation through scoping has decreased in recent years.

## Summary: competition for advertisers and users

174. This paper has analysed the evidence currently available on competition between classified directory providers. It has outlined the two-sided nature of the market and the fact that competition for users and competition for advertisers are interdependent.

175. Though there have been changes in relative prices and new entrants to the market, the evidence suggests that large-scale switching has not occurred. Yell [excised] retention rates, though falling, remain at over 70 per cent. The average expenditure per advertiser in Yell, [excised] and BT directories [excised]; again, this is consistent with an absence of large-scale switching. Survey evidence suggests that some full and partial switching has occurred.

176. Pricing is one way to compete for advertisers. On the evidence currently available, it seems that the price constraints operating in the market differ in their type between directory providers; in particular the undertakings, rather than the prices of other

[73] Thomson has used smaller A5 directories in some areas. In 2006 all Thomson's directories will have 'renaissance' dimensions.

directory providers, appears to have been the binding constraint on the prices of [excised] of Yell's advertisements.

177. Non-price competition occurs through competition for users, rescoping, classification changes, quality improvement and through product innovations. There appears to have been significant non-price competition for advertisers in recent years.

178. Competition for users promotes usage and the leads generated by advertisements; as such it is a way of competing for advertisers. Classified directory providers cannot compete by cutting prices since directories are distributed free to users; providers compete for usage through advertising and product differentiation. Advertising has increased in recent year, particularly since the entry of BT, though the extent to which this trend will continue is not clear. Some aspects of product differentiation have increased in recent years, while differentiation through scoping has decreased.

179. In a two-sided market we would expect both competition for advertisers and competition for users. While our analysis indicates that there is competition between directory providers for both groups, it suggests there is some deficit in price competition for advertisers.

Competition Commission

7 June 2006.

[74] Such as is provided by BT's Operator Services Information System (OSIS) which is sold to other directory providers.