E.CA Economics

Strabag/Lafarge – critical customer approach and other methods

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Rainer Nitsche, E.CA Economics (formerly ESMT Competition Analysis)
nitsche@e-ca.com

Proposed merger and timeline

A transaction with two elements

- Lafarge aquires 70% in a new Strabag cement plant in HU (at the time not yet in operation)
- Strabag acquires 30% in four existing Lafarge plants (2 in AT, 1 in SLO, 1 in CZ)

Time line

- 25 May 10 press release and signature of framework agreement
- 13 Oct 10 notification in Austria
- 10 Nov 10 request for review (Prüfungsantrag) by the Federal Cartel Procecutor
- 13 Dec 10 decision to ask for an economic expert opinion
- 21 Feb 11 decision to stop proceedings as the request for review was withdrawn

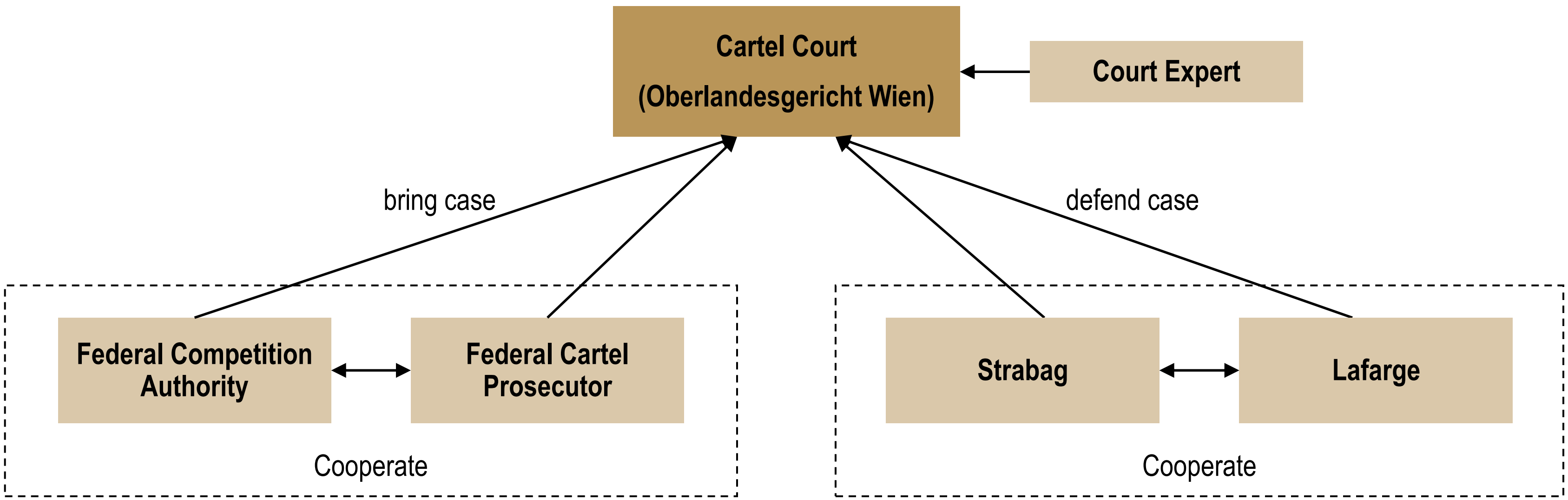
Outcome: competition authorities withdrew the case before a court decision was taken

Remark on jurisdiction

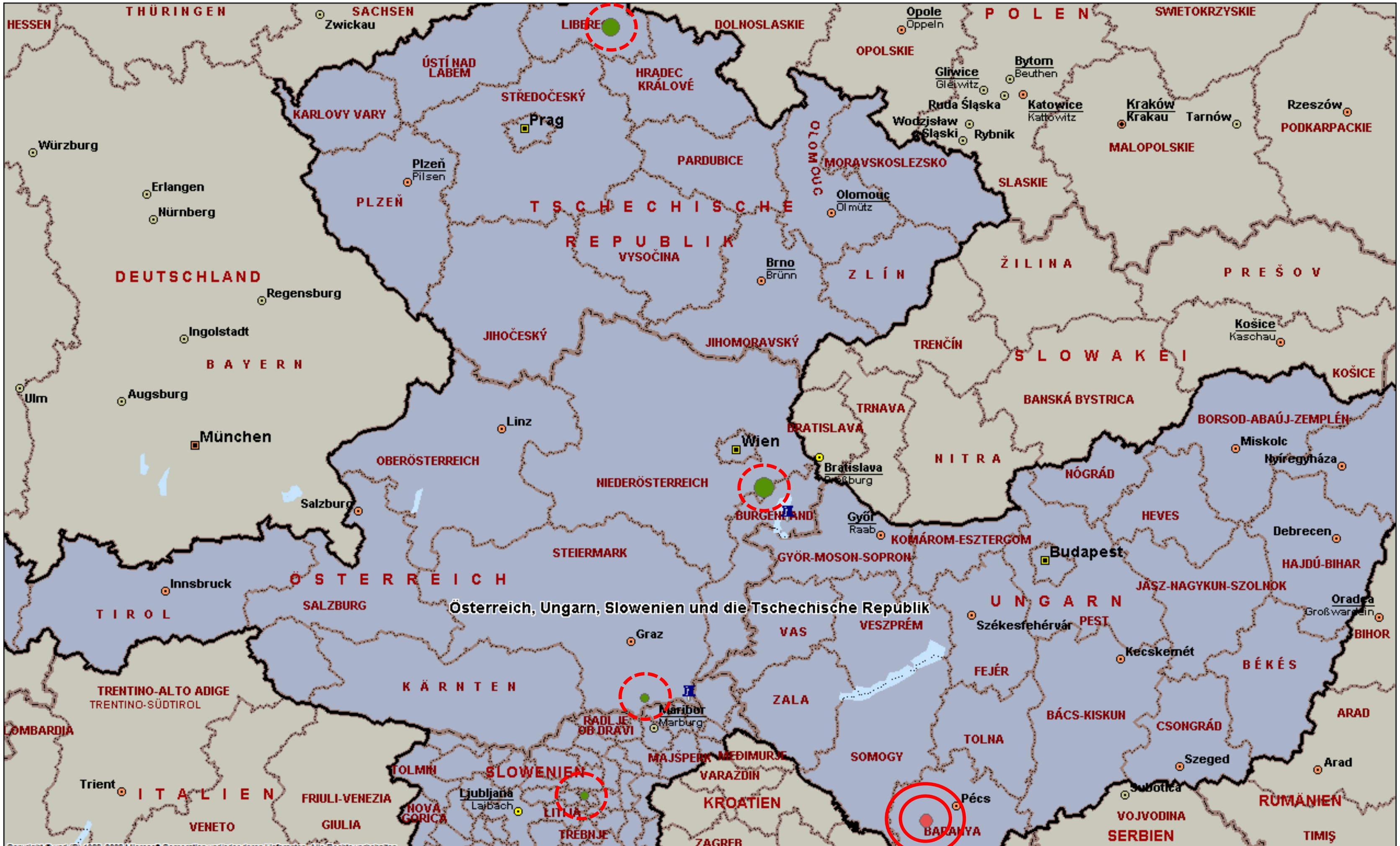
Why Austria?

- EC declined jurisdiction under the EC Merger Regulation
- Hungarian competition authority did not investigate due to turnover threshold

Phase II merger control set in Austria:



Plant locations



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Background and key issues

Background

- Austrian court needs to cater to Austrian consumers only
- Strabag is active in downstream concrete and construction markets (in Austria and elsewhere)
- Lafarge is an important supplier of cement in (east) Austria

Key issues

- Unilateral horizontal effects? Would Strabag capacity in HU have an impact on competition in AT?
- Unilateral vertical effects? Would Strabag‘s stake in Lafarge plants lead to input or customer foreclosure?
- Coordinated effects? De-stabilising effect of new capacity? Effects of vertical integration?

This presentation focuses on market definition and unilateral horizontal effects

Some comments on coordinated effects (if time)

The “Hungarian” part of the transaction

Would Strabag capacity in HU have an impact on competition in Austria?

Methods

- Qualitative information (business plans; interview and survey results)
- „Classical“ delivery distance analysis
- Critical customer analysis
- Chain of substitution analysis
- Price impact analysis (for Antoine to report)

All methods relevant for market definition and the analysis of effects

Qualitative information

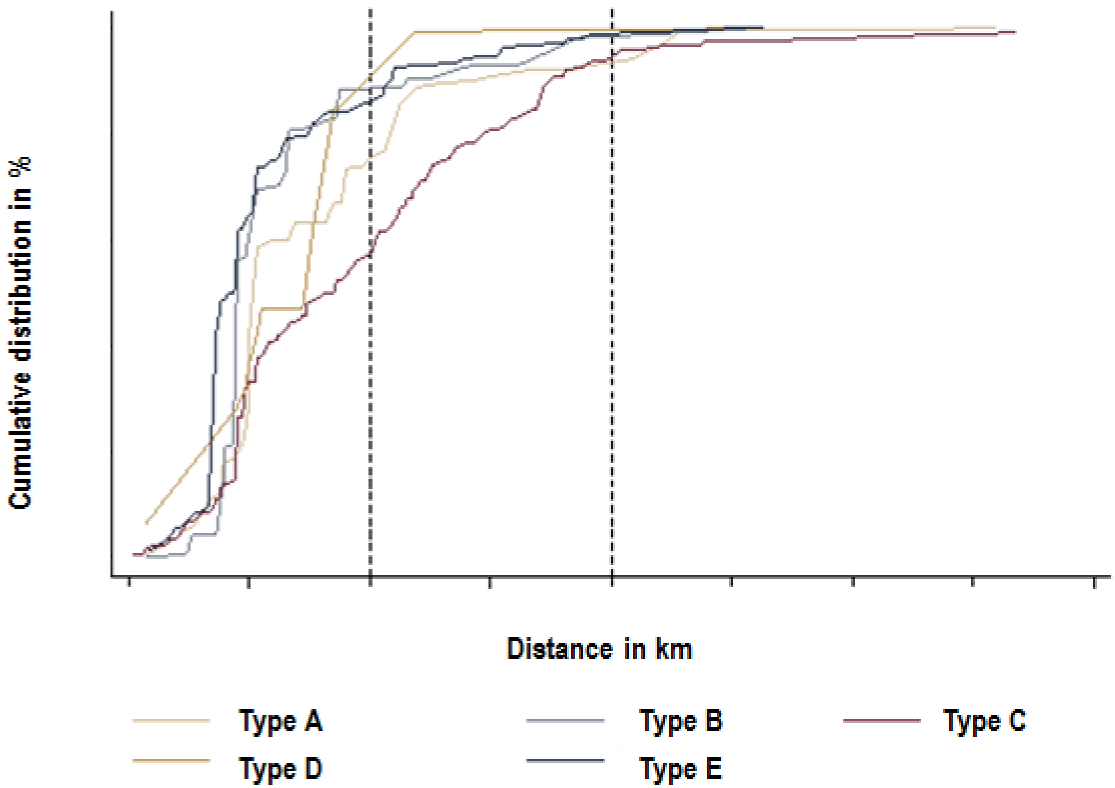
Examples

- Business plan for new plant: deliveries to Austria foreseen?
- Results from competition authorities survey (e.g. on delivery distances)
- Interviews with authorities; market participants (customers; rivals; parties)
- Precedent decisions

Not all qualitative evidence pointed in the same direction

„Classical“ delivery distance analysis

Lafarge provided data on two plants in Austria: deliveries to customer types



- Remarks
  - Only market transactions
  - Depends on distance to rivals
  - May not reflect bidding behaviour
  - Good predictor for other plants?
  - Lower bound

Implication for Hungarian plant: No deliveries to Austria – distance to first customer beyond Austrian border is 255 km

Critical customer analysis I

Idea

- Screening logic for market definition and unilateral effects analysis in markets with significant transport costs
- Limited data requirements and relatively speedy analysis

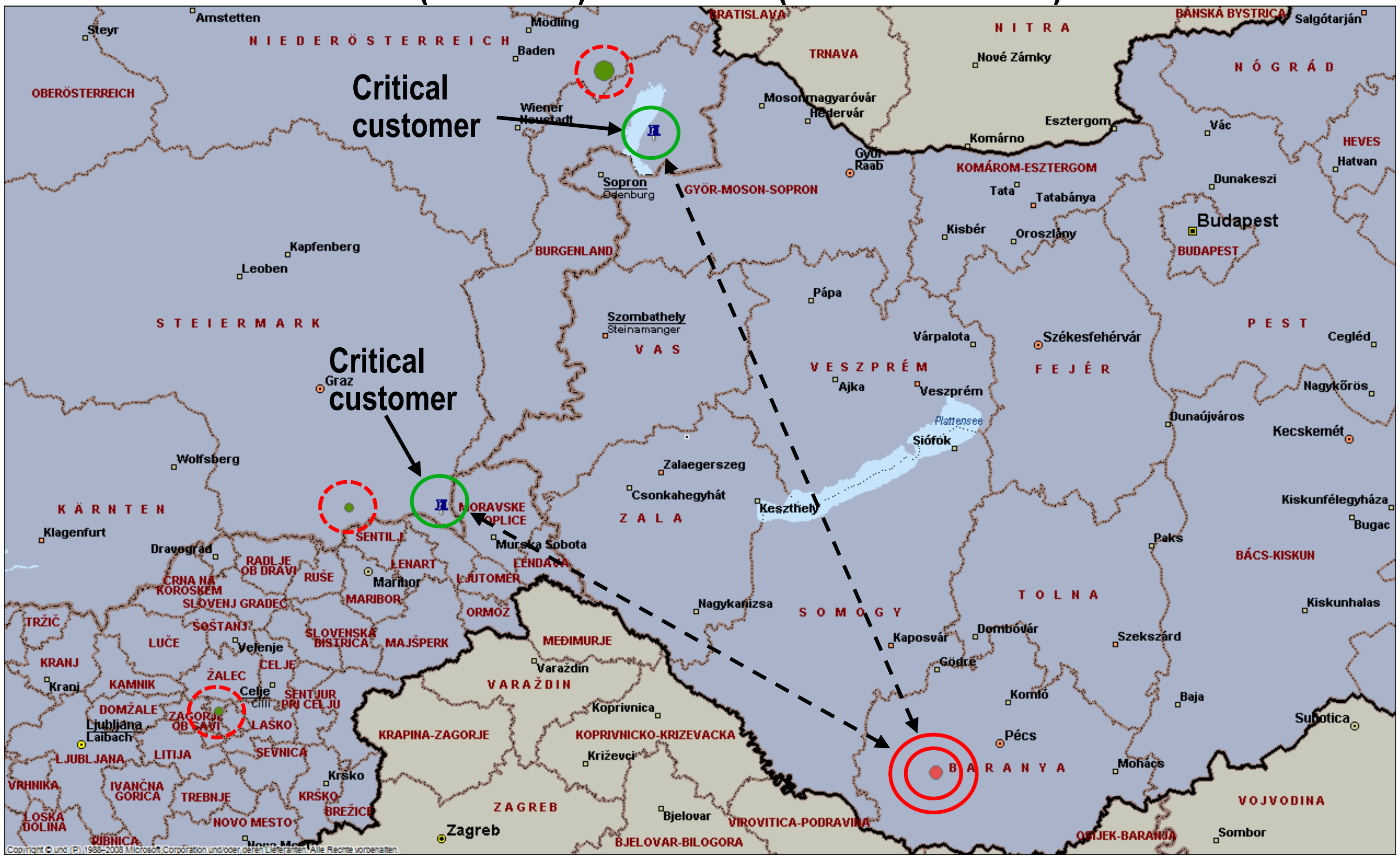
Method

- Identify „critical customer“ who would likely be most affected by the transaction
- Identify relevant suppliers
  - Simulate **SSNIP logic**: who would be in if merging plants would raise their prices by 5 to 10 percent?
  - Check **conditional market**: if the Hungarian plant is „in“ which other plants would be „in“ in order to be consistent?
- Calculate market shares of those that are in (potentially weighted by distance)
- If data allows, keep an eye on the spare capacity of the identified independent players

Method used in several proceedings – mostly for geographic market definition

Critical customer analysis II

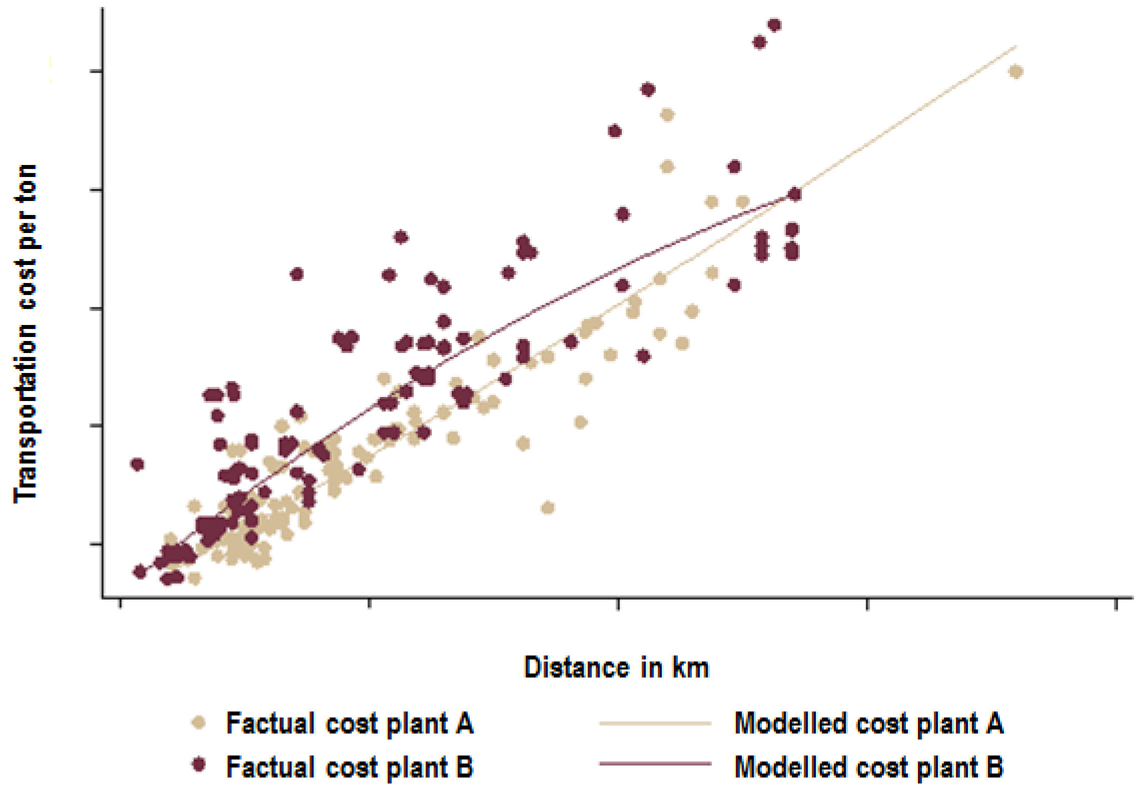
Identification of critical (Austrian) customer (close to border)



Careful: this is heuristic (other customers could have less choices)

Critical customer analysis III

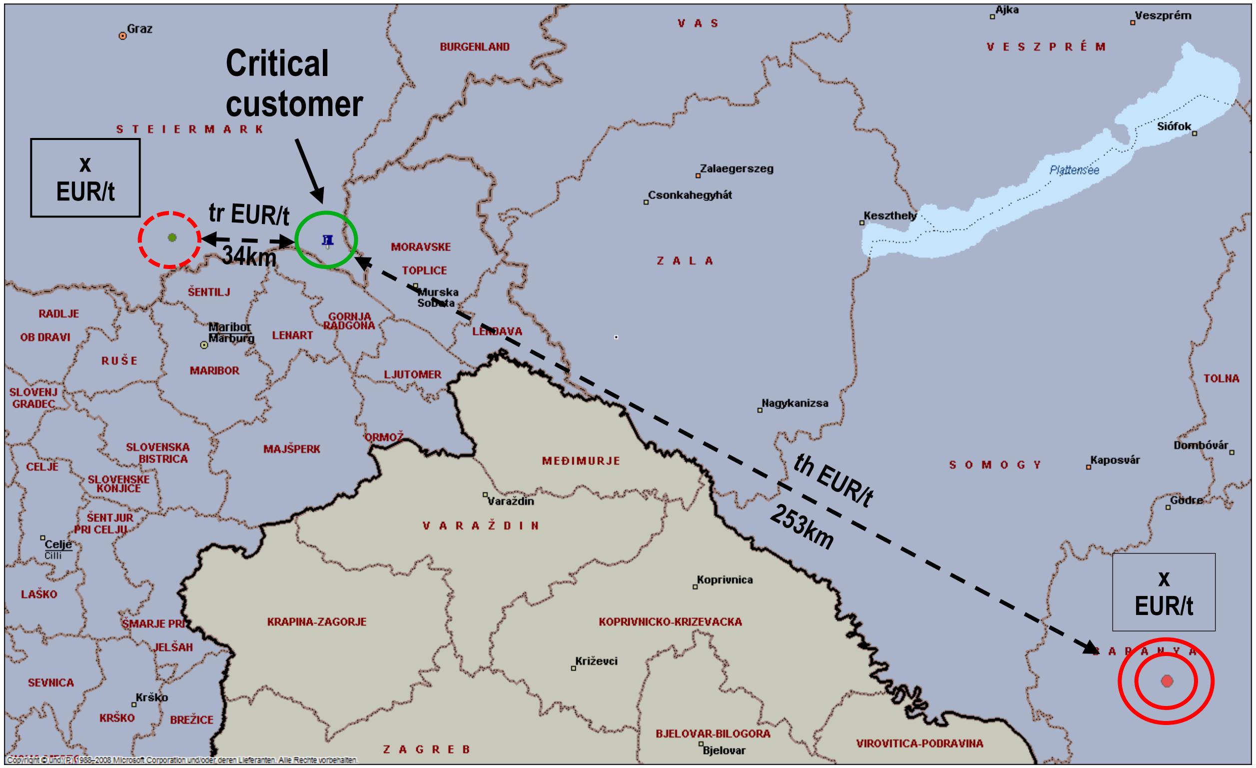
Estimation of transport cost function (it is incremental transport costs that matter)



Here actual transport cost data – can be complemented by info from transport operators

Critical customer analysis IV

Transport costs for Hungarian Strabag plant and closest Lafarge plant

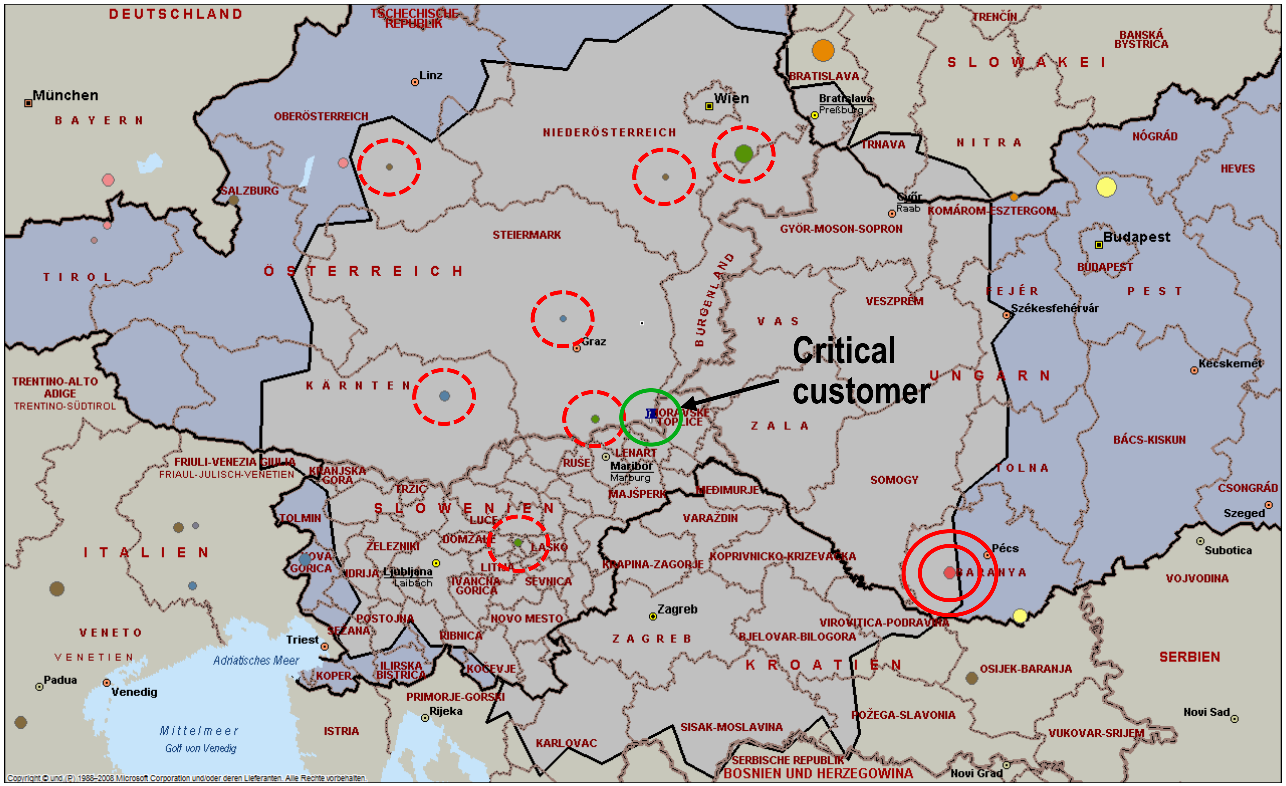


- **Ex-works-price: x EUR/t**
- **Price increase 10%:** x+dx EUR/t
- Critical customer in Halbenrain
  - Transp. cost Retznei: tr EUR/t
  - Transp. cost HU-plant: th EUR/t
- Delivered price Retznei after price increase x+dx+tr EUR/t
- Delivered price HU plant: x+th EUR/t
- Assumptions (due to data limits)
  - Same ex-works-price
  - Same transport cost function

- Following SSNIP logik the **HU plant does not belong to the relevant market**
- Same result for critical customer further north

Critical customer analysis V

Robustness check: Who is "in" if Hungarian plant is?



- Distance critical customer and Hungarian plant: 255 Road-km
- Then those are „in" (besides HU):
  - 3 Lafarge plants + one (50% Lafarge)
  - 2 R1 plants
  - 1 R2 plant
- High share of merging parties
- But: some big rival plants are close to 255 km (R3 (big), R4, R1)

Legend – highlighed (inside range):
Blue pin: Critical customer ||
Green circles: Lafarge || Red circles: Strabag
Blue circles: R1 || Brown circles: other plants

Legend - Not highlighted (outside range)
Grey circles: R5 || Rose circles: R4
Pink circles: R6 ||
Yellow circles: R7 || Orange circles: R3

If Hungarian plant is in, so would be plants of two rivals – not enough to relax

However, few kilometres further more rivals would be included

Critical customer analysis VI

Use in this case

- Showed high concentration for customer likely most affected if merger went ahead AND HU-plant in the relevant market
- Indicated that HU-plant most likely does not belong to the relevant market even when assuming a price increase

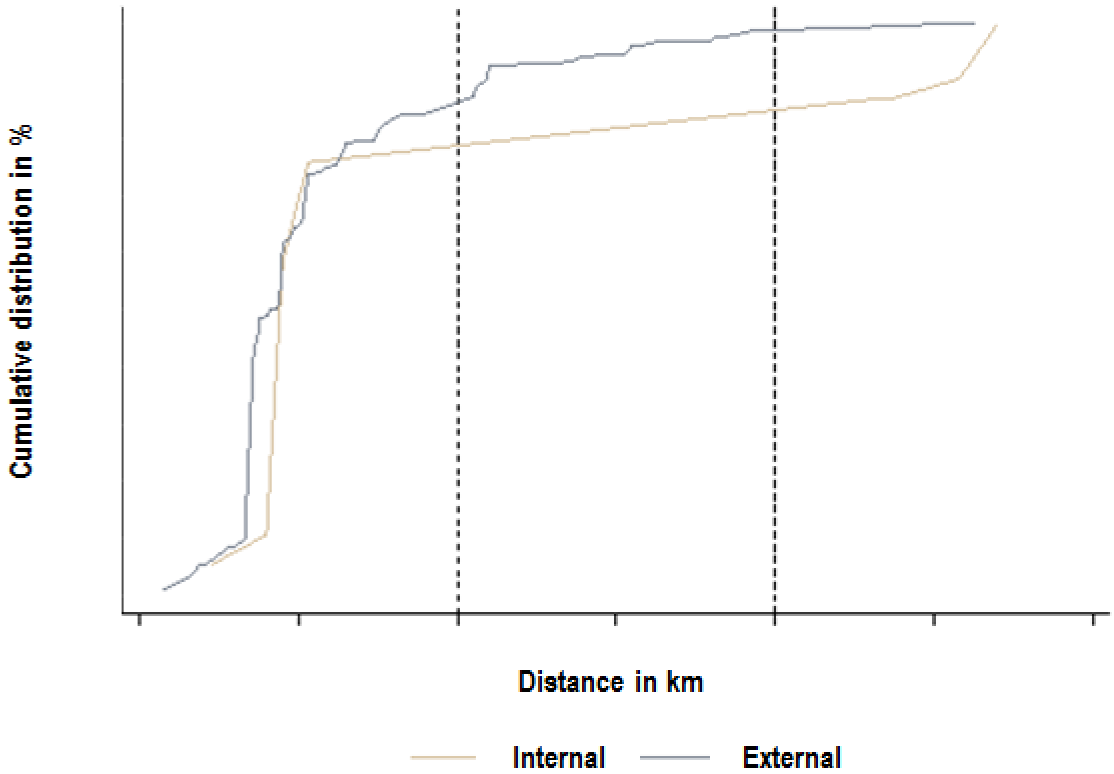
Issues

- What if HU-plant had been relevant for the critical customer? Should we forbid a merger if just one customer is affected?
- Assumptions – e.g. transport cost function; ex-works price etc
- Alternative: draw circles around the plants?

It is only one piece in the analysis but often more telling than drawing circles around plants

Internal deliveries

Lafarge provided data on two plants in Austria: External vs internal deliveries



Implication for Hungarian plant: Internal deliveries just able to reach Austria

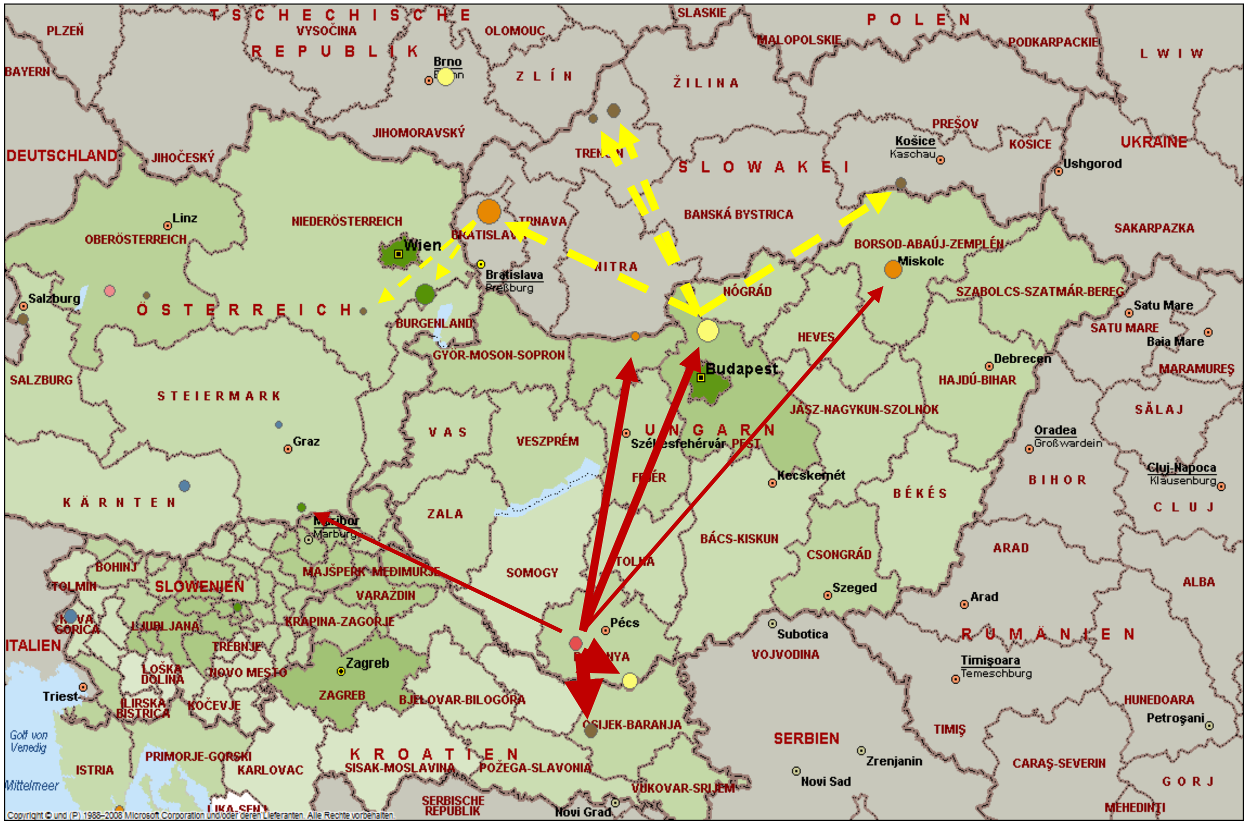
Impact of withdrawn internal deliveries

- **Counterfactual:** Strabag operates HU-plant on its own (no other cooperation)
  - Strabag in AT sources from HU plant (internal sales)
  - Reduces residual demand for cement in AT
  - This could increase pressure on prices compared to merger szenario (and status quo)
  - Would affect Lafarge, as Strabag sourced a relevant share of cement with Lafarge
- **Degree of effects**
  - Worst case: current situation remains
  - Potentially foregone improvement depends on potentially switched quantity
  - Share of Strabag demand in east Austria small part of total demand
  - Full shift contingent on lack of utilisation in HU plant
- No indication for sustained high price levels
- Not raised in market investigation

Effects of potential foregone deliveries appear limited

Chain of substitution arguments

What if effects trickle down to Austria?



- Focus in interviews on direct effects
- Geography not ideal for chain effects
  - Big yellow plant further east
  - Orange circle and Lafarge distant
  - Spreading of effects in all directions

Conceptually not fully excluded but dismissed as non-decisive in this case

Conclusion on geographic market definition and unilateral effects

Austrian perspective: Strabag plant unlikely to be in the same relevant market

- Distance of actual deliveries suggests no deliveries to Austrian customers
- Critical customer analysis suggests no profitable deliveries in case of Lafarge price increase
- Chain of substitution arguments appeard of limited relevance in this case
- Knowing that cement markets „breathe“ (small) effects in some market constellations cannot be fully excluded
- Internal deliveries to Strabag plant not entirely out of the picture

Implications for the case

- No or minimal unilateral effects
- Makes coordinated effects in AT less likely

Competition authorities withdrew the case

Remarks on coordinated effects

- **Issues**
  - Multi market contact
  - Cartel history
  - Inquiry of the Commission

- Assessment depends on **nature of supposed cartel/collusion:** local, national, international

Thank you!

Rainer Nitsche

Managing Director
nitsche@e-ca.com
+49 30 212 31-70 20

E.CA Economics

Schlossplatz 1
10178 Berlin

Tel.: **+49 30 212 31 - 7009**
Fax: **+ 49 30 212 31 - 7099**

info@e-ca.com
www.e-ca.com