

Response to Referee report 1 on *Economics* dp2010-5, received on 04 March 2010-03-04

Many thanks for your helpful and insightful comments and for delivering them so quickly. We will take them into account when revising the current draft of the paper.

In response to your comments:

- 1(a): We are sympathetic to your view that the paper should offer a stronger motivation.  
Indeed, the recent, high profile UK Competition Commission inquiry into groceries markets (2008) involved a price and margin concentration analysis, with the objective to establish effects of local competition on supermarket prices and profits margins. The Commission asserted that its analysis confirms that competition is local, in the sense that higher local concentration is associated with lower prices and margins, and that local competitors exert competitive constraints on each other, in particular when large stores are in local competition with each other.<sup>1</sup> This analysis was heavily contested by some of the main parties to the inquiry, with an array of expert witness testimonies<sup>2</sup>.  
Similarly, the recent UK Office of Fair Trading analysis of local bus services<sup>3</sup> also involved a price concentration analysis; it was used to examine the hypothesis of local bus markets being contestable, in which case there should not be any statistically discernible evidence of unregulated prices being affected by local concentration.
- 1(b): The revised version of the draft will reflect these editorial comments.
- 1(c): Ditto.
- 2: We are certainly not opposed to shortening Section 2 or to move some of the model development into an Appendix. The model is, however, somewhat different from the one in Berry and Waldvogel (1999) in that it allows for heterogeneous firms (p.6), while Berry and Waldvogel treat firms as symmetric (p.406), and that our model captures local concentration in terms of number of firms in a local market, while theirs is cast in terms of the total population share (of radio listeners) in a local market. Our model specification has two main benefits: First, as we argue in the introduction, it is often the case that candidate markets are defined so that firms are of similar in size; e.g. supermarkets with a

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<sup>1</sup> See [http://www.competition-commission.org.uk/rep\\_pub/reports/2008/538grocery.htm](http://www.competition-commission.org.uk/rep_pub/reports/2008/538grocery.htm), Appendix 4.4

<sup>2</sup> See expert witness statements by Jerry Hausman, [http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/main\\_party\\_submissions\\_tesco\\_geographic\\_market\\_definition.pdf](http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/main_party_submissions_tesco_geographic_market_definition.pdf); Ron Smith, [http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/main\\_party\\_submissions\\_tesco\\_expert.pdf](http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/main_party_submissions_tesco_expert.pdf), Ronald Cotterill, [http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/expert\\_report\\_md\\_and\\_mp.pdf](http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/expert_report_md_and_mp.pdf), and Margaret Slade, [http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/expert\\_report\\_margaret\\_slade.pdf](http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/expert_report_margaret_slade.pdf).

<sup>3</sup> See [http://www.of.gov.uk/shared\\_of/consultations/of1112con.pdf](http://www.of.gov.uk/shared_of/consultations/of1112con.pdf); on the basis of its findings, the OFT in August 2009 referred the investigation of local bus services to the UK Competition Commission.

given store size, or cinemas with a given number of screens or seats. Second, it reduces the data requirements for analysis because the number of firms or fascias (brands) in a local market is more readily measurable or quantifiable than market shares. It may be worth noting that this practical advantage is especially significant when different firms measure revenue or “custom” with different metrics. This obstacle is cited, for example, as the rationale for the OFT’s approach in its inquiry into local bus services to use number of competitors as concentration measure, rather than derived market share measures.<sup>4</sup>

- 3(a): The Competition Commission report<sup>5</sup> refers to “different competitive dynamics” with regard to the London cinemas market. This is primarily due to the fact that first screenings of major titles are typically held in London and allows cinema operators to command a price premium. Furthermore, such events of high visibility then may well compete with other entertainment events of similar high profile, such as certain concert, theatre and opera performances (especially with the original cast) that are largely absent in other, smaller cities.
- 3(b): The index of multiple deprivation is published by the Office of the Deputy Prime Minister<sup>6</sup>. It combines an array of weighted measures of deprivation, including: income deprivation; employment deprivation; health deprivation and disability; education, skills and training deprivation; barriers to housing and services; crime; living environment deprivation. It is available for each of the UK’s more than 30000 so-called super output areas (SOAs), with population ranging from 1300 to 1700 people.
- 3(c): The revised draft will refer to planning applications as a footnote.
- 4: The revised version will have a complete list of references.

Walter Beckert  
04 March 2010

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<sup>4</sup> See Appendix C of the aforementioned report.

<sup>5</sup> [http://www.competition-commission.org.uk/rep\\_pub/reports/2006/fulltext/508ad.pdf](http://www.competition-commission.org.uk/rep_pub/reports/2006/fulltext/508ad.pdf)

<sup>6</sup>

<http://www.nomadplus.org.uk/newreportsxml.asp?report=Social%20Issues&sub=Indices%20of%20Deprivation>