

THE ANALYSIS OF EFFICIENCIES IN UPS/TNT

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Outline

- Efficiencies in the market for parcel delivery
 - Source of efficiencies
 - Evidence submitted in the proceedings
- The Commission's approach
 - Computation of net changes in prices
 - Concerns about verifiability
- Out of market efficiencies
- The calibration of remedies in integrated networks

Evidence on efficiencies

- **Pick up and delivery (PUD):** there are economies of density. When the companies merge, the average distance between stops in a typical routing falls. Drivers spend less time driving and more time picking up and delivering parcels.
- The parties submitted evidence on potential cost reductions using the operations research (OR) models that they implement to optimise the routing of the vans and on past experience of network integration. They also provide estimates of cost savings from the reorganisation of the local depots.
- The Commission acknowledges that economies of density can be achieved but considers that these efficiencies are not verifiable and dismisses them altogether.
- Because the core estimates date back to 2007 (updated only by considering the change in TNT volumes) and because a detailed analysis was only performed in four countries (and efficiencies were extrapolated to other countries).
- UPS had discounted these efficiencies. The Commission notes that economies of density are likely to fall at the margin as the network grows and hence cannot assess whether estimates are conservative.

Evidence on efficiencies (ii)

- **Line haul savings.** Reorganisation of the network, from depots to hubs. Both domestically and internationally (for instance, because of increased volumes, it may be attractive to open direct links between depots).
- The parties submitted evidence on potential cost reductions using the “sophisticated network optimisation program” that they use in the course of business.
- The Commission acknowledges that economies can be achieved but considers that these efficiencies are not verifiable and dismisses them altogether.
- Because the a detailed analysis was only performed in three countries (and efficiencies were extrapolated to other countries).
- **International air network.** Re-optimization of the network, use of bigger aircrafts.
- Evidence using the OR model used in the normal course of business.
- Fully accepted by the Commission. The Commission also acknowledges that the discount applied by UPS is warranted given the uncertainty of the estimates

Efficiencies and net increases in prices

- UPS calculates the reduction in the unit cost associated with each type of efficiencies for each type of services.
- For intra EEA express (for which there is a concern) as well as domestic and intra EEA deferred (for which there is no concern).
- Considering the network configuration; efficiencies in delivery in the destination country benefit customers in the origin country.
- The Commission considers only the impact of Air network efficiencies on unit costs for intra EEA express.
- It assumes a pass-through rate of 67% and computes net increases in prices for intra EEA express (using gross increases from its PC analysis).
- Even with the reduced scope of efficiencies taken into account by the Commission, the Commission's concern is removed in 14 countries.
- If all efficiencies had been taken into account, the Commission would have presumably concluded that the merger did not raise any SIEC anywhere.

Standard for verifiability

- Verifiability or reliability ?
- UPS implements methods used in the normal course of business
- UPS used its efficiency calculations to convince investors of the merit of the transaction. This provides information on their own assessment of the reliability of the estimates.
- The Commission assigns no weight to efficiencies despite the fact that it recognizes their sources in principle (a theory of efficiency). Should the Commission not discount the estimates (to reduce the probability that efficiencies may turn out to be lower than their imputed value) ?
- The Commission substitutes its own judgment for that of UPS regarding the marginal benefit from extending the coverage of detailed studies.
- UPS is naturally concerned about the aggregate level of efficiencies and not their distribution across countries. Should this be acknowledged ?
- The Commission declines to take into consideration efficiencies taking place in the fourth year of the integration, because they are more uncertain
- But they are part of the same plan as efficiencies occurring earlier. Taking them into account would have removed concern in another six countries

Out of market efficiencies

- Out of **product market** efficiencies : many customers buy products for which a price reduction is expected (like domestic for which gross prices are not expected to increase and efficiencies accrue because of PUD) as well as Intra EEA express.
- UPS showed that given typical purchasing patterns, almost all customers are likely to benefit from the transaction.
- But the Commission, by denying efficiencies in PUD, ignores this cross market effect.
- Out of **geographic** market efficiencies : an efficiency in the destination market benefits customers in the origin market.
- Hence, imposing remedies in some destination market which prevents the achievement of efficiencies, would have effects on the net increase in prices computed for customers in the origin market.
- By denying efficiencies in PUD, the Commission ignores this effect. In general, when firms operate networks which spans several markets, these effects however should be taken in account in the calibration of remedies.
- The **non problematic** countries account for more than 70 % of the intra EEA express business and more than 95 of the overall business. A very high opportunity cost (in terms of customer benefit) to protect a few