

The role of anchor tenants in the market definition of retail rental space

Recent merger decisions in Poland and France have found product markets that are narrower than in any previous decision. In their analysis, the authorities focussed on supply-side characteristics. This generally leads to relevant markets that are narrower than those reached by applying the logic of the hypothetical monopolist test.

Historically, competition authorities in various jurisdictions have rarely been concerned with antitrust problems in the market for retail rental space and have defined these markets relatively broadly. More recently, the French and Polish competition authorities defined significantly narrower product markets in two merger cases, which identified shopping centres with a set of defined characteristics as a separate product market.¹

The analyses in these two cases started with categorisations of retail space and shopping centres by national industry associations.²

Limitations of characteristics-based approach

Whether in a particular case markets should be defined narrowly (e.g. separating different types of retail spaces even within a given group of shopping centres or high streets) or widely (e.g. including all (rental) space for retail outlets in a given area) is an empirical question that will depend on the facts of the case. However, we find that a segmentation based solely on characteristics will likely fail to identify the correct relevant market.

¹ See Unibail/Rodamco merger decision in France (C2007-52) and Unibail Rodamco/Simon Iwanhoe merger decision in Poland (DKK - 64/10). The mergers were ultimately (conditionally) approved.

² This E.CA Compact draws on ideas from the research paper of Kaluźny, J., R. Nitsche, L.-H. Röller (2011). Defining Product Markets for Retail Rental Space: Thoughts on Methodological Choices. *European Competition Journal*, 7(3): 421-431.

- First, existing industry classifications group shopping centres according to a number of characteristics. However, there is no agreement on which characteristics to use and in which order: more than 25 different categorisations have been adopted by various associations or vendors in different countries. Relying solely on one of these would yield an arbitrary market definition.
- Second, in the shopping centre business rents are set according to the Occupancy Cost Ratio; thus differences in the attractiveness of shopping malls and the expected turnover of a tenant are reflected in the level of rent. A shopping centre that generates less traffic due to inferior characteristics compensates for this disadvantage by setting lower rents.
- Third, tenants or groups of tenants will consider the bundle of characteristics (including the rent) and trade off what they perceive as advantages and disadvantages.

Thus, relying solely on product characteristics and existing classifications while disregarding actual substitutability patterns when defining relevant product markets will likely lead to market definitions that are too narrow. It is well established that studying the customers' likely responses to a small but significant and non-transitory increase in price, which is part of the SSNIP test, is usually more informative for market definition. Why then are approaches based solely on characteristics still so popular with competition authorities?

Challenges for the SSNIP test

One likely reason is that a full formal SSNIP test is often difficult to implement. Indeed, in the industry at hand owners of retail space tend to (or have to) conclude individually negotiated long-term contracts with tenants. Thus, there is a lack of data that would enable us to apply a number of statistical techniques in order to predict the anticipated behaviour of tenants in light of a hypothetical price increase.

However, such difficulties in applying statistical techniques should not lead to abandoning the *logic* embedded in the SSNIP test. In contrast to the characteristics based approach, the SNIPP test focuses on the economic effects and possible consumer harm by identifying markets that are “worth monopolising”.

We suggest making use of a mix of evidence and methods that fits this logic. The most reliable evidence of sensitivity of demand to change in prices comes from tenants’ actual responses to past price changes or the impact of unforeseen “natural experiments” on shoppers’ behaviour and/or the level of rents. More detailed analysis of the cost structure may be helpful in simulating effects of a hypothetical rent increase on tenants and predicting switching. Surveys can be helpful in generating evidence on past behaviour and the ordering of substitutes. Questions related to responses to a hypothetical price increase may complement such evidence.

Accounting for externalities and tenant types

At least two factors appear relevant when applying the SSNIP test logic to shopping centres.

- Positive externalities: While in standard markets (without externalities) often the profit reducing effect of a price increase is limited to the loss of revenue generated by the customers that leave, shopping centres may suffer more due to two further effects. First, if (attractive) tenants leave, traffic in the shopping centre is reduced. This harms other tenants’ revenue and will therefore lead to reduced rents. Second, if rent increases are passed on to shoppers, the number of shoppers will decline. Again this reduces the attractiveness of a shopping centre for its tenants leading to reduced rents. Accounting for the effect of these externalities tends to unambiguously widen the product market and failure to do so results in markets that are too narrow.

- Tenant types: The very business of shopping centre managers is to find an optimal mix of tenants and to negotiate rents that reflect the revenue potential of a given tenant type taking into account the positive effect on traffic in the shopping centre. This implies that there are limits to substituting tenant types. Also, different tenants may look for different rental units, so it may be useful to distinguish tenant types and consider their options separately. Lessons on the relevant markets for tenant types can be drawn from their past location decisions. Different tenant types may also differ in their ability to pass rent increases on to final consumers, which is also relevant for the analysis of profitability of hypothetical price increase and market definition.

In the past, some competition authorities in the United States and in Europe have taken a very lenient attitude to merger control in the market at hand. In recent decisions national competition authorities have moved to the opposite extreme. With the methodology proposed in this paper, we attempt to provide a methodology that can be adopted on a case-by-case basis. It may be complemented, however, by a more general empirical study of the impact of concentration on rents. This appears to be an interesting question for future research.