

Chapter 6

Market structure and the leisure sector



Part 1 of the book introduced the notion of market structure, and outlined its importance in enabling an allocation of resources that is good for society. It is important to see how this works in practice, and this chapter uses a number of case studies in order to evaluate how market structure has influenced the efficiency of resource allocation in the leisure sector.

Learning outcomes

After studying this chapter, you should:

- be familiar with the way in which market structure affects the efficiency of resource allocation in sections of the leisure sector
- understand the way in which the package holiday market operates as an oligopoly
- appreciate that firms in the package holiday business may face the threat of new entry from firms using the internet, thus affecting the contestability of the market
- be familiar with the way in which the market for television broadcasting has evolved over time, from monopoly to duopoly to oligopoly, becoming more competitive as technology has changed
- be aware of the importance of market structure in the market for spectator sports
- understand developments in the market for air travel, and the impact of the low-cost airlines
- appreciate the conditions under which price discrimination can be utilised by a firm in order to increase its profits
- be familiar with the way in which the theory of monopolistic competition can help in understanding the leisure sector

The market for package holidays in the UK

The market for package holidays is big business. In 2006, UK residents made 45.3 million holiday visits abroad, of which package holidays made up a large proportion. This represents a major change in habits over recent decades – in 1971, the number of holiday visits abroad was just 6.7 million. To what extent does the market operate

efficiently? In order to evaluate efficiency, economic analysis suggests that a starting point is to examine the market structure.

The Association of British Travel Agents (ABTA) is an organisation that acts as a trade association for tour operators and travel agents in the UK. In early 2006, ABTA covered more than 6,000 travel agency offices and more than 1,000 tour operators. According to the ABTA website, between them, these accounted for 85% of UK-sold holidays.

Superficially, the fact that there are more than 6,000 travel agency offices seems to suggest a competitive market, but this is misleading, as it is not only the number of offices that is important, but also the number of firms in the market, and the distribution of the business between them. ABTA's membership comprises about 1,722 individual member companies, but the four largest control a significant part of the market. These are Thomson, Thomas Cook, My Travel and First Choice.

With just four major operators in the market, it would be classified as an *oligopoly*. If the firms were to collude together in order to exploit their market power, this could have an adverse effect on allocative efficiency. A monopolist attempting to maximise profits would restrict output and raise price, thus pushing the market away from the point at which price is equal to marginal cost. However, the question is whether the firms do collude in this way, or whether there are other forces within the market that constrain or prevent them from exploiting their position.

One way in which firms in a market may be constrained is through the direct effects of regulation. The market for foreign package holidays has been investigated in the past by the Monopoly and Mergers Commission (now the Competition Commission). Investigations took place in the mid-1980s (reporting in 1986), and again in the late 1990s, with a referral to the commission taking place in 1996. The 1986 report investigated allegations of what was, in effect, *resale price maintenance*. Resale price maintenance is where the producer of a good dictates the price at which it should be sold



Thomas Cook is one of the four big companies that control the travel market

in the retail market – a practice that has been illegal for many years. The commission concluded that this was against the public interest, and outlawed the practice.

In the later investigation, the commission noted that at the time the largest three operators in the market accounted for around 50% of all foreign package holidays sold in 1996. In its report, the commission expressed concern about the degree of *vertical integration* in the market, particularly given that some of the ownership linkages between firms were not made clear to customers. Vertical integration is where a firm is involved in different stages of the production of a good or service. An example is that of First Choice Holidays. The commission pointed out that this firm was not only a tour operator, but also an airline (Air 2000), and for a period was also in a strategic alliance with Thomas Cook (travel agent). Consumers were not always aware that they were dealing with a firm that was involved at these different stages of the production process, which can affect the profit margins on particular holiday packages. However, while recommending greater transparency in the market, the commission did not condemn the operators outright. It did make a number of recommendations about certain practices, such as tying discounts to the purchase of insurance. But the commission concluded that ‘we would characterise the travel trade as at present broadly competitive, and as having served the consumer well’.

The threat of investigation by the competition authorities may be one way of ensuring that operators in a market do not abuse their market position, but are there are other forces at work that might influence firms? And how else might a judgement be reached as to the intensity of competition in a market?

One of the problems in evaluating a market is that, in general, it is not possible to observe marginal cost, so that it is not possible to check whether price is being set above marginal cost. An alternative might be to look at profits, and ask whether firms in a market seem to be making excessive profits. In the case of the travel companies, recent experience may not help in this respect. The substantial reduction in demand for foreign holidays following the terrorist attacks of 11 September 2001 in the USA created difficulties for many of the tour operators and travel agents, many of which posted sharp reductions in profits, or even losses. But this is not conclusive evidence that firms were not abusing their market power; it might just be a process of adjustment to lower demand for their products.

Perhaps more relevant is to examine the extent to which the market may be regarded as contestable. In other words, to what extent can the existing operators in the market rely on barriers to entry to protect them from hit-and-run entry, or to what extent is it possible for new firms to enter the market? If the market is contestable and open to entry by new firms, then it would not be possible for the existing firms to set prices at a level above average cost, as this would attract new competition.

The growth of the internet may be the key factor that determines the intensity of competition in the travel industry. The growing ability of consumers to by-pass the local travel agent by making their own bookings online suggests that the travel market is highly contestable. It is now possible for a potential holidaymaker to find their flights, hotel accommodation, car rentals or hotel transfers from their PCs. This

can be done either by booking direct with airlines and hotels, or by using one of the growing number of online firms, such as Expedia, the world's largest online travel agent.

The travel agents have thus had to respond to these new online entrants to their market. They have done so partly by themselves going online, and developing their own websites and online sales. They have also responded by looking for niche markets, offering specialist advice on long-haul holidays, adventure trips or skiing packages.

The intensity of this competition is likely to be beneficial for consumers in terms of the prices that can be obtained for package holidays. Inevitably, there may also be dangers. For example, it may be that online purchase of the separate components of a holiday is more risky than buying from a travel agent backed by the code of conduct now issued by ABTA. Or it may be that the online companies themselves will go through a process of merger, acquisition and increasing concentration that may lead at some point to market power.



PHOTODISC/CADMILUM

Offering specialist advice on skiing packages — a niche market for travel agents

Exercise 6.1

Discuss the extent to which the growth of online sales of package holidays is influencing the range of destinations and variety of holidays on offer. Do you think that more regulation of online marketing is needed in order to protect consumer interests?

Television broadcasting

According to the 2005 Time Use Survey, watching either television or DVD/video occupies more than half of people's leisure time in the UK (see Figure 5.18). It is thus important to ensure that television broadcasting is being provided in an efficient manner. Again, whether this is the case depends partly on the market structure in the television broadcasting sector, which is likely to influence the behaviour of the enterprises engaged in this activity.

There are other aspects of broadcasting that affect the efficiency of the market. Indeed, there are three areas of potential market failure in the sector. A tendency to *concentration* (and hence imperfect competition) is one of these, but in addition, broadcasting has some aspects of a *public good*, and there may also be some *merit good* arguments.

Television broadcasting may be regarded as a public good because there is an extent to which it is non-rivalrous and non-exclusive. When a programme is broadcast, anyone with a television receiver can pick up the signal, so it is difficult to exclude people from consuming the good. Furthermore, if one person watches the

programme, this does not reduce the amount of it available for others to watch. You will remember from *AS Economics, Chapter 7* that these characteristics mean that public goods are under-provided in the absence of some form of government intervention. Partly for this reason, there has been government intervention in television broadcasting ever since transmissions first began. The BBC derives much of its income from the licence fee, which is one way of ensuring that people pay for the programmes that they watch. The situation has changed with technology in recent years, making it possible to exclude people from receiving some channels, and enabling firms to charge for particular programmes.

There is a view that television broadcasting has merit good characteristics, as it is believed that viewing habits can influence behaviour. Watching educational programmes may bring beneficial spillover effects, whereas watching violent dramas may have the opposite effect. This argument has been used to justify government intervention to influence the content of programmes that are broadcast.

In terms of market structure, television broadcasting began as a *monopoly* (when only one BBC channel was available). ITV was granted a licence to broadcast in 1955, being funded through advertising revenue, so the market became a *duopoly*. As more terrestrial channels were launched, the market evolved into an *oligopoly*. The cost structure of television broadcasting encourages a relatively high degree of concentration. This is because the ratio of fixed to variable costs is very high, which in turn means that there are substantial economies of scale. The major costs arise in establishing the network of transmitters, and in making the programmes. The marginal cost entailed in transmitting the programmes is very small compared to these fixed costs.

How might the resulting market power be exploited by the firms involved? After all, the BBC does not control the size of its licence fee, and the commercial channels do not charge their customers directly. A danger of lack of competition is that firms may cut their costs, and thus may produce low-quality programmes, or only put out populist programmes that will attract audiences, and thus advertising revenue. But it might not provide the sorts of programme that the authorities would regard as meritorious.



Liz Barker presenting the BBC's long-standing children's programme, Blue Peter

The so-called digital revolution has made it possible for many other channels to become established, some of them available only on a subscription basis. This has affected the barriers to entry, and enabled the market to be more contestable than before. In the UK, there are now more than 300 channels available. Some of these channels cater for niche markets, such as cookery, comedy or home improvement.

Issues arising from the merit good argument remain, and clearly the authorities have a greater challenge to face in ensuring that what they see as an appropriate balance of programmes is broadcast, now that there are so many channels to deal with. As with any appeal to a merit good argument, there are bound to be differences between politicians and others about the extent to which the authorities should override consumer preferences.

The way that technology has developed to enable broadcasts to be restricted to subscribers or paying customers has enabled a number of new developments in this market. In particular, there are segments of the market where consumers are clearly prepared to pay a premium in order to view particular programmes. One obvious example of such a market segment is in sporting events, such as Premiership football and test cricket. These examples are discussed in the next section.

Exercise 6.2

Discuss the extent to which the authorities are justified in intervening to influence the sorts of programme that are being broadcast.

Spectator sports

Another important form of leisure activity is watching sport. This takes a wide variety of forms. Parents watch their children playing sport at the local sports centre, people attend sporting events, and there is plenty of 'live' sports action on television, both on the terrestrial channels and on specialist subscription channels such as Sky Sports.

As far as professional sporting events are concerned, there is some interlinkage between the markets. Ever since football matches were first televised, it has been argued that matches should not be shown 'live' at the traditional match time of Saturday at 3 p.m., as this was thought to affect attendance at the grounds. For Premiership and Championship clubs, gate receipts remain an important source of income, although television revenues have also become increasingly important in recent years. A lot of attention has been devoted to the earnings that footballers command in the Premiership. This issue is taken up in Chapter 7 (see page 110).

In terms of market structure, the way that the rights to televising events have become concentrated is an especially crucial area. In particular, BSkyB's position in this market has attracted considerable attention in relation to holding rights to televise live sporting events such as football and cricket. An important question is the extent to which BSkyB has monopoly power, and the extent to which it is able to exploit that market power at the expense of the viewers.

There is a specified list of events that are guaranteed to be shown on free-to-air terrestrial channels. This list includes the Olympics, the World Cup (football), the FA Cup Final, the Grand National and Wimbledon.

Test cricket was delisted in 1998 after lobbying from the England and Wales Cricket Board (ECB), which was keen to raise funds for investment. This enabled BSkyB to bid for exclusive rights to domestic test matches, in a deal that would remove cricket from the terrestrial channels from 2006 to 2009. A further review of the list was promised – but not until the switch-over to digital television has been completed.

Premiership football had fallen prey to Sky at a much earlier date. Sky won the rights to live Premiership football in 1992, and maintained its position until an auction that was held in May 2006. The auction was held following intervention by the European Commission, which had ruled that BSkyB's dominance of live Premiership football was acting against consumer interests. In the auction, six packages of matches were sold separately, four of which were bought by BSkyB, and the remaining two by the Irish pay-TV broadcaster Setanta. Within a week of the auction, BSkyB and Setanta reached a deal in respect of the pubs-and-clubs segment of the market. Under this agreement, Sky's corporate customers would get Setanta's sports channels bundled in to their monthly subscription. It would seem that monopoly had been replaced by a duopoly.

BSkyB's moves in these various sports markets were strategic, aiming to build up the number of subscribers by gaining control of these key market segments. From the perspective of BSkyB, this may be seen as an attempt to gain and consolidate entry into the television broadcasting market, which until the advent of satellite broadcasting had been an oligopoly controlled by the terrestrial channels via licensing agreements. Only by reaching a critical mass of subscribers would BSkyB be able to generate sufficient advertising revenue to become profitable.



The satellite station BSkyB gained a monopoly in the supply of certain televised live football and cricket matches

Another way of viewing the market situation is that the Premier League was a monopsony seller of the rights to live football – and the ECB of the rights to televise test cricket. By opening up to an auction and selling to the highest bidder, the Premier League gained funds to distribute to the Premiership clubs, and the ECB gained funds to invest in cricket.

The evaluation of the effect of market structure in this situation is tricky. It could be argued that BSkyB has been able to use its market power to charge a high price to consumers for watching live football on television. However, if these matches were to be available on free-to-air television, it could be argued that this would damage match attendance and leave the football clubs struggling for revenue. The monopsony position of the Premier League has enabled it to channel revenue to the clubs, making the Premiership one of the richest leagues in the world. Television revenues and audiences may be even more important in the case of test cricket.

The market situation was the subject of investigation by the UK's Competition Commission, which became involved in 1998 when BSkyB's proposed acquisition of Manchester United was referred by the secretary of state for trade and industry. The acquisition was prohibited on the grounds that it would reinforce the trend towards inequality of wealth between football clubs, and would give BSkyB additional influence over Premier League decisions relating to the organisation of football. However, this did not break the monopoly that BSkyB had over live Premiership broadcasts at that time.

After this, the European Commission became involved, and argued that BSkyB's exclusive right to televise live matches was in violation of European competition rules, as it was 'not in the interest of competition in the broadcasting market or the fans'. At the time, the Premier League agreed that after 2006 the tendering process would ensure that there were at least two television broadcasters of live Premiership matches. The commission intervened again in 2005 when it seemed that the Premier League was delaying matters, and the auction finally took place in April 2006.

Exercise 6.3

One advantage of the system that allowed BSkyB to gain a monopoly in the supply of televised live football and cricket matches is that this brought money into the respective sports, enabling investment in football clubs and cricket at grass-roots level. Discuss the extent to which consumers have benefited from satellite broadcasting of sporting activities.

The low-cost airlines

The case study of the low-cost airlines is an interesting example of the way in which intensified competition in a market can affect the operation of markets. As this example is also pertinent in examining the transport sector, this case study appears in Chapter 10. You will find it on pages 170–173.

Monopolistic competition in the leisure sector

The theory of monopolistic competition describes a market with some features of monopoly and some features of perfect competition. Barriers to entry are low, so the market has many firms. However, firms in the market use product differentiation to influence consumers, and thus face downward-sloping demand curves.

If you look back at the analysis in Chapter 3, you will see that this form of market structure has implications for both productive and allocative efficiency. Firms produce at a level of output that is below that at which long-run average cost would reach the minimum, so there is not productive efficiency. Furthermore, price is set above marginal cost, so allocative efficiency is not achieved either.

A growing section of the leisure sector is food outlets. The number of restaurants and fast-food outlets has mushroomed in recent decades, and on many high streets in UK towns there is a proliferation of eating places and takeaways. This market seems highly contestable, as the set-up costs for starting a new restaurant or takeaway are relatively low. One of the characteristics of a market operating under monopolistic competition is the product differentiation that takes place. Each individual seller sets out to be different from its competitors. This is certainly a characteristic of the fast-food sector, where outlets offer different styles of cuisine – burgers, Indian, Chinese, Thai, Mexican and so on. Before condemning such a market as being damaging to consumers because of the effect on productive and allocative efficiency, it is worth being aware that this market offers consumers a wide range of choice for fast food. If they value this choice, then this should be seen as a benefit that arises because of the market structure.

Exercise 6.4

Discuss the factors that may have enabled large firms such as McDonald's, Burger King or KFC to become established as large firms in the fast-food sector alongside the many small competing firms.

Another part of the leisure sector that typifies monopolistic competition is local taxi markets. Count the local taxi companies in your local *Yellow Pages*. Again, firms may seek to differentiate their products through having a fleet livery, by advertising pre-booking only or by offering a limousine service. There may also be firms that specialise in longer-distance trips, say to airports.

Summary

- Market structure is important in determining whether allocative efficiency can be achieved.
- However, productive efficiency must also be taken into account.
- The package holiday market has become oligopolistic, with a few large firms dominating the market.
- However, the growth in the internet has meant that the market has become contestable, and the existing firms are facing intense competition from online entrants.
- Television broadcasting has also shown oligopolistic tendencies in the past, and given its characteristics as a public good and a merit good, there has been much government intervention and regulation.
- Again, changing technology has transformed the market and allowed greater competition among broadcasters.
- Spectator sport is another part of the leisure sector where the competition authorities have been active, particularly in relation to the growth of satellite broadcasting, where BSkyB has become a major player with a monopoly in certain areas.



part 2

- The low-cost airlines have transformed the market for air travel, making use of a thorough understanding of costs and the use of price discrimination.
 - The leisure sector also offers examples of monopolistic competition in food outlets and taxi markets.
-