



Association of Directory Publishers

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Industry Response to SF Economic Report

May 10, 2011

To: All North American ADP Members

Fr: Larry

Re: San Francisco Controller's Report on Economic Impact of Opt-In Ordinance

Please find below two of the many communications being sent in opposition to the San Francisco opt-in proposal.

The first is a copy of the press release issued by the industry in response to yesterday's economic report issued by the City Controller.

The second is a copy of the economic analysis independently authored by Dr. Marc Rysman, Assistant Professor of Economics, Boston University, at the request of ADP.

I urge you to take the time to read them. It's interesting stuff and is a good illustration of the craziness that the industry is up against in the city by the bay.

SF ECONOMIC REPORT ON YELLOW PAGES HURTS SMALL BUSINESS
Data Assumptions by City Controller
Misleading, Illogical

SAN FRANCISCO, (MAY 9, 2011) – With all due respect to the City of San Francisco, the bottom line of the controller’s report is that it is OK to risk \$250 million in annual sales to small businesses generated via the Yellow Pages to save \$600,000 in recycling costs. We strongly disagree with the report’s conclusions and believe that it is an insult to small businesses throughout the city.

The controller’s report makes assumptions that would make most economists wince, specifically:

The job loss assumption is ludicrous.

The controller’s model observes that publisher revenues will be reduced from \$17.5 million per year to \$2.9 million. Yet, it claims that only 20 out of 235 current jobs will be eliminated. This defies all consideration of how the Yellow Pages industry has responded to lower revenues across the country.

In contrast to other "publishing" businesses, 100 percent of Yellow Pages revenue comes from ad sales. If revenues go down, the number of employees will drop proportionally. That means that if revenues drop to \$2.9 million, nearly 190 jobs would likely be lost. Most of these jobs are union jobs.

Advertising model doesn’t account for increased costs.

The model assumes that the \$14.6 million not spent on Yellow Pages by small business advertisers would be returned to consumers, thus increasing spending. But the model also admits that businesses will have to find other forms of advertising to reach consumers. Both of these cannot be true at the same time - the model contradicts itself.

The return from Yellow Pages is \$25 to 1 and far exceeds the overall return to advertising of \$8.61 to 1. Therefore there will be no savings to consumers; in fact, the increased cost of advertising will lead to higher costs of goods and services, which will lead to less goods and services purchased, which will harm the San Francisco economy and in, particular, harm the small, local service businesses that fuel it.

On behalf of the small businesses throughout San Francisco, including those in the Hispanic, Chinese and LGBT communities, we urge the supervisors to see this report for the hogwash it is.

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A Comment on the “Yellow Pages Distribution Pilot Program: Economic Impact Report”

Marc Rysman, PhD.

Associate Professor of Economics, Boston University

In this paper, I provide a few comments on the document entitled “Yellow Pages Distribution Pilot Program: Economic Impact Report” prepared by the Office of Economic Analysis. I found several of the claims in the report to be far-

fetched, and they could possibly lead the Board of Supervisors in a mistaken direction. The report outlines three effects of the opt-in program: the effect on Yellow Pages publishers; the effect on merchants and consumers that use Yellow Pages advertising; and the effect on recycling costs. The report itself argues that the impacts on recycling costs are relatively small and thus that the most important impacts are the economic ones. Remarkably, the report argues that the economic effect of the regulation would be a positive one. It should seem surprising that a regulation designed to damage an otherwise successful local business could improve the local economy, but that is exactly the claim in this report.

Below, I provide comments on specific points in the report. I start with the claim that damaging the Yellow Pages market will somehow improve the local economy, as the report argues that this effect is empirically the most important. Following that, I briefly touch on the other two, regarding environmental costs and the effect on Yellow Pages publishers.

1. Advertisers do not want the Board of Supervisors to regulate their choices.

The report suggests that advertisers will somehow be made better off because opt-in will provide advertisers with a more targeted product. If advertisers preferred an opt-in directory, Yellow Pages publishers would have provided opt-in directories a long time ago. The report recognizes that the directory business is a competitive one which has seen many innovations over time, but somehow imagines that publishers would have missed this simple point. It is far-fetched to believe that publishers need San Francisco regulations to see this point.

This type of thinking is pervasive in the report. For instance, the report highlights the possibility that using regulation to debilitate the Yellow Pages market will cause innovation in marketing. The report seems to imagine that there are profitable opportunities for innovation out there that the private sector can only recognize with the help of the San Francisco legislature. I do not believe that this type of thinking is the foundation for good public policy.

2. Merchants make effective advertising choices.

The report argues that the regulation would cause a massive savings for local firms in advertising costs, and considers this a form of economic benefit. But nobody forces firms to take out Yellow pages advertising – the opposite is true. Merchants advertise in the Yellow Pages because it is an effective medium in which to market their services. Limiting advertising options hurts businesses (and keep in mind that local businesses make relatively more use of the Yellow Pages than national and international ones). Presumably, some of the lost Yellow Pages advertising will go into other forms of marketing, which must be

less effective (unless the Board believes that San Francisco businesses are systematically making mistakes in advertising that the Board can correct). Similar to the point above, the businesses of San Francisco don't need the Board to help them to choose how to invest in marketing.

3. Consumers that do not opt-in can still be valuable to advertisers.

The report argues that people who want the Yellow Pages most will opt-in, which limits the level of damage arising from the regulation. This argument represents a failure to understand this industry. Many people who use a directory are searching for a new firm with which to work, and will build long-term relationships with the merchant they find. That is true even if the consumer uses directories only rarely. Therefore, consumers who use a directory only once in a while may not opt-in, but would still be very valuable readers from the perspective of advertisers. Again, the bottom line is that advertisers do not want an opt-in directory, or else publishers could have easily supplied one.

4. Opt-in regulation can lead to higher Yellow Pages prices for advertisers.

The report claims that the costs of Yellow Pages production will fall, which will lead to lower prices for advertisers. But this formulation is overly simplistic. A well-understood point in economics is that marginal cost, the cost of selling one more advertisement, affects price. Fixed costs of production do not affect a firm's pricing choice. This report does not discuss costs in terms of the marginal cost of advertisement, but rather seems to conflate the concept of marginal cost with variable and fixed costs.

I believe a more likely outcome from the opt-in regulation is exit, which will lead to substantially higher advertising rates. As the report recognizes, the fixed costs of producing a Yellow Pages directory (those costs that do not depend on how many books are published or their size) are substantial. Under opt-in, publishers would have a substantially smaller distribution over which to recoup those costs. It is unclear that the San Francisco market can continue to support two publishers under this regulation.

My research shows that reducing competition causes publishers to raise prices, especially when going from two firms to a monopoly, as would be the case in San Francisco. Merchants in particular lose out when competition is reduced. Many people wonder what are the benefits of having multiple publishers in a jurisdiction. My research highlights a simple point: Just as in any other market, competition reduces prices to the benefit of users.^[1]

^[1] Note that my research is published in highly respected peer reviewed journals of Economics. See Rysman, M. (2004). "Competition Between Networks: A Study of the Market for Yellow Pages," *Review of Economic Studies*, 71,

Now I turn to the other claims in the report, about recycling costs and the direct effect on Yellow Pages publishers.

5. Recycling costs can be addressed in other ways.

The opt-in regulation is specifically designed to damage and shrink the industry. While all municipalities have to be concerned about waste management costs, damaging local business activity via regulation is not a productive response. Yellow Pages publishers are deeply concerned about their communities by the nature of their businesses. I encourage the Board to reach out to local publishers to craft an alternative response that also addresses recycling costs.

6. The negative impact on Yellow Pages publishers hurts San Francisco.

The report recognizes that the opt-in regulation will hurt local Yellow Pages publishers, but argues that the effect on the San Francisco economy will be minimal because “the publishers have the bulk of their Yellow Pages-related employment and expenditures outside of San Francisco.” This claim is made without any proof or citation. It is also wrong. By far the largest cost of producing a directory is sales, and distribution represents another major cost. These expenditures are inherently local. There is no way to generate advertising sales in San Francisco without sales people who work a substantial amount of time in San Francisco. The same goes for distributing directories.

7. Conclusion

Regulation is seen as a last resort in economic policy. Regulation is sometime justified, for instance in the cases of public safety or important externalities. But regulation should only be considered after a clear consideration of the economic costs of the regulation. We should be skeptical of regulations that require us to believe that there are no economic costs, or that there are only economic benefits. This type of thinking leads policy-makers astray.

This report does not follow the simple steps that are necessary to evaluate a regulatory intervention into a market. In order to justify a regulation, we should first identify a specific market failure, and we should then argue that the regulation is the best of the set of different policies we might consider. This report does neither. The report never states what the problem is with the

Yellow Pages market that it needs this regulation, and it does not discuss alternative policy approaches at all. Policy-makers should be wary of regulations that are justified by market outcomes that could easily be provided without the regulation. Policy-makers should be especially wary of claims that a regulation will improve a market without a specific statement of what is failing with the market in the first place. That is surely true in this case.