Workshop on the Application of EU Regulatory Framework

Belgrade 05 Oct 2007

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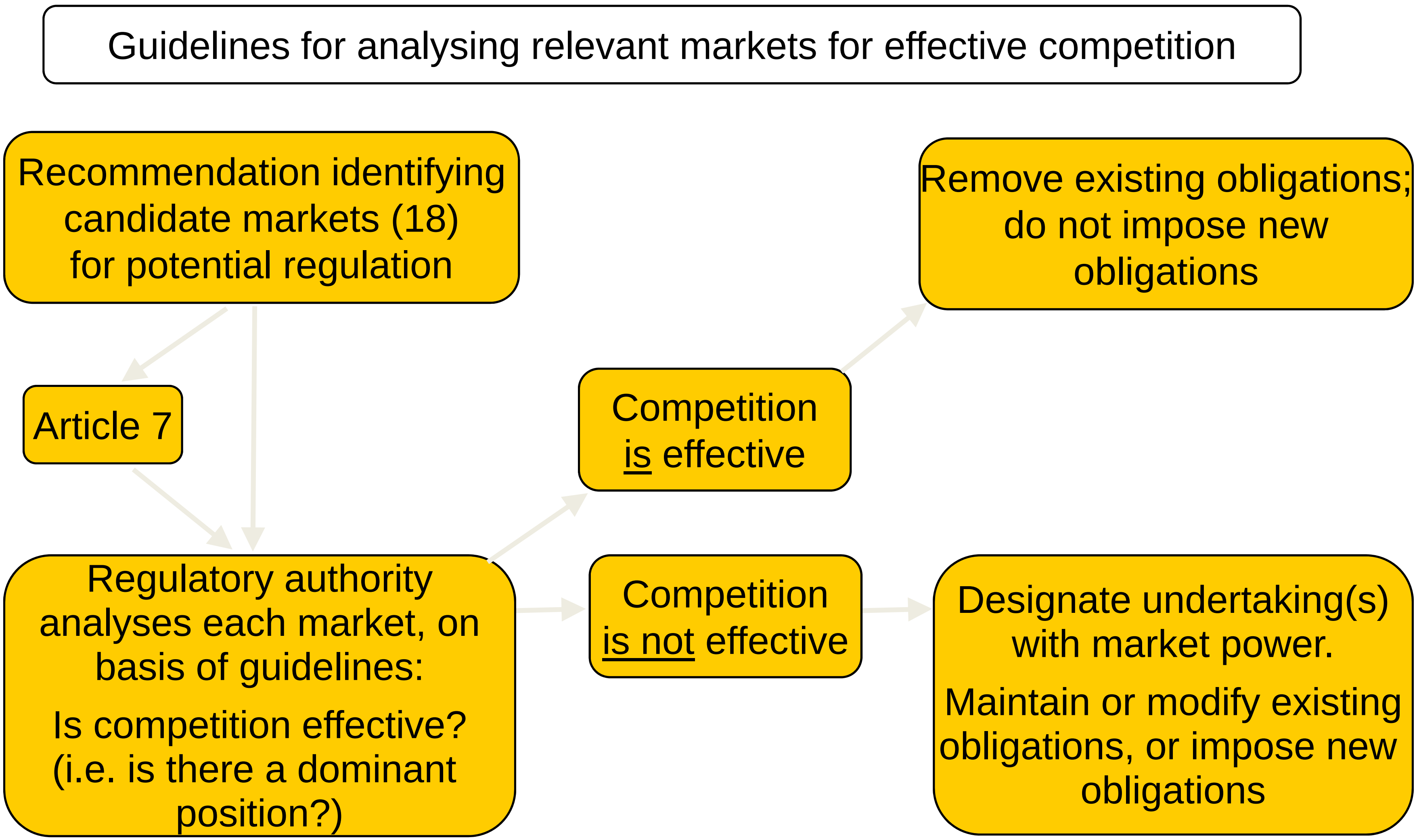
The Economics of Market Reviews

The main steps in Market Analysis process



EU Guidelines

- The European Commission SMP “Guidelines” are the basis of the approach to market definition and finding of dominance
- Guidelines based on economic market theory and EU competition law principles
- Key areas covered by the Guidelines;
  - market definition
  - dominance/Market Analysis

Market Definition

- Product market definition:- what products are in a market affected by <u>substitutability</u>;
  - first "Demand-Side" substitutability, and then
  - "Supply-Side" substitutability, also
  - potential competition

- Demand side substitutability measures the extent consumers would substitute product "A" for product "B" following a change in price
- Supply Side substitution looks at producers who would manufacture product "A" or product "B" as a result of a change of price
- Potential competition can be assessed as a factor under supply-side substitution i.e. the longer term competitive impact, but is also considered when assessing dominance

Market Definition: SSNIP test

- The 'SSNIP' test is used to assess demand and supply substitutability
- 'SSNIP' test is also called 'Hypothetical Monopolist Test' – Small but Significant Non-transitory Increase in Price
- SSNIP test assumes a price is freely set in a market (i.e. not regulated, uncompetitive market)
- The test argues: starting with the smallest market definition a single firm could raise the price of the product by 5-10% and sustain it for 12 months.
  - if yes the product is a single market.
  - if no, then include products that would substitute it until you get to yes.

Market Definition: SSNIP test

- 'SSNIP' is way of identifying which products or services are in the same market
- Products in the market are substitutes. Products outside the market may be referred to as complements
- Debate: Are mobile voice calls and fixed voice calls in the same market?

Market Definition: Supply-side substitution

- Guidelines argue you should assess demand side first then supply side
- Substitutability is possible if companies not in the market can enter in the short term in response to an increase in price
- Supply side substitution can help in term determining the number of competitors

Market Definition: Geographic market definition

- Relevant market definitions may be further limited by geographic market definition.
- Geography can be defined using pricing data, linguistic reasons and supply side reasons
- Most geographic market definitions are local and regional

Market Analysis: dominance

- Dominance in EU Guidelines equates to Significant Market Power
- Operators can be <u>singly</u> or <u>jointly</u> dominant
- Dominance is defined:
  - *"An operator shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."*

Market Analysis: single dominance

- Market Share – normally above 40%, however 100% can be argued not to be dominance
- Size of the company
- Control of infrastructure hard to replicate
- Technological advantage
- Absence of, or low countervailing buyer power
- Easy access to capital markets
- Product/service diversification
- Economics of scale or scope
- Vertical integration
- Highly developed distribution/sales network
- Absence of potential competition

Market Analysis: single dominance(2)

- Market share – can be measured by revenue or other measures, minutes, capacity, etc. Also, the trend in market share is important to consider.
- Absence of, or low countervailing buyer power – a major issue in communications markets as the ability to gain access is important in network industries
- Economics of scale or scope – important in communications markets with a large incumbent operator present
- Absence of potential competition – important to consider into the future

Market Analysis: joint dominance

- Joint Dominance occurs if no single firm has dominance but a small number behave as if they are dominant in market
- Market needs to satisfy certain conditions if considered jointly:
  - mature market,
  - stagnant or moderate growth on the demand side,
  - low elasticity of demand,
  - homogeneous product,
  - similar cost structures,
  - similar market shares,
  - lack of technical innovation, mature technology,
  - absence of excess capacity,
  - high barriers to entry,
  - lack of countervailing buyer power,
  - lack of potential competition,
  - various kinds of informal or other links between the operators concerned,
  - retaliatory mechanisms,
  - lack of or reduced scope for price competition.

Market Analysis: joint dominance (2)

- This is not an exhaustive list and do not need to find all to find joint dominance.
- Recent case law has clarified the conditions for joint dominance:
  - Transparency: each member of the dominant oligopoly must have the ability to know how the other members are behaving in order to monitor whether or not they are adopting the common strategy.
  - Retaliation: Any tacit co-ordination must be sustainable over time. Implicit in this is the view that a *retaliatory mechanism* of some kind is necessary, so that any firm that deviates from the co-ordinated practice would be met by competitive reactions (not necessarily only addressing the cheating firm) by other firms
  - Fringe Competition: It is necessary that existing and future competitors, as well as customers, do not undermine the results expected from the common policy.

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