Effective market analysis carried out by national regulatory authorities under EU directives

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Telecommunication Market Analysis for the CEE countries and Baltic States

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- **WIK**

  → founded 1982; was part of Deutsche Bundespost; now Fed Min of Economics

  → Does research on regulation and competition issues in Telecommunications, Postal and Electricity sectors – in support of RegTP

- **Wik-Consult**:

  → Provides consulting services to European Commission, WorldBank, other international organisations, numerous NRAs and operators

- **WIK is a non-profit organisation. Wik-Consult Ltd. subsidiary consulting company.**

- **WIK \ WIK-Consult has done studies and training workshops for other NRAs on market analysis**

  – Cyprus, Germany, Greece, Ireland, Netherlands, Portugal

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Preliminaries \ Institutional background

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Aims:

- New EU regulatory framework aimed at improving harmonisation of regulation across the EU

- To limit *ex ante* regulation to those <u>relevant</u> telecoms markets where competition law cannot remedy persistent market failure

- **3 stage process**

  - **Market definition**: Definition of **<u>relevant</u>** markets susceptible to *ex-ante* regulation ("candidate markets")

  - **Market analysis**: Identification of relevant markets that are not effectively competitive and designation of operators with SMP

  - **Selection of remedies**: Imposition of *ex-ante* regulatory obligations that are appropriate and proportionate

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Benefits:

- Enables countries with less well developed legal institutions to fast-track toward better regulatory practice

    - One of the 'other' benefits of the EU is that it has enabled individuals countries to accomplish liberalisation where a solely national debate would have taken years longer

- Procedures for defining markets (forward-looking) are well established for merger cases

Preliminaries \ Institutional background

Risks:

- Significantly increases the workload of NRAs

- The Commission has significant powers but also institutional shortcomings

  → Commission also authorises the remedies, but defining remedies and designing suitable regulation often involves disagreement among 'experts'

  → Suggests that the application of the rules will be different across MS

- Will the next Framework involve an EU regulator?

1. Defining relevant markets

2. Identifying firms with SMP

3. Remedies

1. Defining relevant markets

I. Setting the stage: Commission Recommendation

II. Notifying the Commission

III. Methodology

- Art. 15 gives Commission a guiding role

  → shall recommend relevant product markets, "the characteristics of which may be such as to justify the imposition of regulatory obligations"

  → shall publish guidelines for market analysis and assessment of SMP

- Defines relevant product markets in accordance with principles of competition law …

  → Demand and supply side substitution

- … susceptible to *ex ante* regulation (3 criteria test)

  1. Presence of high and non-transitory barriers to entry

  2. Lack of dynamic trends moving market towards effective competition

  3. Competition law not adequate to address market failure

Commission Recommendation

- Fixed narrowband markets

Retail markets	Wholesale markets
Access for residential / non-residential customers (1, 2) National telephony services for residential / non-residential customers (3, 5) International telephony services for residential / non-residential customers (4, 6)	Call origination (8) Call termination on individual fixed networks (9) Transit (10) Access to ULL (11)

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Commission Recommendation

- Fixed broadband markets

Retail markets	Wholesale markets
None	Access to ULL (11) Wholesale broadband access (12)

- Leased lines markets

Retail markets	Wholesale markets
Leased lines up to and including 2 Mbit/s (7)	Terminating segments of leased lines (13) Trunk segments of leased lines (14)

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Commission Recommendation

- Mobile markets

Retail markets	Wholesale markets
None	Access and call origination (15) Voice call termination on individual mobile networks (16) Wholesale international roaming (17)

- Broadcasting markets

Retail markets	Wholesale markets
Outside framework	Wholesale broadcasting transmission services (18)

1. Setting the stage: Commission Recommendation

2. Notifying the Commission

3. Methodology

Deliverables:

- Requirements (deliverables)

  → Publication by NRA of national consultation procedure

  → Consultation with NCA on analysis of relevant markets

  → Other NRAs consulted on measures that effect EU trade

  → Provide notification to the Commission which:

    – Gives information showing the 1st 3 points have been satisfied, and

    – Findings of the market analysis and imposition of *ex ante* regulation, includes relative detailed analyses

NRA notifications (as published on Com website on 10 Sep)

- Large number of NRAs in national consultations

- Notifications now start to accelerate

  → A, FIN, GR, H, IRL, P, S, UK

  → Some markets more addressed than others

    - Mobile voice call termination: 5 NRAs

    - Fixed call origination, fixed call termination, wholesale broadband access, wholesale mobile access and call origination: 4 NRAs

    - …

    - Wholesale international roaming: 0 NRAs

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How might the Commission react?

- If market definition echoes Recommendation

  → "No comment"

- If market definition differs from Recommendation, either:

  → "No comment"

  → May question market definition, but not raise "serious doubts", in particular, if SMP assessment is not affected

  → May raise "serious doubts", in particular, if SMP assessment is affected

  → May veto market definition

1. Setting the stage: Commission Recommendation

2. Notifying the Commission

3. Methodology

Relevant markets susceptible to ex ante regulation

- **Commission** recommends relevant **product** markets susceptible to ex ante regulation based on

    - Competition law principles

    - "3 criteria test"

- **NRA** defines relevant markets appropriate to national circumstances taking utmost account of Commission Recommendation

    - follows Commission Recommendation on relevant **product** markets, or deviates (Article 7 market)

    - adds **geographical** dimension

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- Two dimensions of relevant markets

  → Product market

  → Geographical market

- Two types of relevant markets

  → Retail markets

  → Wholesale markets

Relevant product market definition

- Market boundaries are determined by identifying competitive constraints on the price-setting behaviour of firms

  → Retail markets

  - Demand substitution by retail customers

  - Supply substitution by providers of retail services

  → Wholesale markets

  - Demand substitution by wholesale customers

  - Supply substitution by providers of wholesale services

  - An additional level of analysis: Demand substitution at retail level

Relevant product market definition

- Traditional substitutability analysis

  → Demand substitutability

    - Functional (characteristics, intended use)

    - Price

  → Supply substitution

    - Functional (ability to switch production capacity)

   - Within how long - 2 years?

    - Price

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- Hypothetical monopolist test

  → Could a HM provider of a service (or group of services) raise prices by 5-10% without loosing sales to an extent that would make the price increase unprofitable?

    - If yes, service (or group of services) is a relevant product market

    - If no, include services to which customers / suppliers would switch in relevant product market

    - Begin with a narrow product scope and broaden to find product market

Relevant product market definition

- Hypothetical monopolist test

  → Abstracts from existing firms - only examined at later market analysis phase

  → Assumes cost-based price level as departure point

  → Assumes regulation is absent

  → Goes from narrow to broad

  → In case of wholesale: Market transactions may not yet exist

1. Determine "critical loss" (CL) (%-loss of sales that would make a 5–10 % price increase unprofitable)

Price

P_C+10%

P_C

MC

Quantity

Q_C

Demand
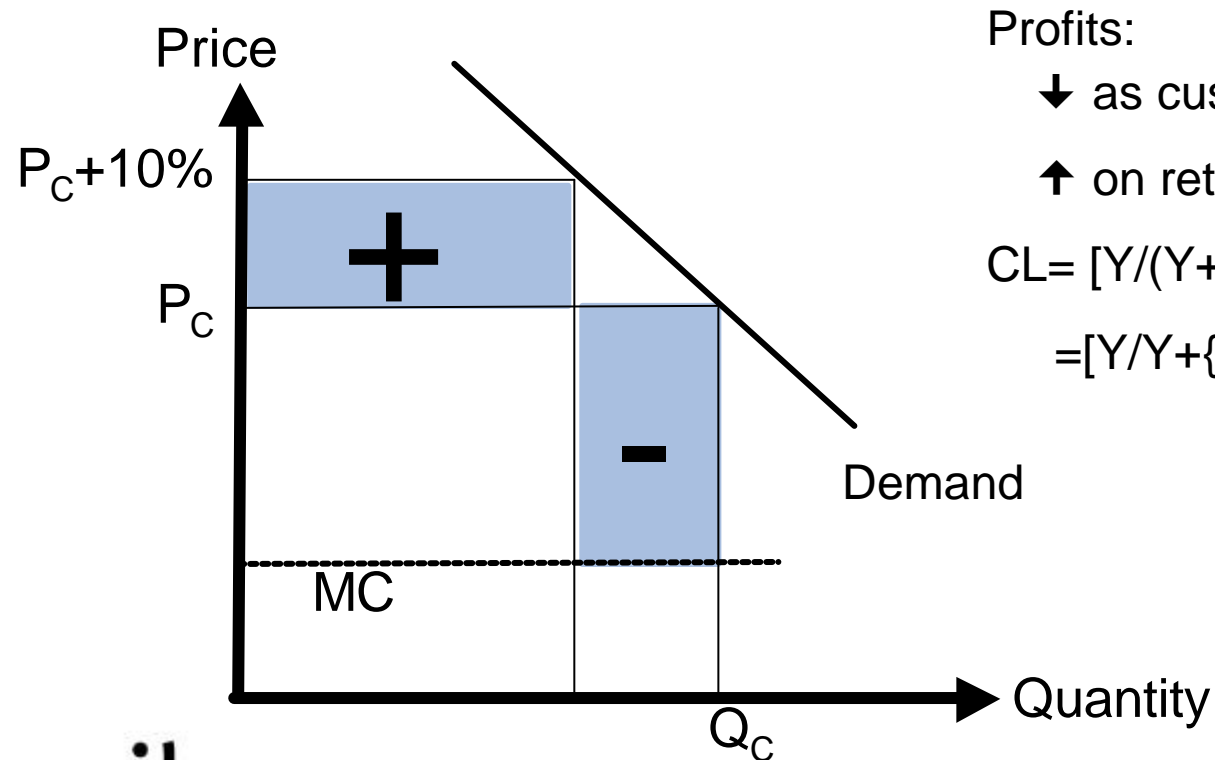
Profits:

↓ as customers switch

↑ on retained sales

CL= [Y/(Y+PCM)] x 100

=[Y/Y+{P_0 – AVC)/P_0}] x 100

Y=assumed proportional increase in P

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Hypothetical monopolist test

Critical loss needed to make P$\uparrow$ unprofitable

Price-cost margin $(P_C - MC) / P_C$	Price increase	
	5 %	10 %
20 %	20 %	33 %
30 %	14 %	25 %
40 %	11 %	20 %
50 %	9 %	17 %
60 %	8 %	14 %
70 %	7 %	13 %

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2. Translate critical loss into "critical" price elasticity

  - CL / Y

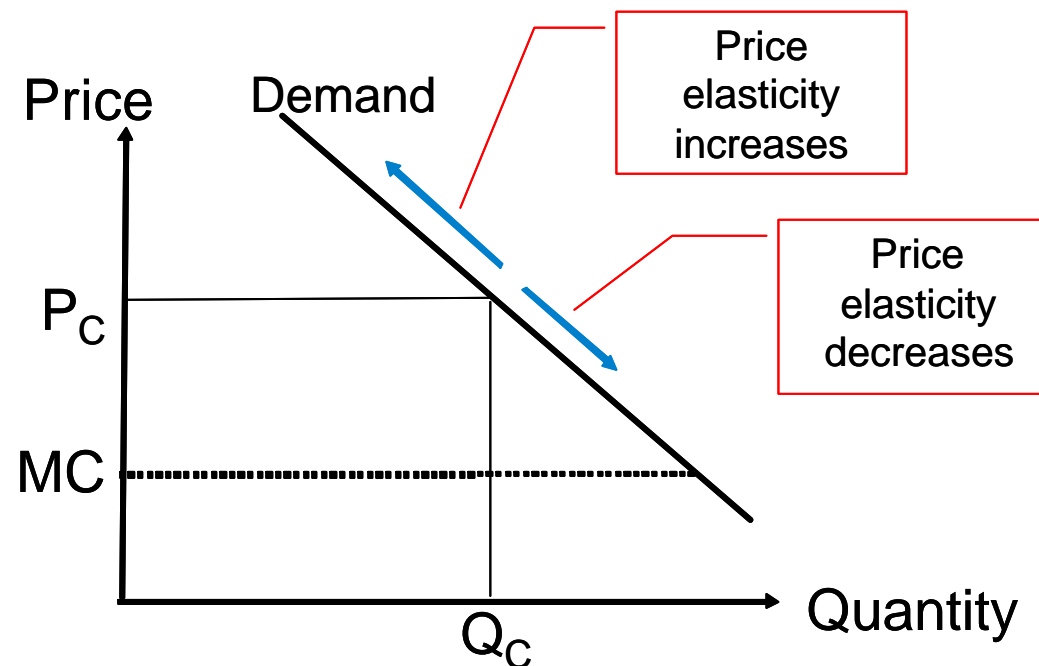3. Estimate actual price elasticity of residual demand

  - Consumer surveys (dubious)

  - Econometric studies (tricky! … data?)

4. Compare both

  – If actual price elasticity > CL, price increase is unprofitable

Hypothetical monopolist test

- Assume cost-based price level as a starting point

  → If price is above costs, substitution may happen, even though, with a cost-based price level, there actually would be none ("Cellophane fallacy")

  → If price is below cost, substitution may <u>not</u> occur, even though, with a cost-based price level, there actually would be substitution

- An area represents a distinct geographical market

  → if the undertakings concerned face conditions of competition that are similar or sufficiently homogeneous

    and

  → which can be distinguished from neighbouring areas in which the prevailing conditions are appreciably different.

Geographical market definition

- Evidence for national markets

  - Uniform conditions of competition throughout national territory

  - Existence of a common pricing constraint evidenced by geographically uniform prices

  - Uniform advertising and marketing policy

3-criteria test (Commission Recommendation)

1. High and persistent barriers to entry

   → Structural (in particular, economies of scale and scope in combination with sunk costs)

   → Legal (e.g., limited number of spectrum licenses)

   → Regulatory (e.g., access deficit)

2. Lack of dynamic factors that will move market towards effective competition

   → E.g., lack of technological changes

3. Competition law not capable of remedying market failure

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1. Setting the stage: Commission Recommendation

2. Notifying the Commission

3. Methodology

4. Selected issues in defining markets

Relevant product market definition

- Market boundaries are determined by identifying competitive constraints on the price-setting behaviour of firms

  - Retail markets

    - Demand substitution by retail customers

    - Supply substitution by providers of retail services

  - Wholesale markets

    - Demand substitution by wholesale customers

    - Supply substitution by providers of wholesale services

    - An additional level of analysis: Demand substitution at retail level

Relevant product market definition

- Traditional substitutability analysis

  ➜ Demand substitutability in terms of

    - characteristics

    - intended use

    - price

  ➜ Supply substitutability in terms of

    - flexibility to switch production capacity to produce other product

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Relevant product markets (Com Recommendation)

- Fixed narrowband

Retail markets	Upstream wholesale markets
• Access for residential customers	• Call origination on the public telephone network (voice calls and dial-up Internet calls)
• Access for non-residential customers	
• National calls for residential customers	• Call termination on individual public telephone networks
• National calls for non-resid. customers	• Transit services in the fixed public telephone network
• Intern'l calls for residential customers	
• Intern'l calls for non-resid. customers	• Unbundled access to metallic loops and sub-loops

- Dial-up internet access not defined as relevant retail market

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Relevant product markets - Issues

- Should self supply be included in transit market?

Demand-side substitution
at retail level ?

Retail voice telephony (Y)	Retail voice telephony (Z)

Self-supplied transit (Y)	Wholesale transit (X)	Self-supplied transit (Z)

Supply-side substitution
at wholesale level ?
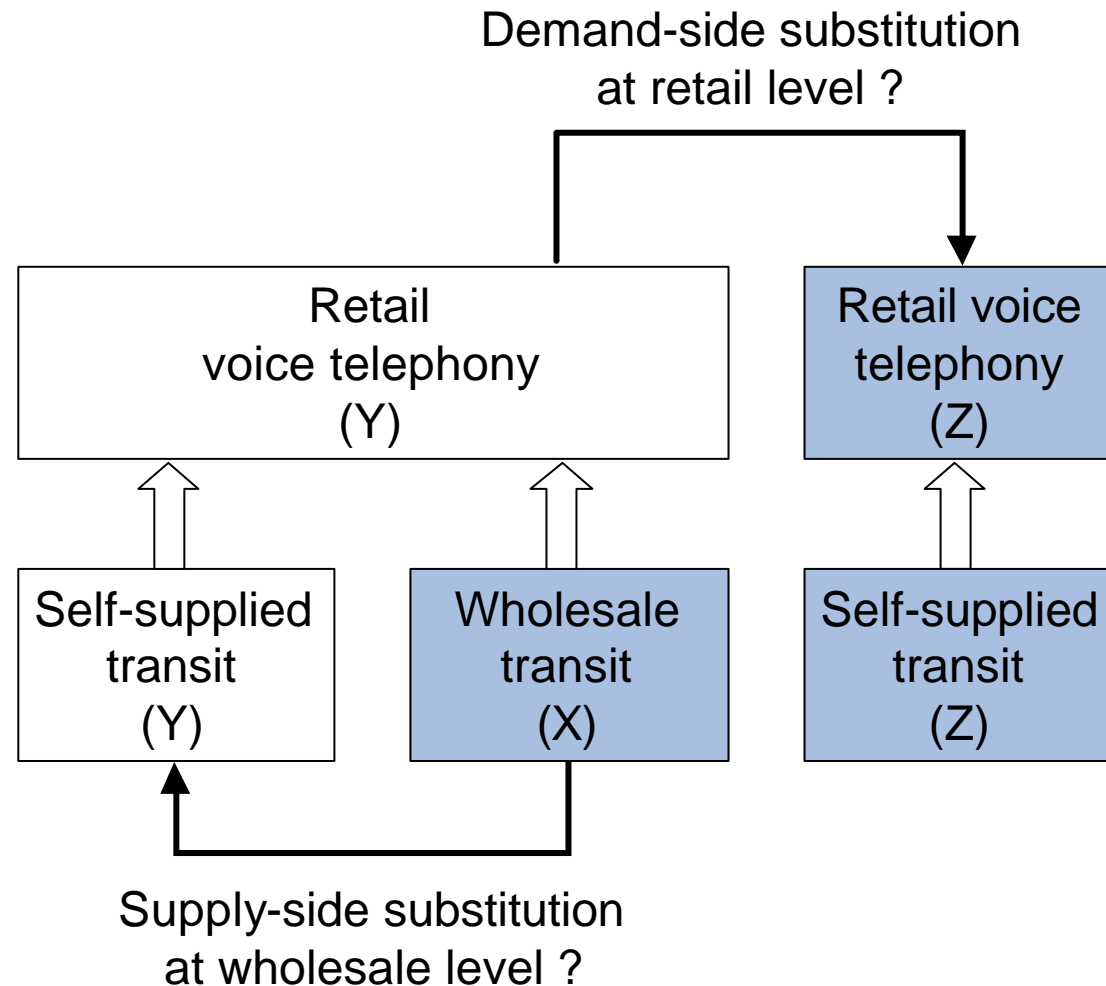
Fixed broadband

Relevant product markets (Com Recommendation)

- Fixed broadband

Retail markets	Upstream wholesale markets
• Leased lines up to and incl. 2 Mbit/s	• Unbundled access to metallic loops and sub-loops (incl. shared access)
• Leased lines above 2 Mbit/s not defined as relevant retail market	• Wholesale broadband access
• Retail broadband access not defined as relevant retail market	

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Relevant product markets - Issues

- Should self supply be included in wholesale broadband access market?
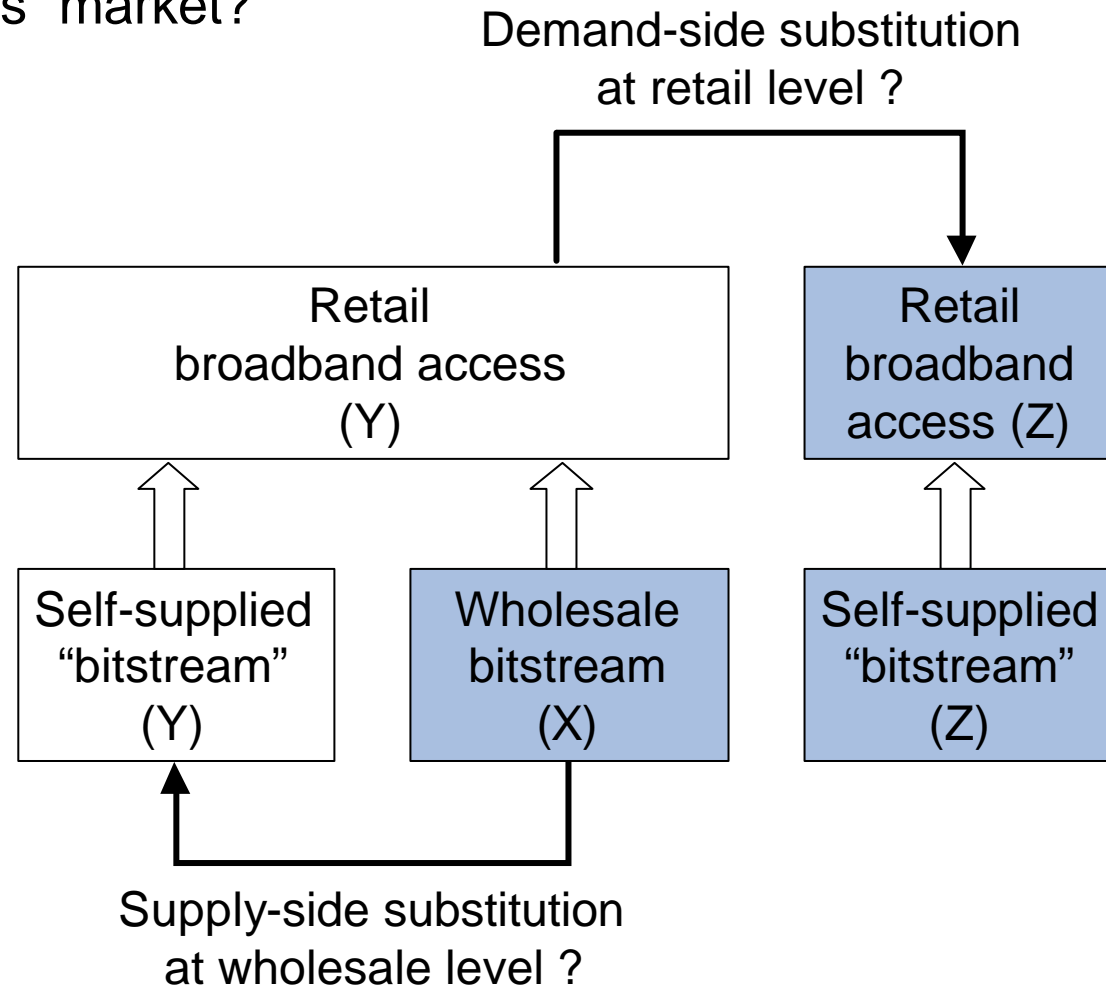
Mobile

Relevant product markets (Com Recommendation)

- Mobile

Retail markets	Upstream wholesale markets
- No retail markets defined	- Voice call termination on individual mobile networks - Wholesale access and call origination on public mobile networks - Wholesale international roaming on public mobile networks

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Broadcasting

Relevant product markets (Com Recommendation)

- Broadcasting

Retail markets	Upstream wholesale markets
• Retail markets outside regulatory framework	• Transmission of broadcasting signals, to deliver broadcast content to end-users