Market Definition and Dominance

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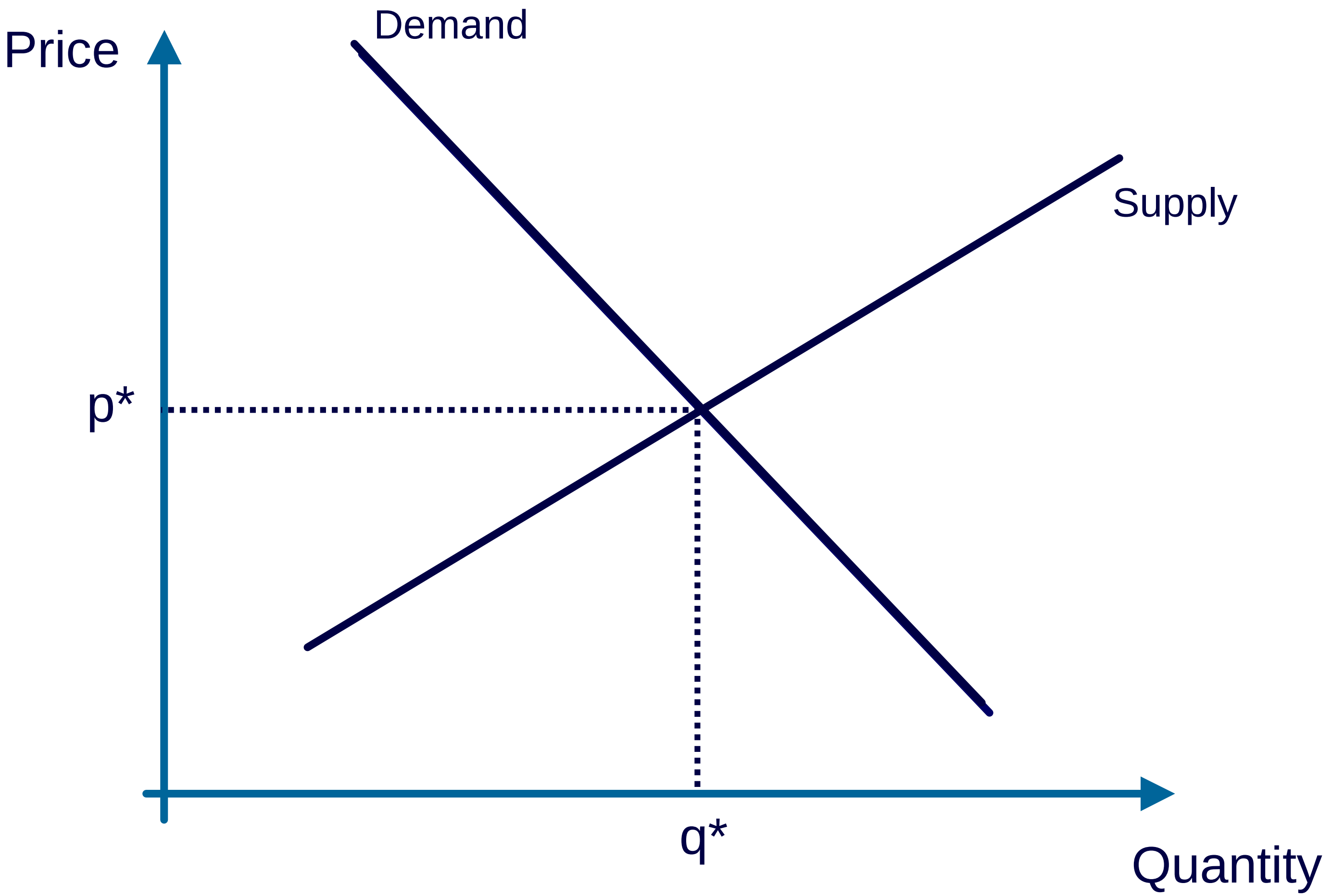
Overview

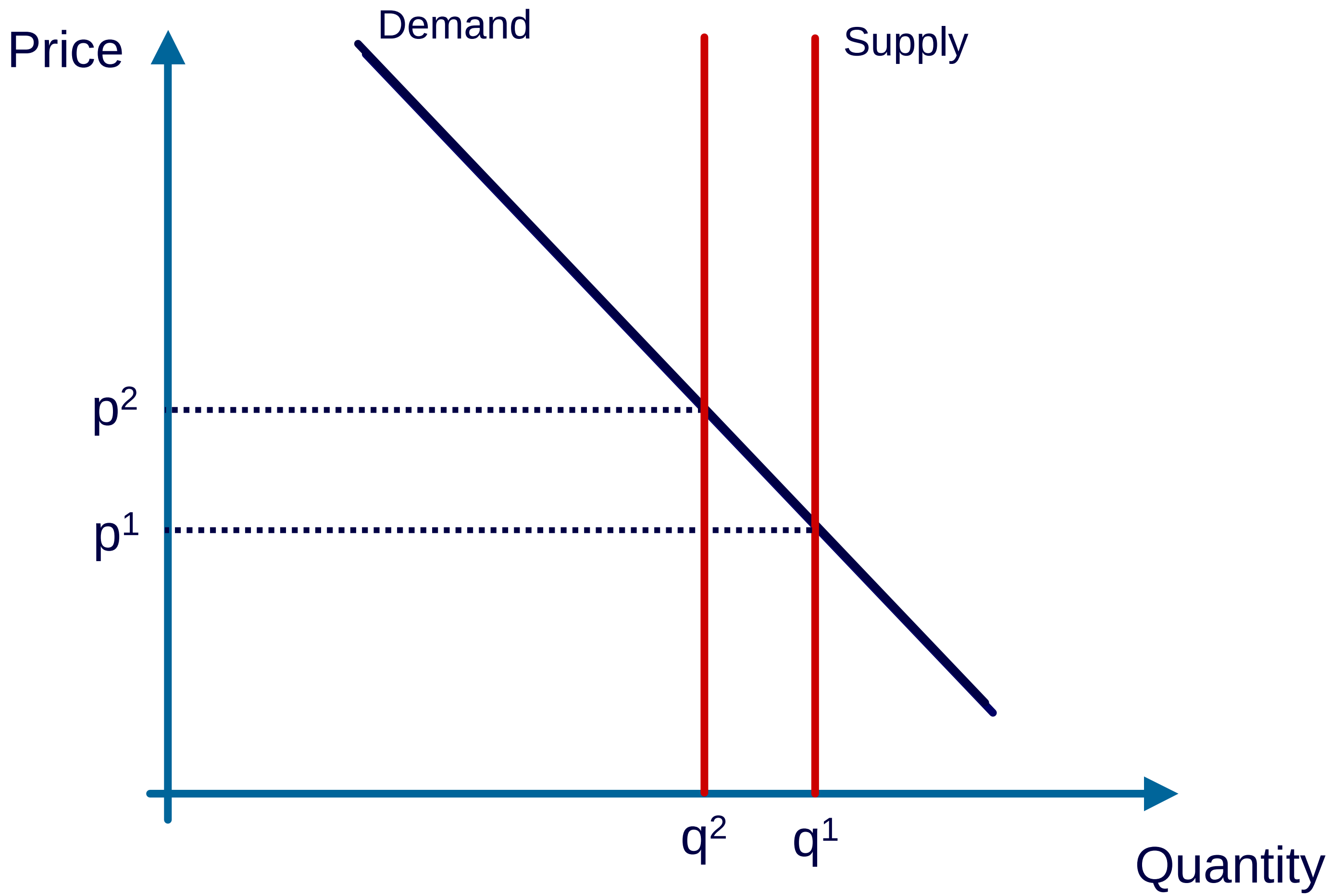
- **What is a market?**
- **Why are we interested in defining markets?**
- **What is the hypothetical monopolist test?**
- **What is dominance?**
- **When is there a need for *ex ante* regulations?**
- **Is *ex post* competition policy sufficient?**

What is a market?

Introducing demand and supply



Monopoly supply – dominance



Market dimensions

- **There are three broad dimensions to a market:**
  - **Spatial or geography**
    - **The market for mobile data in Hong Kong is not in the Brazilian market for mobile data**
  - **Product characteristics**
    - **Coca Cola is not in the same market as lap top computers**
  - **Time**
    - **The market for VOIP telephony today is not in the same market as VOIP telephony in 10 years from now**

Competition policy concerns

- The extent to which an individual firm, or a collection of firms acting jointly, can influence price on a market
- In very competitive markets, influence over price – that is market power – is limited
  - This results in prices equal to cost at the margin
- In markets where there are only a few firms, as is the case in mobile telephony, a firm <u>may</u> be able to influence the market price (individually or jointly)
- <u>Crudely</u>: the fewer firms in a market, the more likely for there to be competition concerns
- But it is possible for a firm with a large market share not to have market power – which is the policy challenge

Substitutes

Demand side substitution

- **Demand side substitutes:**
  - **Can a consumer replace one firm's telephony service with that of another?**
  - **How easy is it for a customer to switch between telephony service operators or ISPs? (The need to change a telephone number or IP address increases switching costs)**
  - **Are loyalty programmes pro or anti-competitive?**
  - **Do long-term contracts impede competition?**

Supply side substitution

- **Supply side substitutes:**
  - **Can a firm currently not supply services move into the market within a reasonable period of time (say within a year)?**
  - **Open standards make it easier for entry to occur**
  - **Proprietary systems may impede competition**
  - **Exclusive ties (especially in a vertical setting) may undermine competition**

Hypothetical Monopolist Test

This is used in practice to define a market

Sometimes known as the *SSNIP* test

Small but **S**ignificant and **N**on-transitory **I**ncrease in **P**rice

Derives from the US Department of Justice 1984 Horizontal Merger Guidelines

SSNIP Test – DOJ 1984

“A market is defined as a product or group of products and a geographical area in which it is sold such that a hypothetical, profit maximising firm, not subject to price regulation, that was the only present and future seller of those products in that area would impose a ‘small but significant and non-transitory’ increase in price above prevailing or likely future levels.”

From narrow to broad

- Implicit in the definition is that it is not possible to raise prices for a subset of products
- Is there a market for whiskey? Obvious to a whiskey sales person – but from a competition perspective whiskey is likely to be part of a wider market for alcoholic spirits (vodka, brandy, gin, etc.)
- Should we extend the market to include other alcoholic refreshments such as beer, lager, and wine?

Applying the test

- Look at a single seller of whiskey and ask whether it would be possible to increase price by, say 5%, for a non-transitory period
- Because of the linkage between whiskey and other spirits, cross-price effects (measured formally by cross-price elasticities)
  - The cross-price elasticity is:
    - Percentage change in the quantity of demand for whiskey divided by the percentage change in the price of another product (say gin)
    - The cross-price elasticity of demand is positive when products are substitutes

Dominance

Dominance

- **For a firm to be found dominant (possess market power), it must be in a position to influence market price**
  - **Defining a market is therefore crucial as part of the test for dominance – it is a pre-requisite**
- **Dominance is more likely where a firm has a large share of a market (usually above 40%)**
- **In practice dominance is presumed at market shares in excess of 50% (stable over 3 years)**
  - **More recently the term super-dominance has been used to refer to firms with shares significantly above 50%**
- **Dominance is NOT illegal or problematic**

Dominance

In European parlance dominance means

"an undertaking, either individually or jointly with others, enjoys a position of economic strength affording it power to behave to an appreciable extent independently of competitors, customers and ultimately consumers"

In the new Framework Directive Significant Market Power (SMP) is equivalent to Dominance

However, SMP triggers *ex ante* regulations to be imposed by NRAs

Assessing dominance

- **In competition cases there is usually evidence available (history)**
- **In electronic communications markets it may be necessary (as in Europe) to assess dominance (or SMP) *ex ante* and therefore rely upon a prospective analysis**
- **Criteria to make assessments include:**
  - **Market shares**
  - **Size of undertakings**
  - **Scale economies**
  - **Countervailing buyer power**
  - **Vertical integration**

Leverage of market power

- Suppose an operator is found to be dominant in the market for residential fixed-line access services
- Could such an operator leverage its market power in that market to a closely related market such as broadband (e.g. DSL)?
- In telecoms an operator may be found dominant in infrastructure markets (access lines) and leverage that dominance into closely related downstream service markets

Collective dominance

- In some situations two or more firms may be deemed to hold a position of joint-dominance (or collective dominance)
- Joint-dominance may be evident because of structural links between firms, but it could derive through parallelism in conduct (co-ordinated effects)
- Collective dominance applies to oligopolistic markets – where there are only a few sellers who interact closely
- In telecoms mobile markets are candidates for collective dominance assessment

Policy recommendations

Policy recommendations

- **Market definition using economic principles and economic tools of analysis required in communications markets to guide appropriateness of *ex ante* regulation**
- **SSNIP test can be used, informed by other evidence and analysis, to define ‘relevant’ markets**
- **Having defined markets, market analysis should be undertaken to determine whether an undertaking, acting individually or jointly with others, is dominant**
- **If a position of dominance is found, then suitable *ex ante* regulations can be imposed**
- **If dominance is not found, there should not be any *ex ante* regulations and instead reliance should be made of *ex post* competition policy**

The End

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