



**Asia-Pacific
Economic Cooperation**

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Market Definition and the Use of Upward Pricing Pressure

Submitted by: United Kingdom



**Seminar on Economic Analysis in Horizontal and
Non-Horizontal Mergers
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Market definition and the use of upward pricing pressure

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All views are my own

Market Definition

- Purpose and dangers
- Product market definition
- Geographic market definition

Upward Pricing Pressure (not covered in these slides)

- Basic concepts and different versions
- Measuring margins
- Measuring diversion
- Calibration: what level of UPP is a concern?
- Examples

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Why define markets?

1) It is part of the **legal framework**

eg in the UK:

*...whether a merger “has resulted, or may be expected to result, in a **substantial lessening of competition (SLC) within any market or markets in the UK for goods or services”***

2) It helps to **frame the analysis**

- In horizontal mergers: helps us focus on main competitors
- In vertical mergers, dominance cases: we need to understand the market, not just changes in a market

3) Calculate market shares, HHIs etc

4) Consistency across cases; precedent value

Market definition is not a separate exercise



OFFICIAL - SENSITIVE

[Completed/Anticipated] acquisition by X of Y

**Decision on relevant merger situation and
substantial lessening of competition**

Parties

Transaction

Jurisdiction

Counterfactual

Background

Market definition

Product scope

Geographic scope

Competitive assessment

Barriers to entry and expansion

Conclusion on substantial lessening of competition

Exceptions to the duty to refer



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Conclusion on market definition

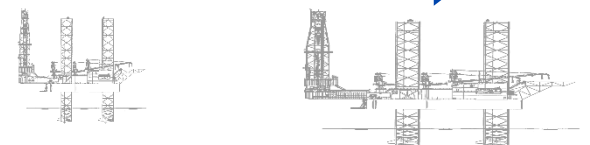
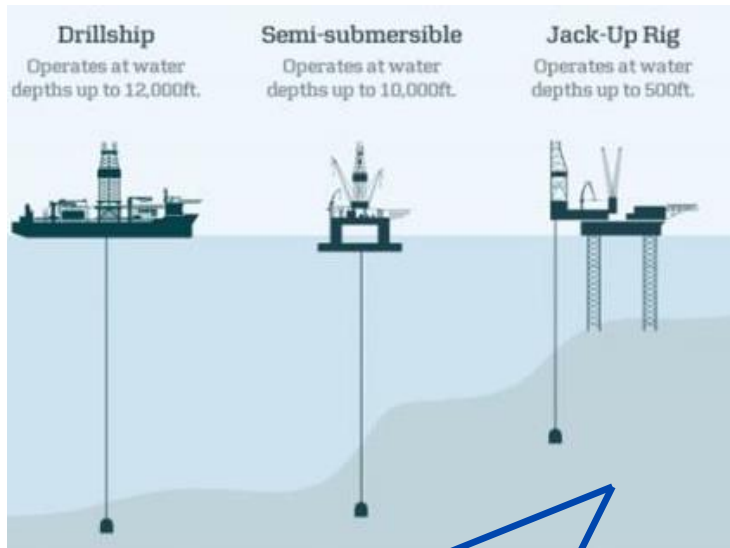
Product scope

Geographic scope

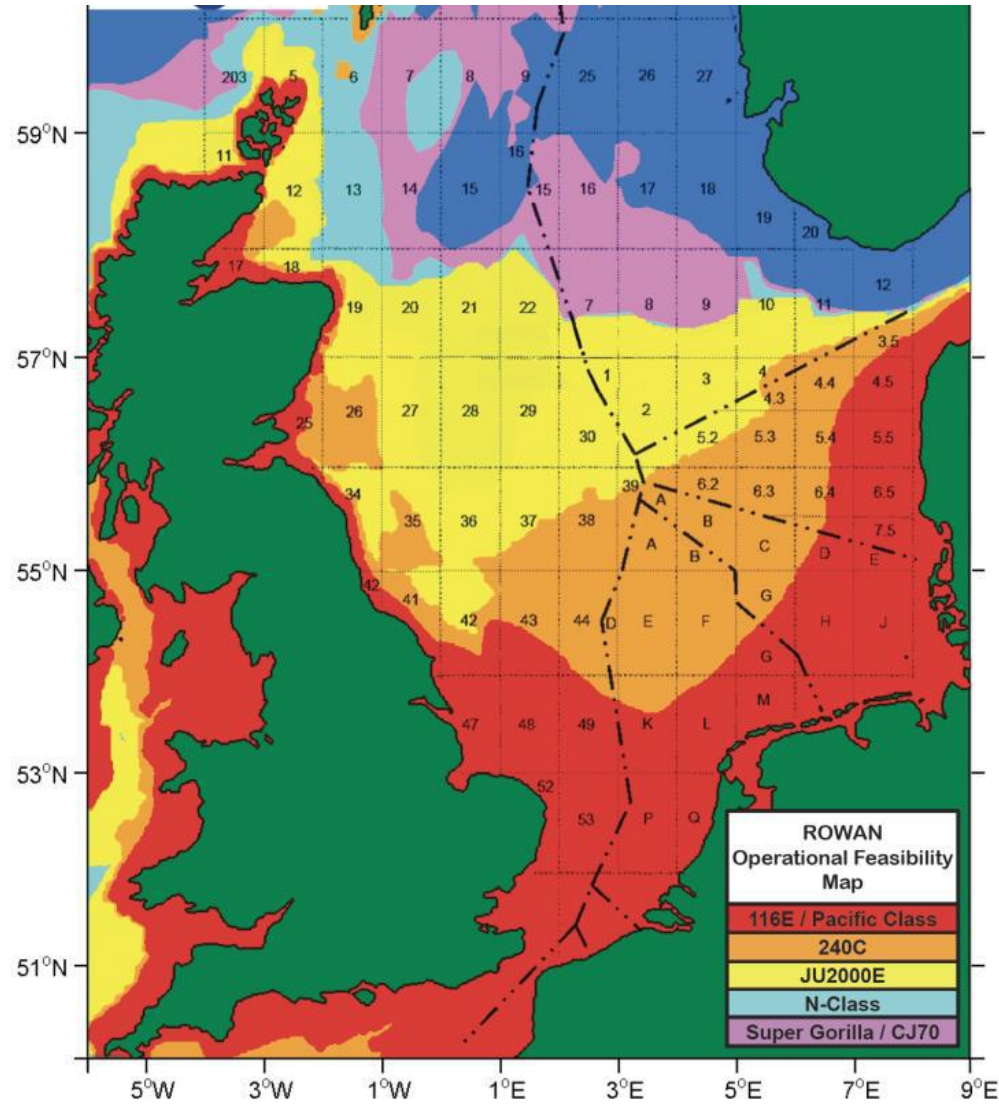
Conclusion on substantial lessening of competition

Exceptions to the duty to refer

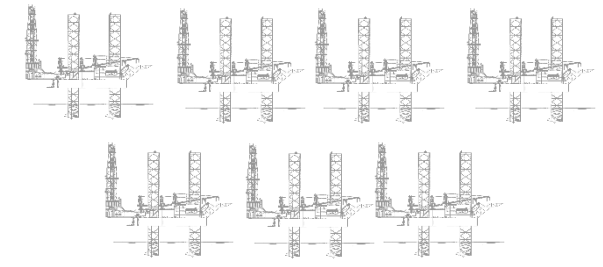
Take care when setting the scene



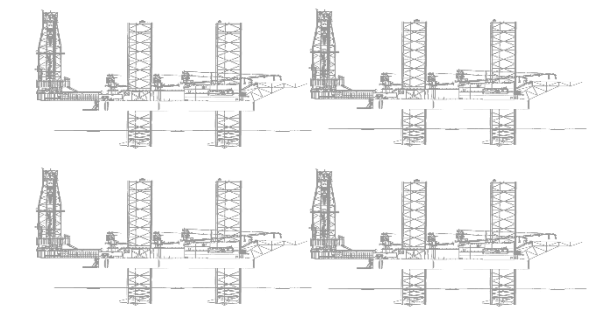
Harsh Environment (HE) Ultra Harsh Environment (UHE)



Ensko



Rowan



What is a market?

For competition law assessment, a ‘relevant economic market’ is defined as:

a set of products or services that can be profitably monopolised

Market definition uses the ‘hypothetical monopolist’ or ‘SSNIP’ test as its intellectual framework:

- “Given a particular set of goods or services, would a hypothetical monopolist of those goods or services be able to sustain profitably a **S**mall but **S**ignificant and **N**on-transitory **I**ncrease in **P**rices above the competitive level?”
 - If yes, this is a relevant economic market
 - If no, widen the set of products and start again, until you can define a market that can profitably be monopolised

What is a market?

Supply-side factors

- Willing & able to supply; OR
- Conditions of competition similar



- Does this lead to a unique answer?

Consider a SSNIP on Fanta...



And it gets more complex...

And how useful are market shares?

- Differentiated products – closeness matters; beware chain of substitution
- Asymmetric competition
- Two-sided markets/network effects
- Potential competition/dynamic effects/killer acquisitions

As a result, merger analysis has moved away from a focus on market shares, and towards a **more direct focus on competitive constraints.**

Did market definition help these cases?



OFT (CMA's predecessor):

“As no substantial competition concerns arise on any reasonable frame of reference affected or potentially affected by the Transaction, it was not necessary for the OFT to reach a conclusion on the exact scope of the frame of reference in this respect.”

So it assessed horizontal overlaps in *“actual competition in the supply of **photo apps** and potential competition in the supply of **social network services**.”*



DG Comp:

On **consumer communications services**:

“...the Commission will assess the effects of the Transaction in the narrowest relevant product market for consumer communications services, that is the market for consumer communications apps for smartphones.”

And on **social networking services**:

“there are important differences between WhatsApp and social network services”

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Product market – issues with price

- Different prices do not necessarily imply different markets
 - “Quality adjusted price”
 - Common price movements may be useful
 - But price movements are normally a firm, not all products
 - Or may be driven by common input cost changes
- Focus on marginal customers
 - How many need to switch? (eg United Brands – “toothless fallacy”)
 - Beware price discrimination
- Some products do not compete on price (eg online) – how to do a SSNIP?

Price correlation

- A and B closely correlated (0.8)
- C is not (0.1)
- eg Nestle/Perrier (EC case)
 - A = still water
 - B = carbonated water
 - C = other carbonated drinks
- How much correlation do you need for market to be A+B?
 - Benchmark against two products “known” to be in the same market
- But will we see common price movements across all products in A?
 - If so, is it common input costs changing?



Migration vs diversion



Miura



Future



Future/Miura (2016)

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You can have more than one market

- National vs international



Pricing – national

Innovation – international



- National vs local/regional



Pricing – national



Service – local

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 - Local/regional

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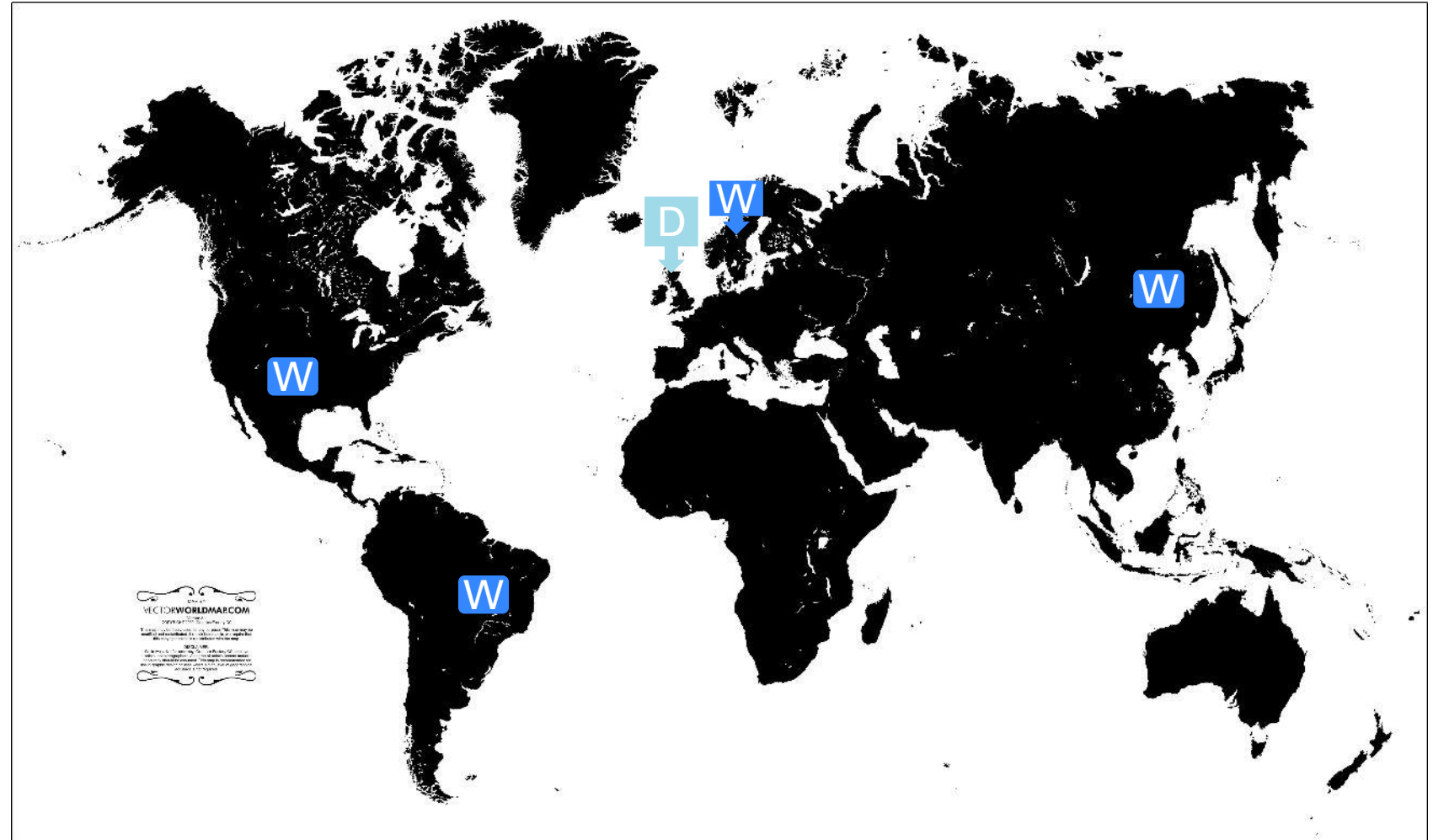
National vs international

- Current scale of imports
- Don't focus on where goods are produced – what do customers need?
 - Sales, distribution, support
- Is competition similar (eg same suppliers, shares of supply)?
- Barriers: tariffs and regulation
- **What is important to competition? →**

Consider local factors, not where it's made



Dover/Wayne (2016)



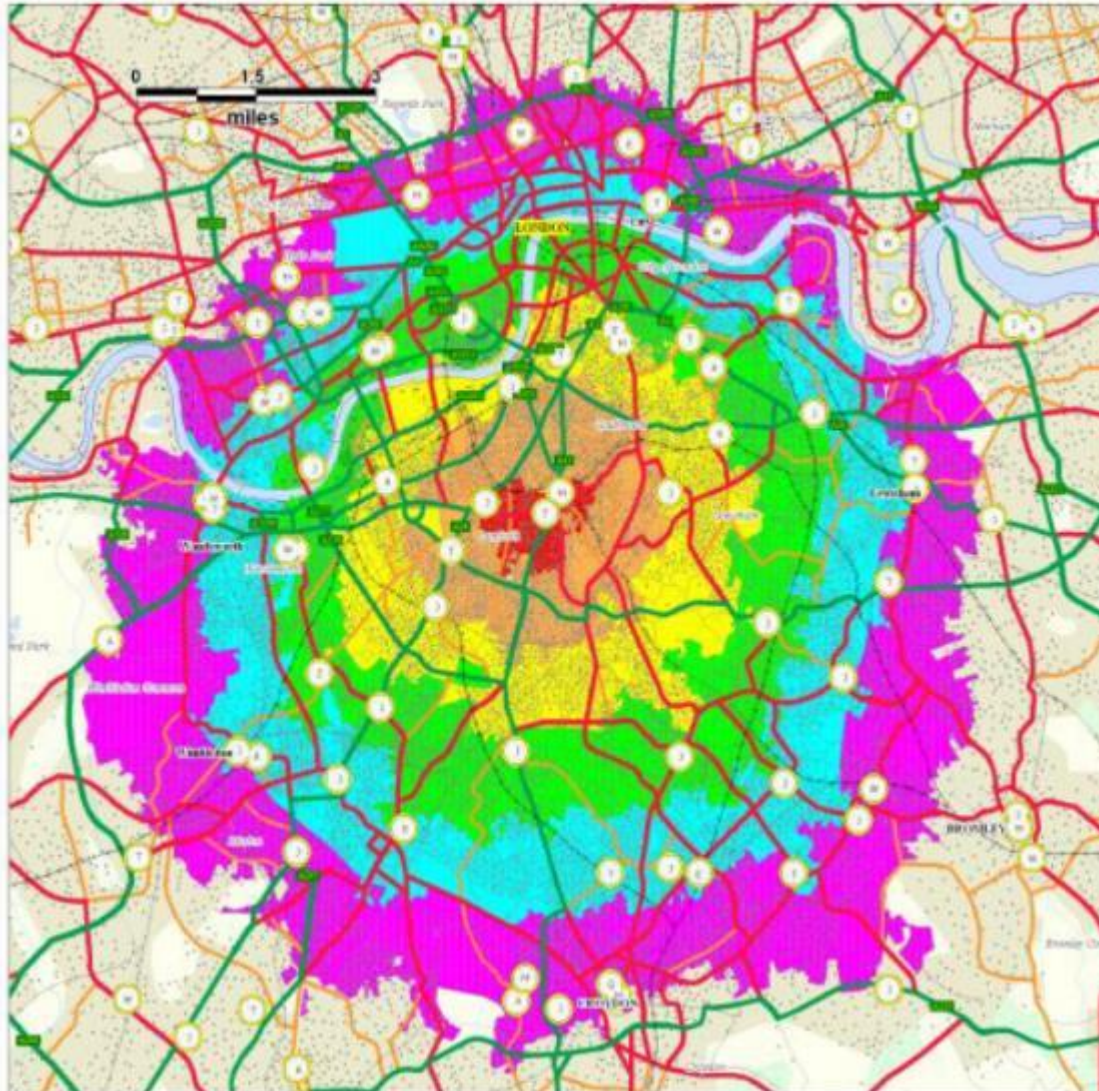
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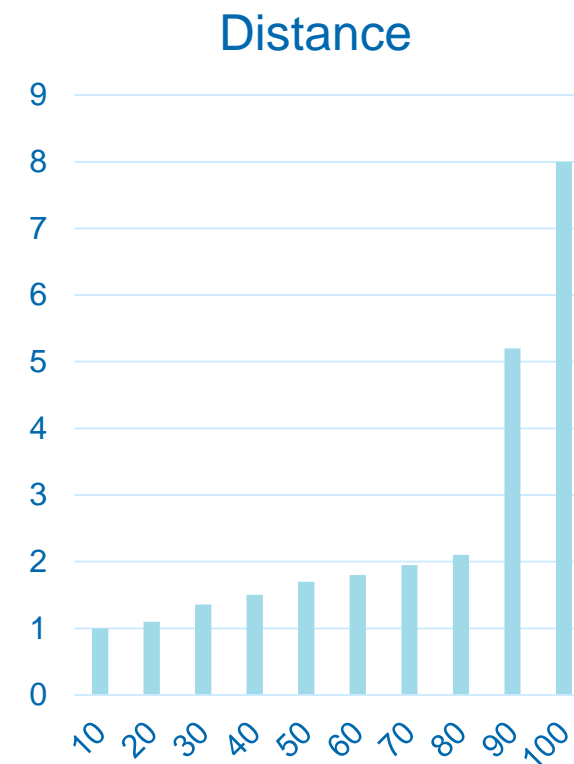
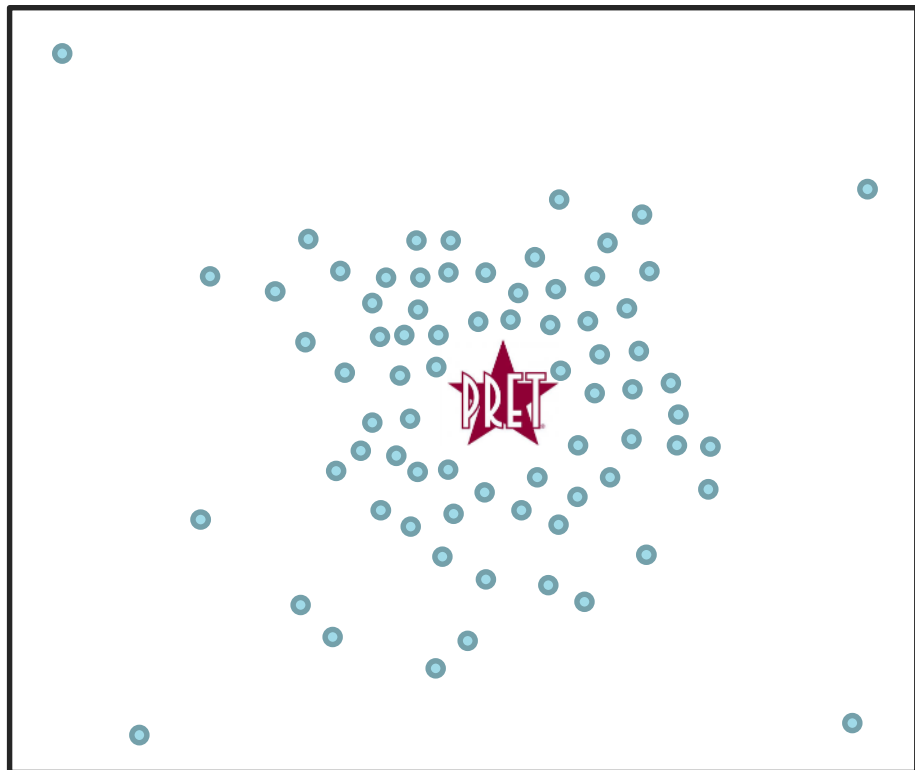
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In theory, use the HMT



- Figure shows store locations and households in Brixton
- Colours reflect 5/10/15 min etc. isochrones
- Make three assumptions:
 - Customers on average shop at their nearest store
 - Customers travel/distance trade-off equivalent to opportunity cost of leisure time (e.g. DfT transport modelling)
 - All stores have same VFM
- Start at 5 mins, increase prices at all 5 mins stores by a SSNIP, see if enough customers would switch outside market, if so expand
- Run until SSNIP test fails
- Results should vary across areas depending on locations of stores and customers
- Similar approach possible to explore e.g. rival ferry routes

The 80% 'rule'

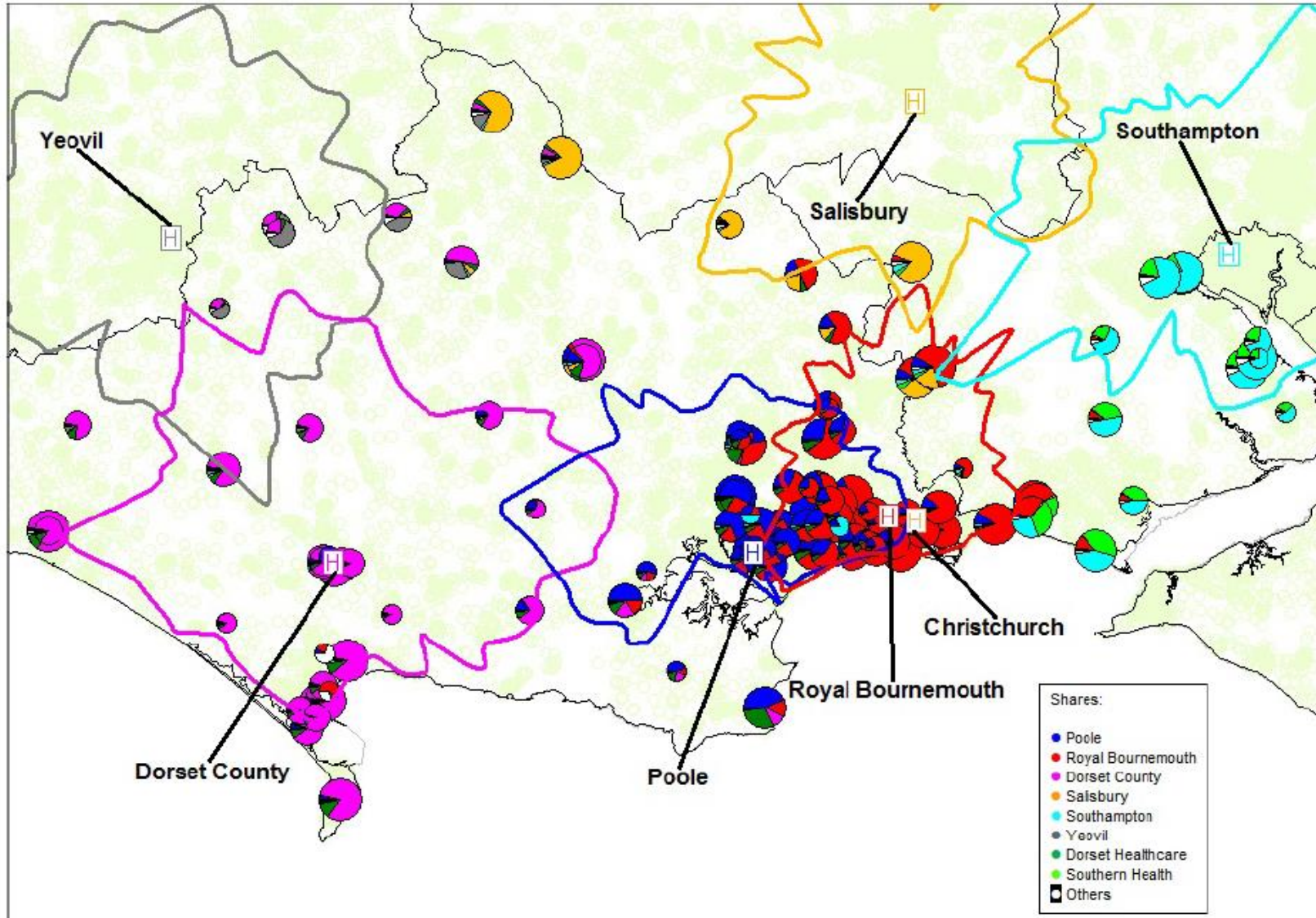


A catchment is not a market



*Royal Bournemouth and Christchurch
Hospitals NHS Foundation Trust / Poole
Hospital NHS Foundation Trust (2013)*

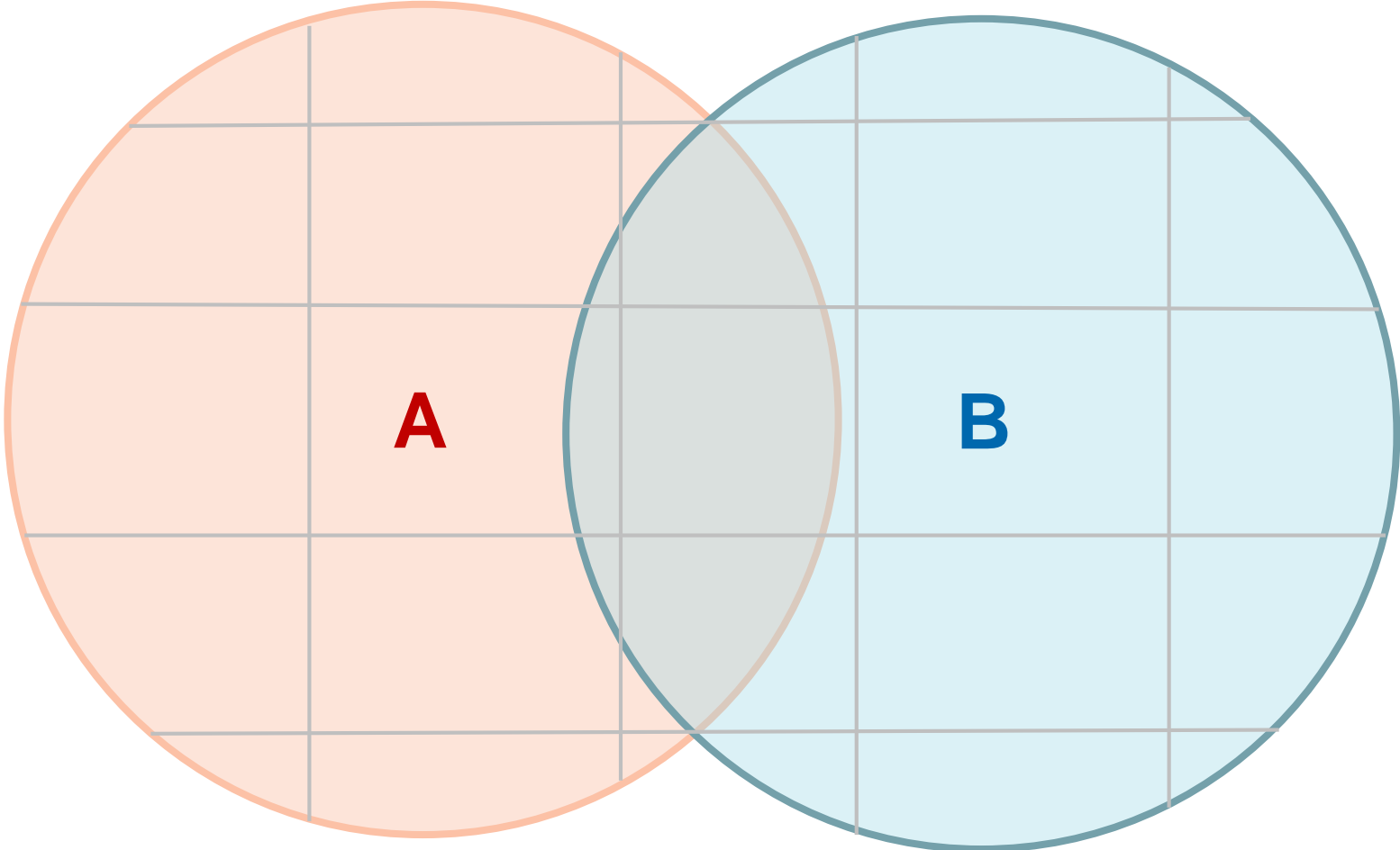
Willingness to travel?



So why not just look at competition directly?

Royal Bournemouth and Christchurch Hospitals NHS Foundation Trust / Poole Hospital NHS Foundation Trust (2013)

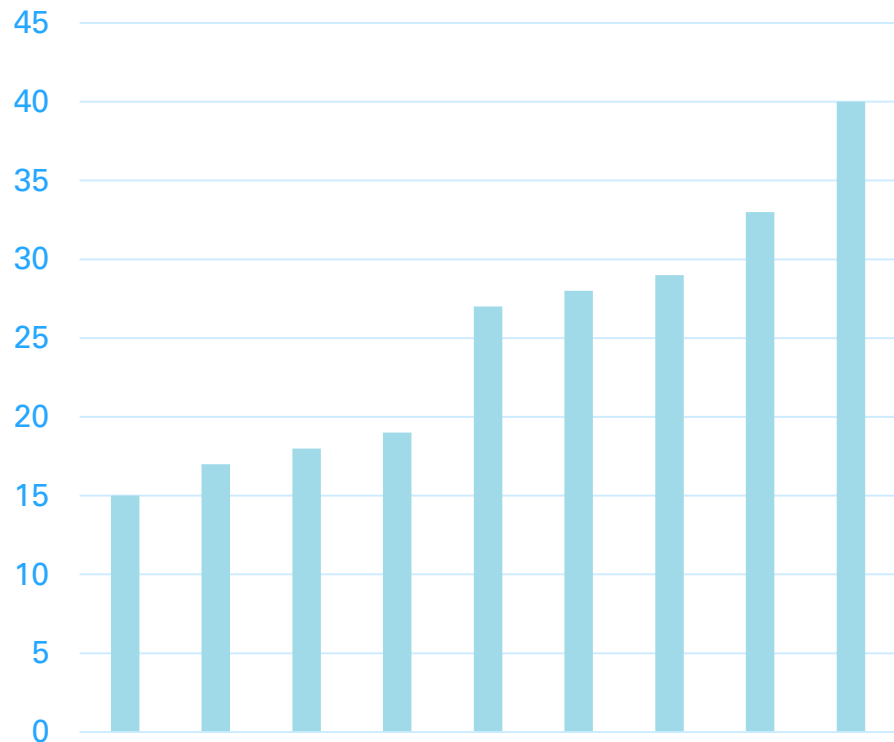
Catchments are endogenous to competition



postcode/zip
code area

Uniform vs individual catchments

Individual catchment size for 10 stores



What catchment should we use?

- Average
- Maximum
- Individual
- More than 1 different catchment?

- Do we know why it varies?
 - Urban vs rural
 - Demand is different
 - Density of competitors
- How far apart are company X's stores?

Suggestion:

- Be cautious in identifying overlaps – large catchments
- Consider individual size in competitive assessment

Why define markets (2)?

- 1) It is part of the **legal framework**
 - OK – but at what stage?

- 2) It helps to **frame the analysis**
 - This is scoping the case, not market definition

- 3) Calculate market shares, HHIs etc
 - Less important/reliable than competitive effects analysis

- 4) Consistency across cases; precedent value
 - Each case is different. This is part of scoping

Questions?

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