RELEVANT MARKET IN COMPETITION CASE ANALYSES

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INTRODUCTION

Delineation of "relevant market" is central to effective enforcement of competition laws. For the Competition Authority, such delineation clarifies the space within which he/she needs to adjudicate on competition cases. It is indeed the first step in the analysis of conduct on the part of the market players concerned.

Definition of the relevant market involves the description of the context in which certain economically harmful conduct could take place. The process, therefore, of defining a market and a relevant market, is of the first moment, meaning thereby that any assessment of the conduct of a market player can only follow and not precede the definition. The process begins by assuming provisionally that certain anti-competitive conduct exists in the market. It then proceeds to define through a series of questions, the boundaries of the smallest market in which such conduct could be sustained. After the contours of the smallest market are defined and drawn, the actual conduct in question is subjected to an analysis, to determine if it has or could have an anti-competitive effect.

This short paper seeks to define the relevant market, relevant product market, relevant geographic market and the analytical methodology applicable by Competition Authorities to define relevant markets.

RELEVANT MARKET

'Relevant Market' refers to the line of commerce in which competition has been restrained and to the geographic area involved, defined to include all reasonably substitutable products or services, and all nearby competitors, to which consumers could turn in the near term if the restraint or abuse raised prices by a not insignificant amount[1]. In simple terms, relevant market identifies the particular product/service or class of products produced or services rendered by an enterprise(s) in a given geographic area. Identification also includes identification of enterprises that compete to supply those products or services.

A relevant market has therefore two fundamental dimensions, product and geographic. The product market describes the good or service. The geographic market describes the locations of the producers or sellers of the product or service. Relevant market is defined by consumer or purchaser preferences and actions. For instance, if purchasers consider two goods to be close substitutes or readily interchangeable, those two goods are considered to be in the same relevant market. As an illustration, butter and margarine can be considered to be in the same relevant market. In contrast, even if producers/sellers consider two goods to be very similar on the ground that they are manufactured on the same machines, the goods may not be in the same relevant market. As an illustration even if 13–inch automobile tyres and 14–inch automobile tyres are made on the same machine, purchasers do not substitute between 13-inch and 14-inch tyres and thus the two sizes are in two different relevant markets.

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1 "Continued Work on the Elaboration of a Model Law or Laws on Restrictive Business Practices" – UNCTAD, TD/B/RBP/81/Rev.3 – Geneva, 2 August 1994

In sum, relevant market means the market determinable with reference to the relevant product market or the relevant geographic market or with reference to both the markets.

PRODUCT MARKET

Competition Authorities in various countries use or adopt different definitions of the product market. Despite the lack of uniformity, the veneer that runs through the definitions is that the product market has the characteristic of interchangeability or substitutability of goods/services by the consumers/purchasers. Put differently, goods/services that purchasers consider to be substitutes are generally regarded to be in the same product market and those that the purchasers do not consider to be substitutes are regarded to be in separate product markets.

On the demand side, the relevant product market includes all such substitutes that the consumer would switch to, if the price of the product relevant to the investigation were to increase. From the supply side, this would include all producers who could, with their existing facilities, switch to the production of such substitute goods. There are 3 elements that pin a product market. They are:

- Price increase
- Reaction of purchasers
- Smallest size requirement.

Price Increase

The critical issue in the element price increase is that the purchasers shift for substitutes when the price of the product/service increases. The price increase must be non-transitory, meaning thereby that the increase is expected to continue over the foreseeable future. The reaction of the purchasers to a transitory or short-term change in price is likely to be different from their reaction to a long-term change in price. If cake bakers know that an increase in the price of butter is temporary, then they are likely to continue to use butter in baking cakes. On the other hand, if they know that such a price increase is permanent and over a long period, then they are likely to invest in developing a recipe that uses margarine. Thus, if the price of butter is expected to be high for a long period of time, butter and margarine are in the same product market.

The price increase needs to be small but significant. A small price change is likely to make the purchasers identify close substitutes. A large price change is likely to make them identify more distant substitutes. For the Competition Authority, the inclusion of distant substitutes in the relevant product market may be warranted, if the increase in the price is big. Otherwise, close substitutes alone would fall into the relevant product market. Another point to be made is that the price change should be significant, so that purchasers react to the change. A very insignificant price change may cause no purchaser reaction. The expression "significant" is subjective but some countries adopt 5 % price change as significant as in United States and Canada[2].

Reaction of Purchasers

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[2] Background notes from the Seminar on "Topics in Competition Policy", OECD, Paris, 17-28 February 1997.

Purchasers react to price increases generally rationally. Continuing with the butter and margarine example, assume that all the purchasers at the old prices bought butter. If the price of butter increases and if all the purchasers switch to margarine from butter, then margarine and butter would be in the same product market with margarine being the substitute for butter for all the customers. If the purchasers do not switch to margarine in response to price increase to butter, then margarine is not a good substitute to butter in the perception of the purchasers and therefore, butter and margarine would not be in the same product market.

Smallest Size Requirement

The third element constituting the product market is that the market should be the smallest collection of goods or services for which the purchaser reaction holds. This requirement prevents product markets bracketing non-substitute products. The rationale for including this element is that products should not be considered as substitutes merely because there is a price increase in the product in demand/use by customers. Substitutability should have a direct nexus with the price increase in the product in demand/use.

Relevant product market could be determined by the Competition Authority having regard to all or any of the following factors:

- physical characteristics or end-use of goods;
- price of goods or service;
- consumer preferences;
- exclusion of in-house production;
- existence of specialised producers;
- classification of industrial products.

For determining the product market, Competition Authorities may estimate the demand elasticity of some group of products in the neighborhood of prevailing prices. Demand elasticity is the percentage change in quantity demanded divided by percentage change in the price of the product. But data may not be available for computing elasticity and therefore, competition officials, who do the spade work investigation, would be advised to interview a host of economic agents to gather sufficient information to enable the Competition Authority to make reasonable inferences about the correct relevant product market. Economic agents who could provide useful information include:

- Purchasers of the product
- Purchasers of similar products
- Sellers of the product
- Sellers of the same product in another region
- Sellers of similar products
- Association of purchasers or sellers of the product
- Wholesalers/retailers of the product and similar products
- Statistical bureaus for the product

Some useful questions that may be posed to buyers are:

1. Who are your current suppliers?

2. Who have been your suppliers in the past?

3. Why did you switch suppliers? (if answers to one and two are different)

4. Who else have you considered as suppliers?

5. Why have you not bought from them?

6. What is important when you decide from which supplier to buy? Why?

7. Is there a substitute for the product that you are using?

8. What is necessary to substitute the product you are presently using?

The above questions need to be modified during actual investigation as relevant information unfolds. Likewise, sellers could be asked the following questions:

1. Who are your competitors?

2. What needs to be done by you to convince purchasers to buy from you? (Timely delivery, advertise, superior technical service).

3. What needs to be done by you to convince purchasers to switch from buying from one of your competitors to buying from you (provide discount in price)

4. Is there any type of purchasers who tend to buy from you rather than from your competitor?

5. If so why do they prefer you?

Answers to questions listed above (subject to additions and modifications to the list as may be necessary) should be collated, analysed and placed before the Competition Authority for judicial determination of the relevant product market. The list of questions should not be construed as exhaustive or comprehensive but as indicative and enabling. A point worth emphasizing is that products can be considered as substitutable, if purchasers are inclined to shift to another product with similar characteristics, in the event the price of the product in use is raised by a small but significant amount and if such price rise is continuously maintained or is likely to be maintained over a reasonable length of time, say, 6 months.

GEOGRAPHIC MARKET

The geographical boundaries of the relevant market can be similarly defined. Geographic dimension involves identification of the geographical area within which competition takes place. Relevant geographic markets could be local, national, international or occasionally even global, depending upon the facts in each case. Some factors relevant to geographic dimension are consumption and shipment patterns, transportation costs, perishability and existence of barriers to the shipment of products between adjoining geographic areas. For example, in view of the high transportation costs in cement, the relevant geographical market may be the region close to the manufacturing facility.

The principle of geographic market is similar to that of product market. The geographic market is defined by purchasers' views of the substitutability or interchangeability of products made or sold at various locations. In particular, if purchasers of a product sold in one location would, in response to a small but significant and non-transitory increase in its price, switch to buying the product sold at another location, then those two locations are regarded to the in the same geographic market, with respect to that product. If not, the two locations are regarded to be in different geographic markets.

For example, markets for sand, gravel, cardboard boxes, refuse hauling and other heavy but low value products are often quite small because the cost of transportation is a large fraction of the cost of the product. Transportation cost therefore can indirectly affect the limits of the geographical markets. Limits of geographic markets are often determined by transportation costs, tariffs, trade barriers etc. As an illustration, if foreign producers of a product must pay a tariff (domestic producers do not) then the resulting increase in the price of the foreign product may be so large that the consumers would not switch from the domestic product for the foreign product. Similarly regulations such as for health and safety can serve as barriers to the sale of some goods and services. The relevant geographic market could be determined by the Competition Authority having regard to all or any of the following factors:

- regulatory trade barriers;
- local specification requirements;
- national procurement policies;
- adequate distribution facilities;
- transport costs;
- language;
- consumer preferences;
- need for secure or regular supplies or rapid after-sales services.

Barriers to market entry include administrative decisions by State agencies, legal provisions relating to conditions of manufacturing and delivery, legal professional standards, trade policy (tariffs, quotas, anti-dumping measures etc), financial barriers laid down by the State and barriers in terms of techniques, technologies and intellectual property rights.

TWO MODELS

To find the contours of the relevant market, some competition offices identify only suppliers and potential suppliers. This approach may be in order, if dominance is defined in terms of market share criterion. But if the market has many other enterprises in addition to the dominant one and if those others would immediately shift their production capacity into production of the relevant product in the event the dominant enterprise were to behave anti-competitively, then the approach may suffer from the flaw that the dominant enterprise is really not dominant. The desirable approach may therefore be to use demand substitution plus supply substitution model for purposes of determining the relevant market. The diagram below illustrates the 2 different approaches to relevant market determination.

Model 1

Demand side substitution

Market definition   Supply side substitution and entry barriers

Assessment of competition

Model 2

Demand side substitution
and
Supply side substitution

Market definition   Entry barriers

Assessment of competition

RELEVANCE OF RELEVANT MARKET IN COMPETITION CASES

Relevant market is crucial in analyzing **Dominance** and offences of **Abuse of Dominance**. The new Indian competition law[3] defines a dominant position as a position of strength, enjoyed by an enterprise in the relevant market, which enables it to operate independently of competitive forces prevailing in the relevant market or affect its competitors or consumers or the relevant market in its favour. The same Act describes, ***inter alia***, abuse of dominance to occur when an enterprise uses its dominant position in one relevant market to enter into, or protect, other relevant market. For an enterprise to abuse a dominant position, it must hold a dominant position in a relevant market. The first step, therefore, in an evaluation of an enterprise's actions is to define the relevant market.

Likewise, **Merger Regulation** cases require identification of the relevant market. By and large, mergers (or combinations, to use a more comprehensive term), which cause or are likely to cause an appreciable adverse effect on competition within the relevant market are likely to be blocked by the Competition Authorities. Relevant market boundary is therefore germane to adjudication of mergers on the touchstone of competition.

The Boeing-McDonnell Douglas merger is a good case[4] on the relevance of the relevant market in merger regulation. Boeing wanted to acquire its jet aircraft competitor McDonnell Douglas. This attracted competition law. In connection with this merger (acquisition), Boeing entered into contracts with 3 large American airlines to be their exclusive supplier of commercial jet airplanes for 20 years. Even though, the merger was on the US soil, the European Commission exercised its jurisdiction in the matter on the ground that many countries, particularly Europe, constituted the relevant market. The logic behind the said contention of the European Commission was that after the merger, there were only 2 suppliers, namely, the merged entity and Airbus Industries, an European Consortium, thus reducing the number of market players in supplying jet aircraft from 3 to 2. The European Commission saw the exclusive contracts as an emanation of Boeing's increased dominance (its share of the commercial jet aircraft market would increase to about 70%

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[3] New Indian Competition Law - Competition Act, 2002

[4] See E.Fox – 'The United States of Boeing vs the European Union of Airbus" – 16 Brookings Rev.30 (Winter 1998).

upon merger with McDonnell Douglas). The European Commission also feared that the contracts would unfairly foreclose the European Consortium from access to a substantial part of the market. It ultimately allowed the merger to proceed only on the condition that Boeing forego the exclusivity of the contracts and share technology of McDonnell Douglas.

FINALE

The determination of 'relevant market' by the Competition Authority has to be done, having due regard to the 'relevant product market' and the 'relevant geographic market'. In practice, defining a relevant market is sometimes only approximate. It is often difficult to predict the reactions of purchasers/consumers to a price increase. It is here that investigation becomes critical to the determination of the relevant market. Good investigation would involve identifying the important economic agents and posing questions appropriate to their operations and germane to the case on hand. A possible road map has been set in this paper, but there is no short cut for determining the relevant market.