



Geographic market definition in EC merger control

João Azevedo
DG Competition

All views expressed are strictly personal and do not necessarily reflect the official position of the European Commission

Competition

Outline

- 1) Introduction
- 2) Principles of geographic market definition
- 3) Background and context of report on geographic market definition
- 4) Conclusion

1) Introduction

- **Market definition:** a tool that allows an antitrust authority to identify in a systematic way the boundaries of competition between firms in their quest for customers.
- **In geographic terms:** identifies the area from which companies face competitive constraints which may limit their ability to exercise market power.
- It identifies the effective alternatives for customers of the merging companies
- It allows calculating market shares:
 - a meaningful starting point for an analysis of competition forces
 - central to evaluating economic incentives

2) Principles of geographic market definition

From the Commission's Notice on Market Definition(para 7):

*"The relevant product markets comprises all those **products** and/or services which are regarded as **interchangeable or substitutable by the consumer**, by reason of the products' characteristics, their prices and their intended use".*

In geographic terms (para 8):

*"The relevant geographic market comprises the **area** in which the merging companies offer their products and in which the **conditions of competition are sufficiently homogeneous**".*

How does a geographic market look like?

National



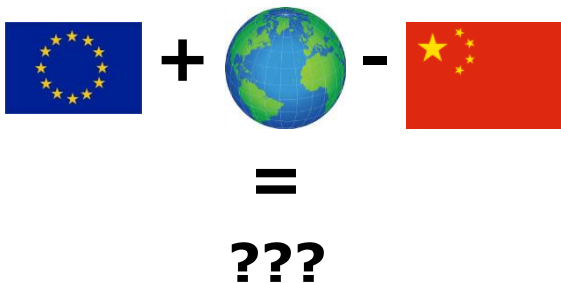
EEA



**At least EEA /
Global**



Other



2) The SSNIP test

- Test based on substitution arising as response to a Small but Significant Non-transitory Increase in Prices.
- **Key question** is whether competitors from other geographic areas exercise sufficient competitive pressure on the merging companies to prevent them from significantly raising prices or reducing quantity or quality of products and services to customers located in a certain area
- Would such a price rise be unprofitable due to one of several competition pressure forces:

2) Competitive pressure that may defeat a SSNIP

- **Demand-side substitutability** measures how easy it is for customers to substitute away from the consumption of the goods and services provided by the merging parties.
- **Supply-side substitutability** assesses if there is a ready ability on the part of suppliers to switch existing production with an effective and immediate impact.

When its effects are: "***equivalent to those of demand substitution in terms of effectiveness and immediacy.***" (para 20)

- **Entry:** Potential competition or entry is not taken into account when defining markets but is part of competitive assessment.

2) The basic principles of demand side substitution

- Is the traditional way of defining a market
- Looks at the problem from the side of consumer and how easily can he substitute away from the product
- It is concerned with the marginal consumer and not the average consumer
- Will rely on the following type of information:
 - Actual substitution in the past
 - Statistical measures of substitution
 - Business decisions based on consumer substitution
 - Interviews with customers

2) The basic principles of demand side substitution: in geographic terms

- Still focussing on the consumer, the geographic market has to be checked against demand characteristics like
 - Importance of national/local preferences
 - Current pattern of purchases of customers
 - Product differentiation;
 - Importance of brands.

(Market Definition Notice, para. 29, 1997)
- Question to answer is whether customers in a candidate geographic area would switch to suppliers located in other/neighbouring areas in the case of a SSNIP.

2) The basic principles of supply-side substitution in geographic market definition

- Focussing on the producer, the geographic market has to be checked against supply substitutability
- A further check of supply factors is needed to see if companies located in a different geo. area can compete effectively with companies in the candidate geo. area
- This analysis will include
 - Examination of requirements for a local presence
 - Conditions of access to distribution channels
 - Costs associated with setting of distribution network
 - Presence or absence of regulatory barriers(Market Definition Notice, para. 30, 1997)
- The Commission will identify possible obstacles/barriers isolating companies in the candidate geographic area from the competitive pressure of companies located outside that area.

2) Supply side substitution: Commission practice in product market definition

- The paper industry:
 - *"Paper is usually supplied in a range of different qualities, from standard writing paper to high quality papers[...]. **From a demand point of view**, different qualities of paper cannot be used for any given use[...]. However, **paper plants are prepared to manufacture the different qualities**, and production can be adjusted with negligible costs and in a short time-frame.[...] Under such circumstances, the Commission would not define a separate market for each quality of paper and its respective use."*(para 21)
- Approach confirmed by the Commission's practice (M.6101 - UPM/ Myllykoski/Rhein Papier, 2011):
 - Although finding that the various grades and sub-grades of magazine paper have differing characteristics and prices, the Commission concluded that the market for magazine papers comprised a range of different grades of paper quality that are used for the publication of consumer magazines.

2) Market definition and competitive assessment

- Defining a relevant market is not an end in itself, it is **only a first step in the competitive assessment** of how a merger would impact competition
 - Allows calculating market shares of companies that effectively compete with the merging firms=> meaningful starting point for an analysis of competition forces.
- Relationship between geo market definition and competitive assessment:
 - **Market definition** defines the area where companies compete for consumers
 - **Competitive assessment** assesses the competitive interaction of the companies that operate in that area (including imports into that area).

2) Types of evidence in market definition and competitive assessment

1. Current geographic pattern of purchases (or of locations of companies that participate in tender processes).
2. Basic demand characteristics, including national preferences such as for national brands, language, culture and lifestyle, and need for a local presence.
3. Trade flows/patterns of shipments and barriers and switching costs associated with trade across areas, such as transport costs, tariffs, quotas and regulations.
4. Economic evidence: Price similarity, correlation or convergence. Evidence of diversion of orders to other areas, especially if due to changes in relative prices
5. Views of customers and competitors

3) Study on Geographic Market Definition: Background and context

- **Questions raised** by some stakeholders:
 - Does the Commission define **geographic markets in merger cases too narrowly?**
- In times of **growing globalisation and the deepening of the single market**, many companies operate on a global scale and compete with various suppliers in different corners of the world=> from their perspective, competition should be defined as global.
 - Does the Commission sufficiently take account of "global" competition?
- Is the Commission's methodology and practice in merger control up-to-date:
 - Do we fully take into consideration important constraints, in particular from outside the EEA, when defining relevant markets?
 - Should a more flexible approach to supply-side substitution be considered in market definition?

3) Fletcher/Lyons Geographic market definition report

- Report commissioned by DG COMP to evaluate recent practice of geographic market definition in merger cases.
- Through reviewing a sample of ten recent merger cases in which geographic market definition was a key issue, the report was asked to comment on:
 - a. The Commission's geographic market analysis in terms of the methodology used and the conclusions reached on the basis of the available evidence.
 - b. How the Commission incorporated constraints from outside the geographic market in its competitive assessment.
 - c. Whether a more flexible approach to supply-side substitution could have been considered, and whether such an approach might have changed the outcome of the case.

3).1. Methodology of the Report:

- Detailed review of 10 recent merger cases (2010-2014)
- Deliberate *biased* selection of complex or contested cases where geographic market definition was an issue
- Only 1 unconditional clearance
- Market defined at several levels:
 - national;
 - regional;
 - EEA;
 - Global
- Phase I and Phase II decisions
- Different types of industrial sectors

3).2. List of cases

Case	Year	Case	Decision	Product market investigated
Friesland/Campina	2008	M5046	Phase II-Commitments Phase II – Commitments	Several (all dairy products)
Arsenal/DSP	2009	M5153	Phase I- Clearance	Solid benzoic acid
Alstom/Areva	2010	M5751	Phase II – Commitments	N/A (Parties active in power systems and components)
Western Digital/Hitachi	2011	M6203		Hard Disc Drives
Glencore/Xstrata	2012	M6541	Phase I-Commitments Phase II – Commitments	Zinc metal
Outokumpu/Inoxum	2012	M6471		Cold-rolled stainless steel
Refresco/Pride Foods	2013	M6924	Phase I-Commitments	Bottling of Non-Carbonated Soft Drinks (NCSDs) in Aseptic PET
SSAB/Rautaruukki	2014	M7155	Phase I-Commitments	Flat carbon steel, and its distribution
Chiquita/Fyffes	2014	M7220	Phase I-Commitments Phase II – Commitments	Bananas
INEOS/Solvay	2014	M6905		S-PVC and bleach

3).3. General findings

- Commission's definition of geographic markets, taken together with its analysis of external competitive constraints, has broadly set an appropriate framework within which to analyse mergers.
- Commission's practice in respect of geographic market definition is generally well-evidenced and in line with its own 1997 Notice on market definition.
 - Wide range of evidence used => Commission and parties prioritise their resources to key issues and in reflection of data availability
 - Responses to market investigation provide bulk of evidence
 - Statistical and economic evidence, when used, is not the sole decisive evidence, but part of a rounded and holistic assessment
- Some repetition of evidence between market definition and competitive assessment, and cross-referencing between the two (see: supply-side substitution)

3).3. Main technical recommendations

- A) Commission should publicly clarify the aim of geo. market definition
- B) Commission should be clear that it will not use supply side substitution (particularly by imports) for geo. market definition
- C) Consideration to calculating capacity shares to include 'swing capacity' and 'rapid entrants' from outside the market
- D) Greater use of isochrones where relevant and data permits

A) Publicly clarify aim of geo. market definition

- Clarify that geographic market definition is not an end in itself:
 - it provides a useful framework for assessing competition
 - it identifies a geographically coherent group of customers whose purchases are competed for by suppliers located in the same geographic area
 - and possibly also by suppliers located at a greater distance
- Geographic market definition does seem to matter but does not determine outcome
 - Rather it plays an intermediate and non-decisive role that allows Commission and parties to focus on what really matters in the competitive assessment
- Even if supply-side substitution arguments are presented in relation to market definition, the Commission should feel free to postpone discussion of that evidence until the competitive assessment.

B) Supply side substitution not to be used for geo. market definition

“Supply-side substitutability may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy”.

Commission Notice para. 20

- For product market definition => situations typically arise when companies market a wide range of qualities or grades of one product (example: Paper)
 - Different types of product will be grouped into one product market, provided that most of the suppliers are able to offer and sell the various qualities immediately and without significant increases in costs.
- For geographic market definition=> if suppliers can start supplying a different product or the same product into a different geographic area immediately, then they would be included in the market definition.



B) The Commission should be clear that it will not use supply side substitution (particularly by imports) for geo. market definition

- According to US authorities (DoJ/FTC) product and geographic market definition is done mainly on the basis of demand-side substitutability considerations, in line with the 2010 Horizontal Merger Guidelines.
- Conversely, supply-side substitutability plays a role only at the stage of the competitive assessment, in order to identify who are the participants in the relevant market and determine their importance.
- Firms that currently earn revenues in the relevant market are considered market participants.
- Rapid entrants and committed entrants can also be taken into account at the stage of the competitive assessment.
- In particular, rapid entrants that are currently not supplying into the US can be assigned market shares on the basis of their capacities.

B) Supply side substitution not to be used for geo. market definition

- **Note:** US and UK guidelines similar, but clearer that supply-side substitution will only be used to aggregate markets for “convenience”, where this does not alter outcomes.
 - They really apply it mostly for product market definition, not geographic market definition
- Notice does not envisage the potential for imports to come into an area and constrain competition as justifying a widening of the geographic market to include the source of such imports. Nor should it.
- **Example:** Chinese production into the EEA should be reflected in the analysis by including them in the market, as imports
- *Not* by expanding the market to include all Chinese production or firms => market conditions are too different

C) Other recommendations

- i. Include both potential 'rapid entrants' and more general 'swing capacity' within the calculation of capacity market shares, like in the US merger guidelines.
- ii. Greater use of isochrones in Commission decisions where relevant and data permits
 - In cases reviewed, the relevant geographic market was typically determined by political boundaries: Member State, Region Western Europe, EEA, Global
 - Commission does use isochrones, like in recent cement mergers
 - But NCAs use isochrones use them more commonly although for good reasons
 - More retail mergers at NCA level
 - Data availability (as collected by firms)
 - Nevertheless, there may well be potential for Commission to use them more, where relevant

5). Conclusion

- Market definition is an important a tool that allows an antitrust authority to identify in a systematic way the boundaries of competition between firms in their quest for customers.
- However, defining a relevant market is not and end in itself, it is **only a first step in the competitive assessment** of how a merger would impact competition
- Main recommendations from the recent study on geographic market definition:
 - More public clarity in aim of geographic market definition
 - Import and most other supply-side analysis do not belong in market definition
 - They should be kept for competitive assessment (and public clarity on this point)
 - Develop analysis in competitive assessment on ability and incentive for external firms (e.g. swing capacity)
 - More usage of isochrones instead of political boundaries.

Reading material

- OECD Policy Roundtable on Geographic Market Definition Across National Borders (2016)
- Lyons/Fletcher, Geographic Market Definition in EU Merger Control, Study for DG COMP, January 2016
- EC Competition Policy Brief, Market definition in a globalised world, March 2015