



Geographic Market Definition in EC Merger Control: *How it is done and how it can be improved*

*Presentation to ACE/Bruegel, Brussels
30 June 2016*

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Geographic Market Definition (GMD)...

...is a prerequisite to calculating *market share*...

- ...which is central to evaluating economic incentives, so...
- ...is the most powerful statistic in merger control

Commission's 2004 Horizontal Merger Guidelines:

“The larger the market share, the more likely a firm is to possess market power. And the larger the addition of market share, the more likely it is that a merger will lead to a significant increase in market power... Although **market shares** and additions of market shares **only provide first indications of market power** and increases in market power, they are **normally important factors in the assessment**” (#27)

What is a ‘relevant geographic market’? *Legal answer*

- ❖ Court of Justice in *Hoffmann-La Roche* (1979):
 - “The relevant geographic market comprises the **area** in which the **undertakings concerned are involved in the supply and demand of products or services**, in which the **conditions of competition are sufficiently homogeneous** and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.”

- ❖ We like ‘conditions of competition’ ...
 - ...but ‘supply and demand’ are not necessarily aligned in GMD

What is a ‘relevant geographic market’? *Economic answer*

- ❖ “Hypothetical monopolist” (or SSNIP) test based on substitution in response to a small and permanent change in relative prices (or qualities, etc)
- ❖ Would such a price rise be unprofitable due to either...
 - ***Demand-side substitution*** = ability and willingness of *customers* to switch to suppliers located elsewhere, or...
 - ***Supply-side substitution*** = ability and incentive for *firms located elsewhere* to find marketing channels, utilise spare capacity or switch production in the short term?

Research questions behind our report

❖ Background concerns...

- ...that core of Commission merger analysis is detailed definition of '*relevant market*', and '*competitive assessment*' of harm is less important
- ...that geographic markets are *defined too narrowly*, especially given globalisation

❖ Questions posed by the Commission for this project

- Does the Commission use the *right methodology in its* GMD?
 - ✦ In particular, should a *wider supply-side analysis* be used?
- Does the Commission appropriately incorporate *constraints from outside the GM in its competitive analysis*?



- 1. The 10 case studies**
- 2. Key findings and recommendations**



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Methodology

- ❖ Detailed review of GMD in 10 recent cases
 - Primary focus on published decisions
 - Access to confidential versions of decisions, plus some additional technical and market investigation evidence

 - ❖ **Not** an unbiased sample
 - Deliberate selection of difficult or contested GMD cases
 - ✦ Only 1 unconditional clearance
 - Different levels of GMD: *national; regional; EEA; global*
 - Phase I and Phase II
 - Different types of industrial sector
- *'Small' but revealing sample*

The 10 case studies (by type of industrial sector)

Grocery-related products	Technological products	Basic industrial goods
Friesland/Campina (2008) - Dairy products	Alstom/Areva (2010) - Power systems and components	Arsenal/DSP (2009) - Benzoic acid and sodium benzoate
Refresco/Pride Foods (2013) - Bottling of non-carbonated soft drinks	Western Digital/ Hitachi (2011) - Hard disc drives (HDDs) and external HDDs	Glencore/Xstrata (2012) - Zinc metal and zinc concentrate
Chiquita/Fyffes (2014) - Bananas		Outokumpu/Inoxum (2012) - Cold-rolled stainless steel
		SSAB/Rautaruukki (2014) - Flat carbon steel (and its distribution)
		INEOS/Solvay (2014) - S-PVC and bleach

GMD and external constraint findings for markets where merger harm found (i.e. SIEC)

Case	Key products	Commission decision	Parties argued	Constraints from outside as decided by Commission
Friesland/Campina	Several dairy products	National	Wider	Insufficient
Refresco/Pride Foods	Bottling of NCSDs in Aseptic PET	National	Wider	Insufficient
Chiquita/Fyffes	Bananas	National	Wider	Sufficient (SIEC related to specific issue of buyer power with shippers)
Western Digital/Hitachi	Hard Disc Drives	Global	N/A	N/A (SIEC found on global basis)
	External Hard Disk Drives	EEA	Wider	Not discussed (potential SIEC solved by remedies for global HDD market)
Arsenal/DSP	Benzoic acid	EEA	Wider	Insufficient
Glencore/Xstrata	Zinc metal	EEA	Wider	Insufficient
Outokumpu/ Inoxum	Cold-rolled stainless steel	EEA	Same	Insufficient
SSAB/Rautaruukki	Flat carbon steel	Nordic cluster	Wider	Insufficient
	Distribution of FCS	National	Wider	Insufficient
INEOS/Solvay	S-PVC	NW Europe	Wider	Insufficient
	Bleach	Benelux	Wider	Insufficient

GMD and external constraint findings for selected markets where *no* SIEC found

Case	Key products	Commission decision	Parties argued	Constraints from outside as decided by EC
Friesland/Campina	Organic milk	National	Same	Sufficient
	Long-life milk and packet butter	Netherlands, Belgium and Germany	Same	N/A. No concerns on wider geographic market
	Bulk butter	EEA-wide	Same	N/A. No concerns on wider geographic market
Refresco/Pride Foods	Bottling of NCSDs in cartons	National	Wider	Sufficient
Alstom/Areva <i>(NB No SIEC found for this merger)</i>	Various power systems and components	Left open, but at least EEA	Broadly same (EEA or Global)	<i>If markets drawn narrowly, then yes, constraints from outside found sufficient</i>
Arsenal/DSP	Sodium benzoate	Left open, but at least EEA-wide	Wider	<i>If market EEA-wide then constraints from outside EEA found sufficient</i>
Glencore/Xstrata	Zinc concentrate	Either worldwide or WW excluding intra-China sales	Same	N/A. No concerns on wider geographic market

Our report examines six types of evidence on geographic market definition [*as in Commission Notice (1997)*]

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



1. The 10 case studies
2. **Key findings and recommendations**

General observations

- ❖ The Commission's GMDs are **generally well-evidenced** and broadly in line with the approach set out in the Notice
 - Wide **range of evidence** sometimes used, but
 - ✦ Commission and parties appropriately prioritise resources to key issues
 - ✦ Effort also limited by data availability
 - For several of cases, **responses to market investigation** do provide the bulk of the evidence, but no evidence of Commission being persuaded by self-serving responses
 - Where **statistical and economic evidence** is used, it is not the sole decisive evidence, but part of a rounded and holistic assessment
- ❖ **Some repetition of evidence** between market definition and competitive assessment
 - Reflects: some unavoidable overlap in analysis; presentation of evidence by parties
 - Also some lack of clarity re *supply-side substitution* arguments?

A) The Commission should publicly clarify the aim of GMD

- ❖ Commission should clarify that **GMD is not an end in itself** but rather that...
 - ...it provides a useful framework for assessing competition...
 - ✦ identifying a geographically coherent group of customers whose purchases are similarly competed for by suppliers located in the same geographic area...
 - ✦ and possibly also by suppliers located at a greater distance...
 - ...but GMD should not *unduly* affect outcomes
 - ✦ Rather it plays an intermediate and non-decisive role that allows Commission and parties to focus on what really matters in the competitive assessment
- ❖ Commission should feel free to **postpone discussion of evidence** until the competitive assessment, if this is more appropriate....
 - ...even if parties present such evidence in relation to market definition

B) The Commission should be clear that it will *not* use supply-side substitution (including by imports) *for GMD*

- ❖ Commission Notice: “*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*”
 - ✦ US and UK guidelines similar, but clearer that supply-side substitution will only be used to aggregate markets for “*convenience*” (i.e. where this does not alter outcomes)
 - Notice does not envisage widening of the GM to include the source of imports
 - ✦ ..or of potential imports
 - ✦ *Nor should it!*

- ❖ Nevertheless, Commission actively considers the **possibility of the market being widened** (beyond the ‘convenient’) in a number of cases reviewed
 - ✦ Particularly in *Arsenal/DSP*, but also *INEOS/Solvay* and *Glencore/Xstrata*
 - ✦ Partly reflects evidence put to Commission, including econometric evidence

Why shouldn't imports be relevant for market definition?

- ❖ *Consider the following illustrative example:*
 - Suppose 2 large EEA firms and 1 major Chinese competitor [ChinaCo], all selling to EEA consumers each with 1/3 of sales
 - ✦ ...and that ChinaCo also sells in China, competing against only local rivals
 - *Which market definition provides a better frame for the competitive assessment?*
 - ✦ **Global** [=EEA + China] with very large market and small shares for EEA firms, or
 - ✦ **EEA** with potential competitive constraint from ChinaCo and others?
 - ✦ Note that imports still have a share of supply into the EEA market, so directly limit measured local market shares

- ❖ *Suppose alternatively that the 2 EEA firms each have 1/3 share of Chinese sales (competing against only ChinaCo in China) as well as in EEA*
 - GMD should now be global
 - ✦ But in such markets, the precise market definition matters less!

C) Commission should clarify & develop its analysis of supply-side discipline (particularly imports) in the *competitive assessment*

- ❖ *Worrying hint of a critical level of imports that eliminates any possible SIEC*
 - “The **[25-45]% market share** held by Chinese producers of sodium benzoate constitutes a constraint that would **discipline the merged entity post-transaction** should it intend to increase or increased prices above a competitive level. In previous merger cases, it has been considered that **import market shares lower than 25%** would already constitute a constraint on the entity resulting from the transaction.” [*Arsenal/DSP*, #257]
 - ✦ Level vs elasticity! [e.g. econometric analysis of import supply curves]
 - ✦ *Not crucial in this case but dangerous talk?*

- ❖ Should also consider calculating **capacity shares** to include ‘swing capacity’ and ‘rapid entrants’ from outside GM
 - Capacity shares for firms *within* the GM were considered relevant in 3 of our case studies but no estimates of *swing capacity* available for firms *outside* the GM
 - ✦ *Outokumpu/Inoxum, INEOS/Solvay and SSAB/Rautaruukki*

D) Our other suggestions for GMD

- ❖ Greater use of *isochrones* where relevant and data is available
- ❖ More consistent methodology for meaningful analysis of *transport costs*
- ❖ Greater consistency in identifying separate *distribution level markets*
- ❖ More explicit discussion of impact on GMD of *vertical integration into distribution*

Conclusions on ‘how GMD is done and how it can be improved’

- ❖ *Basically fine*
 - No evidence of any obvious errors in SIEC decisions (or remedies) as a result of GMD

- ❖ *GMD would benefit from...*
 - Greater public clarity in its purpose
 - Reserving import and most other supply-side analysis for the competitive assessment
 - ✦ ...and public clarity on this point
 - Some development and tightening up of practice
 - ✦ e.g. isochrones, transport costs, distribution, VI

- ❖ *Competitive assessment would benefit from...*
 - Developing the analysis of ability and incentive for external firms to provide a competitive discipline