Economics of competition law

Seminar on "Competition Policy and Law" organized by PHD CCI

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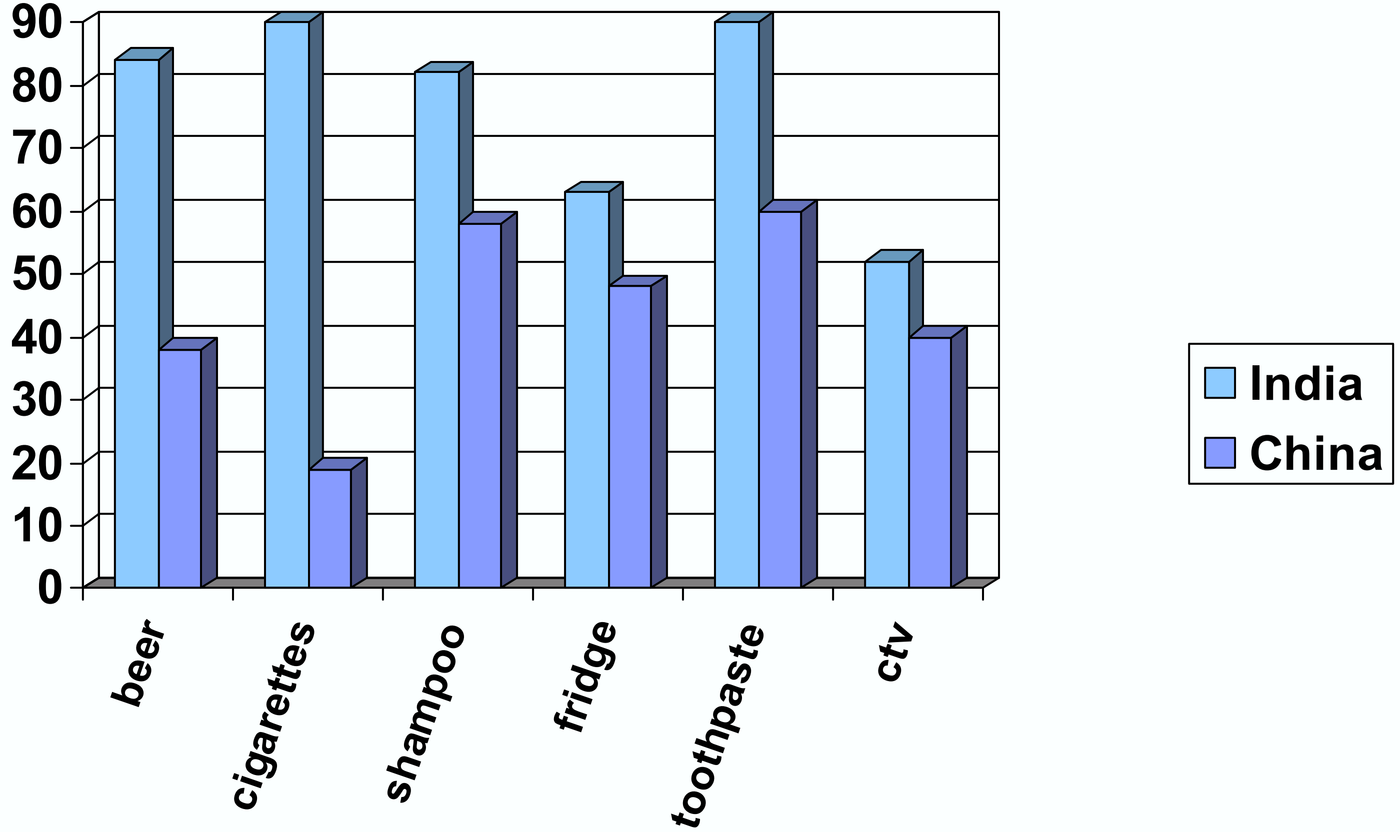
Basic elements

- Anti-competitive agreements
- Abuse of dominant position
- Merger control
- Advocacy

Newspaper report : top 3 cos' market share



Newspaper report : margins

- Indian companies enjoy more ‘pricing’ power – reflected in higher margins and lower distributor margins
- Can it be due to market power? Leading to monopoly profit and price squeeze on distributors!

Market power

- Key concern of competition law is with acquisition of market power i.e. when a firm can profitably raise prices above marginal cost.
- A firm that has market power can raise price without loosing sales.

Conditions necessary to acquire market power

- Such firm's ability to raise price depends on
  - Availability of substitutes
  - Number of competitors
  - Market share
  - Barriers to entry
  - Threat of potential competitors
- The size of a firm's market share is an important indicator for the existence of market power (EU Glossary of Terms, 2002)

Dominant position : Indian law

- Dominant position?
- Definition :
  - "..means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to –
  - ✓ (i) operate independently of competitive forces prevailing in the relevant market; or
  - ✓ (ii) affect its competitors or consumers or the relevant market in its favour."

Dominant position

- What is meant by position of strength?
- Market power –
  - ability to
  - profitably increase price
  - independently of competitors/ suppliers/consumers

Determination of dominant position

- There is no arithmetic figure - % of market share
- *Per se* rule does not apply
- Rule of reason test – many factors to be considered by the Commission in determination of dominance

Factors to determine dominance

- Market share – no threshold – Hoffman –La Roche case – United Brand case
- Size and resources of the enterprise – size– technological lead – capacity
- Size and importance of the competitors – relative size is important

Factors to determine dominance

- Economic power of the enterprise including commercial advantage over competitors – control over source of supply – brand value – distribution network - credit sales
- Vertical integration of the enterprise or sale or service network of such enterprise – network cannot be established in the short run – supply and/or distribution channels secured
- Dependence of consumers on the enterprise – habit – inertia - inelastic demand

Factors to determine dominance

- Dominance created by statute or government authority – sole licensee/concessionaire – public sector monopoly
- Entry barriers – regulatory barriers – high sunk cost – technical entry barriers – economies of scale –
- Countervailing buying power – does it offset market power? –

Factors to determine dominance

- Market structure – Structure-Conduct-Performance model
- Social obligation and social costs – cost benefit analysis
- Relative advantage of the dominant firm to economic development
- Any other factor – discretion of CCI – residual factors

Relevant market

- Dominance must be established in the relevant market
- Determination of the relevant market first
- Relevant market has two aspects
  - Relevant product market
  - Relevant geographic market

Relevant product market

- Relevant product market is the smallest set of close substitutes
- Determine substitutability of products –
- Two aspects:
  - Demand side substitutability- shift of demand to competing product on price rise
  - Supply side substitutability- shift of production to meet demand

Relevant product market

- Factors to be considered while determining relevant product market:
  - Physical characteristic of product
  - End-use of product
  - Price
  - Consumer preference – empirical evidence
  - Classification of industrial products - NIC

Relevant geographic market

- Relevant geographic market can be defined as the area in which products are available at approximately the same price given transport costs and any increase in demand can be met from neighbouring areas profitably.

Relevant geographic market

- Factors to be considered:
  - Shipment cost – very important
  - Regulatory trade barriers – octroi/sales tax
  - Local specification requirements – language display
  - National procurement policy – only local (state-level or national) suppliers permitted
  - Adequate distribution facilities – perishable products

Economist's tools to establish dominance

- HMT or SSNIP test
  - Whether the dominant player can <u>profitably</u> increase price by a small percentage, usually 5-10%
  - Based on recent data on price and quantity – the actual test is based on calculation of elasticity
- Price correlation analysis – prices of products that are substitutable will move in tandem – availability of data

More tools

- Calculation of elasticity gives an idea about substitutability
- Close substitutes form the relevant product market
- If the market is defined too broadly, difficult to establish dominance – akin to not punishing the guilty
- If the market is defined too narrowly, the efficient get punished

More Tools

Elzinga - Hogarty test to determine relevant geographical market

- LIFO
- LOFI

Usually both should be at least 90% to define the relevant geographical market – shipment data required

Dominance – some issues

- Joint dominance
- Concertation
- Third party access
- Parallel behaviour
- Following market leader
- Pro-competitive actions to meet competition

Abuse of dominant position

- The first step is to establish dominance
- Then definition of “abuse” can be applied
  - Imposing unfair or discriminatory conditions on purchase/sale or on price (including predatory price)
  - Limiting production
  - Denial of market access
  - Forcing supplementary obligations
  - Using its position in one market to enter another

Abuse – determination not easy

- So we come back to SCP model
- **Structure** of the industry (say number of firms and their market share) determines the way in which firms compete (**conduct**) and this in turn is determines their **performance** (profit)
- Competition authority is interested in knowing structure

Studying structure

- Concentration Ratio – C2,C3,C4…
- HHI (Hirfindahl-Hirschman Index)

Competition assessment begins with analysing conduct which distorts competition and then turns to law to determine whether distortion harms those whose protection is required under law.

Refer to slides 3 and 4 and draw your own conclusions

THANK YOU

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