Market Definition Guidelines

MyCC

Malaysia Competition Commission

Role of Economics in Competition Law

- Modern competition law practice is based on economics – eg that monopoly is bad and competition good
- Competition law is good for the Malaysian economy and will lead to higher income because:
  - Firms are forced to be internally efficient – this leads to higher productivity and higher incomes
  - Uncertainty about what competitors will do forces prices to be low and their products of a good quality
  - Firms must be innovative to avoid being put out of business by new products etc

Market Definition

- The term ‘market’ has a special meaning in competition law which may differ from how enterprises define a market for their own business purposes. The reason for this is that defining a market for competition law purposes is ultimately about determining the **level of competition** and so issues of **market power**.
- **The goal is to include within the defined market are all those firms that can effectively compete with the product that is being complained** about – which includes firms that can enter a market within a reasonable time. A market for competition law purposes is called a ‘**relevant market**’.
- The term ‘market’ is defined in Section 2 of the Competition Act as:

  ‘a market in Malaysia or in any part of Malaysia, and when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services’.

Defining a Relevant Market

- Defining a 'relevant market' means identifying all the **close substitutes** for the product under investigation. Products can be substituted both on the demand and on the supply side. For example, suppose there is a complaint about an anti-competitive agreement between apple producers. The question for competition law is whether the 'relevant market' is the 'market for apples' or a broader market that includes substitutes for apples. The essential issue is whether, **if the price of apples goes up:**

  - **will consumers (i.e. on the demand side) switch to other fruits? or**
  - **will producers of other fruits (i.e. on the supply side) quickly switch to produce apples?**

- If consumers will not switch to other fruits or producers will not switch to apples then the relevant market is a market for apples. On the other hand, if consumers switch to other fruits or other producers switch to producing apples, then this means the other fruits and producers compete with apple producers. The relevant market should include these competing fruits and those producers. This will be explained in more detail below.

Market definition

Why definition of "market" is important

Section 4(1)	**when considering whether an agreement has the effect on competition**
Section 4(1)	**in determining significantly preventing competition**
Section 5	**when considering relief, whether an agreement would eliminate competition**
Section 10	**when considering dominance - market power**
Section 11	**when conducting market review**
Section 40	**when determining level of financial penalty**
	Individual/Block exemptions when imposing market share threshold
	****Merger assessment whether post merger resulted in market power**

Defining a Relevant Market

- Defining a 'relevant market' allows the MyCC to:
  - identify all the enterprises who compete against the enterprise against whom the complaint has been made (i.e. who compete **in the same market**)
  - determine whether an agreement violates the Chapter 1 prohibition because it has the "effect of significantly preventing, restricting or distorting competition **in any market** for goods or services". Market definition is important to determine whether there is a **significant anti-competitive effect in a market.**
  - determine whether conduct by a dominant violates the Chapter 2 prohibition by engaging in conduct which "amounts to an abuse of a dominant position in any market for goods and services". To be dominant in a market requires assessing whether a firm has substantial market power **in a market**.
  - take into account the turnover of the firm in the relevant **market** in assessing the size of penalty.

Defining a Relevant Market

- To define a relevant market for competition law purposes the MyCC will use the **'Hypothetical Monopolist Test'** ("HMT"). This test is commonly used in other jurisdictions with competition law and is described in detail below.
- Once the market has been defined, the next step involves conducting an analysis of the competition within that market. This involves:
  - Determining the market shares of competitors
  - Assessing how easy it is to enter the defined market by examining whether there are any barriers to entry into the market
  - Evaluating the way competition is conducted e.g. whether competition is mainly on the basis of price or on the basis of product features etc

Defining a Relevant Market

- To define a relevant market for competition law purposes the MyCC will use the 'Hypothetical Monopolist Test' ("HMT"). This test is commonly used in other jurisdictions with competition law and is described in detail below. It should be remembered that market definition is a crucial first step in a competition analysis.
- Once the market has been defined, the next step involves conducting an analysis of the competition within that market. The second step involves:
  - Determining the market shares of competitors
  - Assessing how easy it is to enter the defined market by examining whether there are any barriers to entry into the market
  - Evaluating the way competition is conducted e.g. whether competition is mainly on the basis of price or on the basis of product features etc

Defining a Relevant Market

- The MyCC will define the relevant market using the Hypothetical Monopolist Test ("HMT")

- This test originally derives from the United States where it is called the 'SSNIP' test' i.e. a 'Small but Significant and Non-Transitory Increase in Price' test. They are equivalent.

- While the definition of a market is important in determining anti-competitive effect and determining whether a firm is dominant, it is also useful from an enforcement perspective because it allows the MyCC to identify relatively quickly situations where agreements do not have a significant effect on competition or where enterprises clearly do not possess market power.
  - For example, if a potentially anti-competitive horizontal or vertical agreement involves competitors with a small market share then the MyCC will normally close a Chapter 1 investigation at an early stage because the anti-competitive effect of the agreement is unlikely to be great - unless other relevant factors provide strong evidence of collective market power.

Market Power

- Defining the market enables the MyCC to assess market power
- Market power is defined as:
  - The ability to raise prices above the competitive level
  - The ability to harm competitors eg by excluding them entering a market, driving them out of the market or forcing them to ‘behave’ with the threat of retaliation if they don’t.
- Competition is trying to gain market share at expense of competitors ie harming them by producing a better product at a lower cost (and price)
- Conduct by a company without market power benefits consumers eg lowers price. But the same conduct by a firm with market power may be anti-competitive.
  - For example, a firm with market power can drive equally efficient competitors out of business by setting price below cost
  - Once a firm with market power drives an equally efficient competitor out of the market it can then raise price (exploit consumers) without constraint – leading to a worse outcome in the longer-term

The Hypothetical Monopolist Test

- For most people a "market" usually means a particular geographical area where buyers meet sellers to buy a product. However, for competition law purposes the word 'market' has a more precise meaning. To avoid potential competition law problems enterprises should identify the markets in which they operate for competition law purposes using the approach provided in this Guideline.

- The HMT defines the relevant market as:

  the smallest group of products (in a geographical area) that a hypothetical monopolist controlling that product group (in that area) could profitably sustain a price above the 'competitive' price i.e. a price that is at least a small but significant amount above the competitive price.

- The MyCC will use a price-range of **5-10%** to represent **a small but significant increase in price** ("SSNIP"). However, it should be recognized that the HMT only provides an analytical framework for assessing whether products are likely to be "substitutable for, or otherwise competitive" with the relevant product. The HMT is rarely able to provide a precise answer. Once identified that product group (and area) is the relevant market for competition law purposes because all the competitors to the enterprise(s) about whom a complaint has been made have been identified.

- So the goal of market definition is to find the smallest market in which a hypothetical monopolist could impose a SSNIP (of 5-10% above the competitive price). Applying the HMT involves the following steps.

Steps in HMT

- **Steps in Market Definition**

- **Step 1:** We start with a hypothetical monopolist of the **focal product** (i.e. the product that is under investigation). We then ask:
- **Step 2:** Would a hypothetical monopolist of a market for the focal product find it profitable to sustain a price for the focal product of **5-10%** above the competitive level?
  - If the answer is YES – then this market definition is the relevant product market for competition purposes because all the products that compete with the focal product around that price (i.e. could be substituted for the focal product at that price) have been identified. The market definition is completed.
  - If the answer is NO - then this means that other products compete with the focal product. So, the products that next compete with the focal product (the closest substitutes) should be included in the definition of the relevant market. The next step involves asking the same question with a broader product.

- **Step 3:** The question is repeated. Would a hypothetical monopolist of a market for a combined market for the focal product plus the close substitutes identified in Step 2, find it profitable to sustain the price of the focal product 5-10% above the competitive level? If yes then the relevant market is the market for the focal product plus the close substitutes. If no, then we add the next closest substitutes and repeat the question until the point is reached where a hypothetical monopolist could sustainably maintain price 5-10% above the competitive price.

Steps in a MyCC Competition Analysis

- Starts with
  - Product being complained about eg durians
  - Next identifies all the competitors to the company being complained about eg BIG DURIAN, TYPE OF DURIANS
  - Market definition tries to identify all the competitors by seeing what products are substitutable – and then finding out who supplies those products ie the competitors
  - Involves both a product and a geographic market
- Once the **relevant market** is determined the MyCC will conduct a competition analysis by looking at the:
  - Existing market: how many competitors, how big are they? What is their market shares? How do firms compete?
  - Future market: can new competitors easily enter the markets? eg by setting up new production or distribution facilities

Box 1 Determining the Relevant Product Market – Example

- The MyCC receives a complaint that a green apple producer GREENAPP has signed an exclusive contract (which could include an exclusive distribution agreement) with the biggest retail store in a town in Malaysia. How would the relevant market be determined? The MyCC starts with the focal product 'green apples' and asks whether a *hypothetical monopolist* of green apples would be able to profitably increase the price of green apples by **5-10%** above the competitive price. If the answer is yes then the relevant product market is green apples. If the answer is no – then the next available substitute product – say red apples – is added to the proposed relevant market definition. The question is then asked: would a hypothetical monopolist of green + red apples be able to profitably raise the price of green apples by **5-10%** above the competitive price? If yes then the relevant market is the market for green + red apples because there are no other products that consumers would substitute for green and red – all the competitive products have been identified. If the answer is no then this means there are other products apart from green and red apples that consumers would switch to if the price of green apples was increased – and so those products should be included in the relevant product market. The process continues until all the products that reasonable compete with green apples are identified.

The Time Element

- An important issue is whether the hypothetical monopolist could sustain the SSNIP price. **The more quickly buyers can switch products, the greater the constraint on the exercise of seller market power**. This will depend on the kind of market. As a general guide the MyCC will only include products in the relevant market that consumers could switch to within 12 months. Any longer would mean the product does not provide an effective, immediate constraint on the hypothetical monopolist's ability to price as it likes. However, the time period used to assess buyer switching may be significantly shorter than one year. For example, in markets where purchases are made frequently. Each case will be examined on its merits.

The Relevance of the Supply-Side to Market Definition

- Enterprises might be prevented from charging higher prices if other enterprises currently not supplying the product in question could easily switch production or otherwise supply the focal product and its substitutes within a short time period. In other words, substitution can occur from the supply side as well.

- Supply-side substitution can be thought of as a special case of entry into a market that:

  - occurs quickly (generally less than one year);
  - is effective (generally on a scale large enough to affect prices); and
  - does not involve substantial sunk investments (i.e. investment costs that cannot be recovered if the investment fails – e.g. advertising expenditures on a new product).

- For example, different kinds of soft drinks can be produced using the same production facilities. Suppose one soft-drink manufacturer produces a premium drink but the other producers currently do not. Suppose the premium soft drink manufacturer raises the price of the premium brand by 10%.

  - Consumers may be reluctant to switch to (substitute) other brands because of its ‘image’.
  - However, even if consumers do not switch, other soft-drink producers may be able to easily switch to producing the higher quality soft-drink by simple changes to their production processes.
  - If so, then the relevant market includes not only the premium soft-drink but also the lower quality soft-drinks because this immediate supply side substitution places a constraint on the ability of the premium soft-drink manufacturer to profitably raise price.

- Enterprises that can potentially supply the product in less than 12 months would normally be included in the definition of the relevant market.

The Geographic Market

- As mentioned previously the term ‘market’ is defined in Section 2 of the Competition Act as “a market in Malaysia or in any part of Malaysia”. This means that other countries are not included as part of the definition of the relevant geographic market. For example, even if imports could easily come into Malaysia from Thailand for a particular product, the geographic market would not be defined to include both Malaysia and Thailand. Instead, the relevant geographic market would be defined as Malaysia and imports from Thailand would be considered in the next stage as part of the competition analysis.

- Similar to the definition of the product market, for competition law purposes the geographic market refers to the area over which consumers can substitute the products under consideration and the area over which sellers can competitively sell the relevant products. If consumers can travel from Gombak to Petaling Jaya to have their hair cut when the price in Gombok is increased, then the geographical spread of a relevant hairdressing market is wider than just Gombok. If, on the other hand, hairdressers from Penang would travel to Kuala Lumpur because the price in Kuala Lumpur has risen, then the geographic market should also include Penang.

The Geographic Market

- The geographic scope of the market is defined using the same framework used to analyse the product market. Defining the geographic market starts by identifying a relatively narrow geographic area, called the focal area. This is the narrowest area in which the group of products identified in the product market definition compete – for example a town or suburb. Then the question is asked: **could a hypothetical monopolist of the group of products identified in the relevant product market, operating in that focal area, profitably increase the price by 5-10% above the competitive price?** If the answer is:

  – Yes – then this is the geographic market because consumers will not buy elsewhere and producers outside the region will not supply the focal area

  – No – this means buyers will go to neighbouring areas to buy or sellers from neighbouring areas will now come into the focal area to sell in response to the higher price. This means these neighbouring areas should be included in the geographic market definition

- This process continues until a hypothetical monopolist of the group of products identified in the product market definition could profitably raise price by SSNIP (i.e. 5-10%) in that area

Market Definition Where there is Product Differentiation

- The HMT works best when products are homogeneous. However, many markets contain differentiated products, for example products that are differentiated by features such as brand, location or quality. Here, it may not be possible to identify clear boundaries in defining the market, even within the same area at the same time. For the purposes of the HMT sometimes product differences may be ignored for the analysis. For example, expensive sports cars can be considered together even though they are not exactly the same.

- However, there are markets where the degree of product differentiation may be so great that the HMT is misleading. In that case the MyCC may decide not to define a market precisely and simply focus on the constraints to the exercise of market power directly.

- For example, market definition is essentially about whether a product is 'in the market' or out of it. Do Malaysian shoes compete in the same market as Indonesian shoes or not? If Indonesian shoes are in the same market then they serve as a competitive constraint to producers of Malaysian shoes. Market definition is an intermediate step to get to the final analysis of competition. Products and areas in the market compete. Those outside the market do not.

Market Definition Where there is Product Differentiation

- Where products are highly differentiated it may be more productive to assess the extent to which the differentiated products are substitutable directly, rather than working through the HMT. So the question would be whether Indonesian shoes directly affect the decisions of consumers when considering Malaysian shoes. Inevitably, pragmatic judgement is required.

- In other cases, sellers may bundle distinct products. For example, furniture sellers might bundle different items of furniture for sale for the bedroom or dining room. Or telecommunications companies might bundle local calls with an internet subscription. Buyers' views would be important in assessing the appropriate frame of reference i.e. whether consumers see the bundle as a group of products that they prefer to buy together or not.

- While, normally competitors are identified in the same market, sometimes competition up or downstream may also constrain competition. For example, suppose a wholesaler sells product A to a retailer which the retailer in turn uses to sell product B. Suppose another vertically integrated wholesaler sells product C which is a substitute for product B at the retail level. The ability of buyers to substitute product C for product B at the retail level may constrain the first wholesaler's ability to raise the price of product A.