

Joe Farrell, Univ. of Berkeley: Making Market Definition Helpful

Comments by Lars Sørgard
The Norwegian Competition Authority

My comments

- Defending market definition
 - Farrell's main points
 - The need for threshold levels
- Market definition's role
 - More scope for it than indicated by Farrell?
- Market definition vs the new approach (UPP)
 - SSNIP and UPP quite closely related?
- Some lessons
 - On the right track
 - Experience in Norway

Farrell on market definition

- What is the *appropriate role for market definition and analysis of concentration (MDAC)*?
 - If not constrained by court
- Not so much in unilateral conduct (non-coordination)
 - If differentiation, diversion ratios and margins matter
 - But then not so much areas MDAC could cover?
 - Coordination; # of rivals and their size matters?
 - In search for other areas
- Market definition relevant when market definition is obvious!

The market definition approach: Nice with threshold values

- Helpful for structuring the analysis
 - Market definition (MD) to define the competitive landscape; products and geography
 - Given MD, analyse the nature of competition between the firms in the same market
 - Anti-competitive merger?
 - Consider efficiency gains, if any
- Can then have some safe harbours
 - Using market shares threshold levels, both for dominance and for clearing some mergers ...
 - .. and the lawyers are quite happy



My comments

- Defending market definition
 - Farrell's main points
 - The need for threshold levels
- **Market definition's role**
 - **More scope for it than indicated by Farrell?**
- Market definition vs the new approach (UPP)
 - SSNIP and UPP quite closely related?
- Some lessons
 - On the right track
 - Experience in Norway

Unilateral I: Capacity constrained firms

- What about old style industries, such as steel etc?
- # of firms and market shares may then matter
 - Competition a la Cournot
 - If homogenous products, HHI and Δ HHI can be a good proxy for nature of competition and harm
- Then it really makes sense to talk about # of rivals and their market shares
 - Even so with capacity constraints and differentiated products?
 - No clear link to HHI, but still relevant to do the old style analysis?

Unilateral II: # of firms matters

- Bidding market
 - Number of firms may affect each firms' bid
 - A sort of market definition may help us to find the potential bidders?
- Electricity market: Residual demand approach (RSI = Residual Supply Index)?
 - Must look at all the firms and their capacities
 - Who is the pivotal player, if any?
 - A merger leads to a pivotal player?

My comments

- Defending market definition
 - Farrell's main points
 - The need for threshold levels
- Market definition's role
 - More scope for it than indicated by Farrell?
- **Market definition vs the new approach (UPP)**
 - **SSNIP and UPP quite closely related?**
- Some lessons
 - On the right track
 - Experience in Norway

SSNIP vs Critical Loss vs UPP

- SSNIP \approx The hypothetical monopolist test
 - Profitable to monopolise the market?
- SSNIP test quantified in *critical loss (CL) test*:
 - Product 1 and product 2 in the same market if:

$$D > \frac{\alpha}{\alpha + L}$$

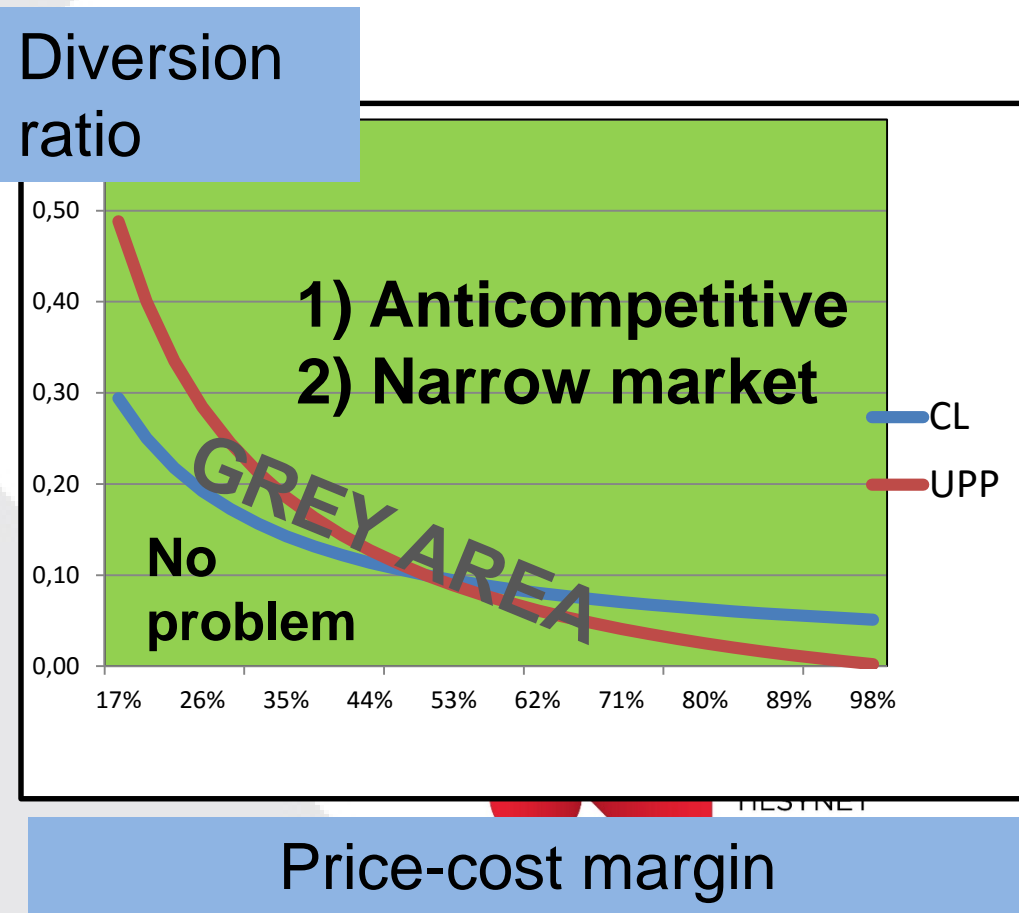
Diagram illustrating the variables in the critical loss test formula:

- D : Diversion ratio from 1 to 2 (and reverse)
- α : Price increase: F.ex. 5 %
- L : Price-cost margin

- CL shares some similarities with the UPP approach:
 - Diversion ratio
 - Margin

Market definition closely related to UPP

- A proper SSNIP (= CL analysis) means that **diversion ratio** and **margins** matters for market definition
- Similarities, but CL less informative than UPP?
- We are concerned about *how* close rivals
 - Not yes or no, as in CL (market def.)
 - Better as in UPP, considering a scale
 - Some are close, others not



My comments

- Defending market definition
 - Farrell's main points
 - The need for threshold levels
- Market definition's role
 - More scope for it than indicated by Farrell?
- Market definition vs the new approach (UPP)
 - SSNIP and UPP quite closely related?
- **Some lessons**
 - **On the right track**
 - **Experience in Norway**

An economist's view: On the right track!

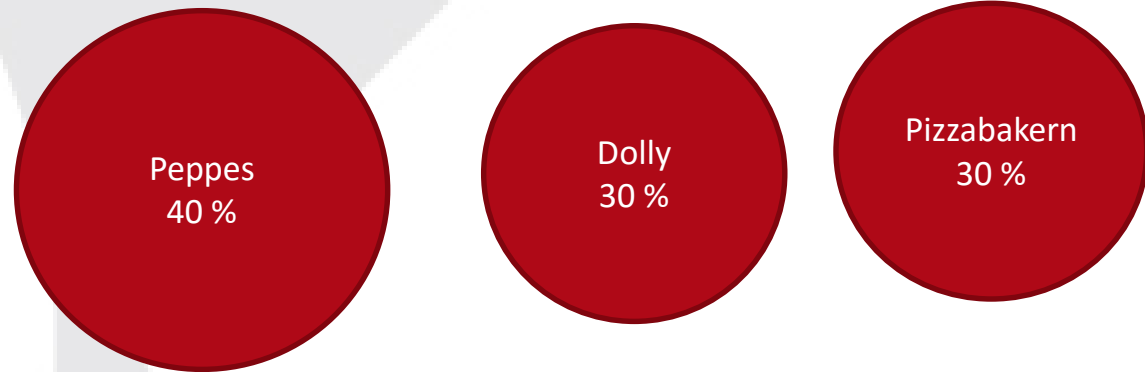
- Old school – Bananas
 - Product characteristics often decisive
 - 'Toothless fallacy'
 - Bananas are soft
 - Old and very young can eat them, but not other fruit
 - But forgot all other people
 - EU Guideline from 1997 very clear (see para. 36)
 - Strong warning against product characteristics
- Not so old school – SSNIP and Critical Loss (CL)
 - EU Guideline refers to economic methods (38-43)
 - Shock analysis, price correlations, demand studies, etc
- New school – Upward Pricing Pressure (UPP)
 - UK/US 2010 merger guidelines
 - More direct assessment of competitive harm
 - Even closer link to economics

The experience in Norway

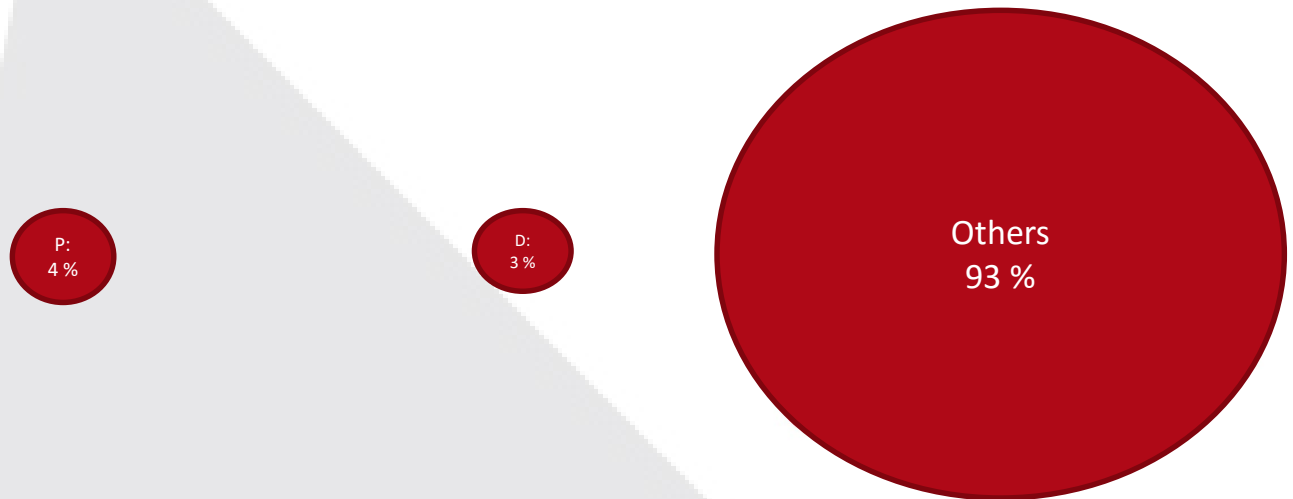
- Long time a traditional approach, and still so to a large degree in abuse and cartel cases
 - Abuse: Threshold level important for dominance
- Gradually a more pragmatic approach in merger control
 - Market delineation is still a chapter in our decisions on merger control
 - But we do not always conclude firmly
 - Indicates the market definition, but more as a framework for the competitive assessment
 - In some cases not even market shares mentioned

Ex. from pizza merger: Market definition is not at all clear cut

- A narrow market:

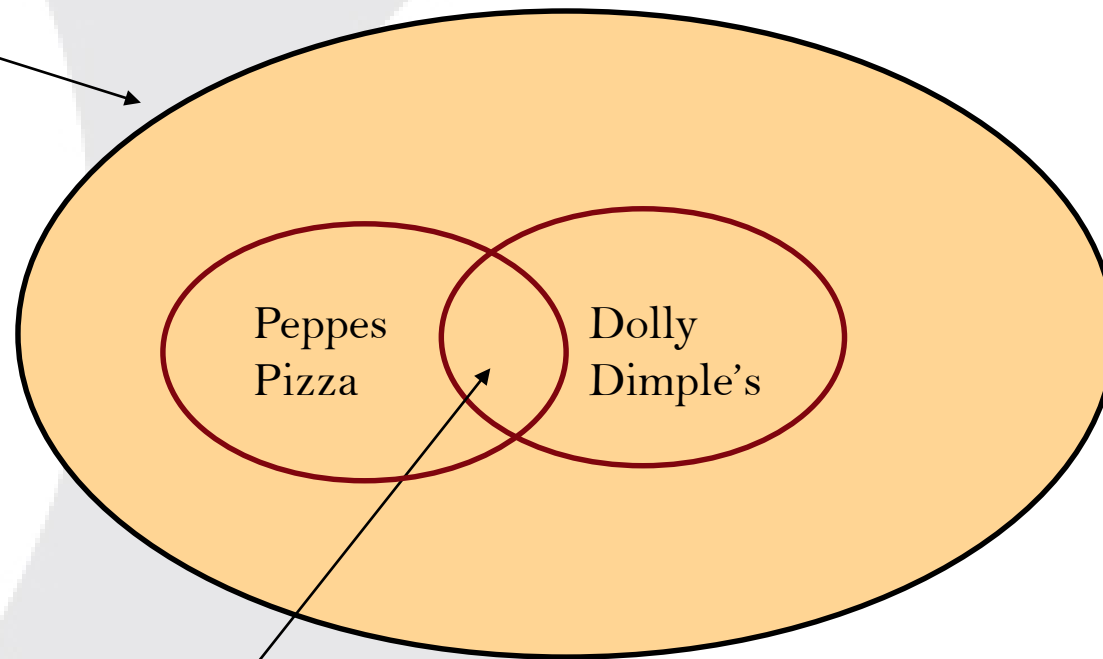


- A broad market:



Our approach in the pizza merger: Market definition as a framework

- Indicates a possible market definition, but we do not conclude



- Given that, we discuss how close rivals the merging parties are