FAIR TRADING COMMISSION OF SEYCHELLES GUIDELINES ON RELEVANT MARKET AND MARKET POWER

CONTENTS

1. INTRODUCTION:

Market definition is an essential tool in competition assessment. The definition of the relevant market is featured in all the competition assessments under the Fair Trading Act 2022. The relevant market defines the substitutes for the product or service in question and regions of interest which provide significant competitive constraints for the parties concerned. The establishment of a relevant market is comprised of the identification of both the product market and the geographical market.

The Fair Trading Commission (hereinafter referred to as “the Commission”) has rendered its guideline on relevant markets to the public to increase transparency on its procedure for market definition. The Commission hopes that the increased transparency will also enable enterprises to better understand the type of information used for market definition. Depending on the characteristics and conditions of each case, the Commission will generally rely upon the criteria and appropriate evidence as set out in the guideline to assess the relevant market(s).

The guideline is not a substitute for the Fair Trading Act 2022 or any Regulations and should instead be read in conjunction with the relevant legal instruments. The examples used within the guideline are for illustration and do not set a limit on the investigation and enforcement activities of the Commission. Any persons in doubt about how their commercial activities may be affected by the Act may wish to seek legal advice. The Commission may, from time to time, review and issue revised versions of its guidelines.

2. PURPOSE OF DEFINITION OF RELEVANT MARKET

The concept of the relevant market plays a central and often critical role in the application of competition assessment under the Fair Trading Act 2022. The objective of defining the relevant market is to identify all the products (and/or services) which are regarded as substitutable by the consumer and the geographic area(s) in which these products (and/or services) are offered, produced, and/or traded.

The relevant market in effect allows attention to be focused on the 'important' or 'primary' competitive constraints which exist between products (and/or services) and between regions. The definition of the relevant market allows the competition assessment to include an analysis of market share and market concentration.

3. THE BASIC PRINCIPLE OF RELEVANT MARKET

The concept of a relevant market for the enforcement of the Fair Trading Act 2022 is different from that used by firms in other contexts. Firms often use the term " market" to indicate the whole industry in which they operate or the markets where they supply their goods or services.

For the purpose of the Act, a relevant market is defined to include those suppliers among whom there is close competition. The focus is on those goods or services that are close substitutes in the eyes of buyers and upon those suppliers who could produce or who could easily switch to producing those goods or services.

The relevant market is comprised of three types of competitive constraints:

- Demand-side substitution: The extent to which consumers consider other products as effective substitutes;
- Supply-side substitution: The extent to which productive assets outside the control of the hypothetical monopolist can be redirected for production of the directly competing product; and
- Potential Competition: The extent to which new firms can enter a market.

Demand Side Substitution:

The most direct source of competitive constraint, for the definition of the relevant market, is demand-side substitutability. Demand substitution constitutes the most immediate and effective disciplinary force on the suppliers of a given product, in relation to their pricing decisions.

Demand-Side Substitution takes place when consumers switch from one product to another in response to a change in the relative prices of products. If consumers are in a position to switch to available substitute products or to begin sourcing their requirements from suppliers located in other areas with relative ease, then it is unlikely that the price increases will be profitable. Hence, in establishing the relevant market, the Commission includes all the products to which consumers would most likely switch in response to a relative price rise. This involves using the Small but Significant and Non-transitory Increase in Price test ‘SSNIP Test”. Consumers are interviewed regarding their buying decisions to determine whether a hypothetical monopolist would still profit from a 5%-10 % price increase, above the competitive price, assuming that the prices of all other products remain constant. Although, the actual percentage increase used may vary depending on the particular facts of each case, the Commission considers 5%-10% to be a “small but significant” price rise.

Supply-side substitution:

The Commission may also take into account supply-side substitution when establishing the relevant market as producers like consumers may also be able to react to a price increase. Supply-side substitutability is concerned with the producer’s preparedness and ability to switch production capacity from the manufacturing of one product to another in response to a relative change in price, without incurring significant additional costs or risks in response to small and permanent changes in relative prices. When these conditions are met, the additional production that is put on the market will have a disciplinary effect on the competitive behaviour of the enterprises involved.

These situations typically arise when enterprises market a wide range of qualities or grades of one product; even if from a demand perspective the different qualities cannot be substitutable for any given use, if suppliers can manufacture and sell the different qualities, and production can be adjusted with negligible costs and in a short time-frame, the various qualities will be considered as a single product market. The same reasoning may lead to group different geographic areas.

In such cases, the relevant product market will encompass all products that are substitutable in demand and supply, and the current sales of those products will be summed to calculate the total value or volume of the market. The same reasoning may lead to group different geographic areas.

Potential Competition:

The assessment of potential competition is only carried out at a subsequent stage once the position of the companies involved in the relevant market has already been ascertained, and their position raises competition concerns.

4. MARKET DEFINITION:

The relevant market is comprised of the relevant product market and the relevant geographical market.

The Relevant Product Market

The relevant product market 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. Product market definition starts by considering the products which the parties to an agreement produce, or the products which are subject to a complaint. The effects of a price increase or corresponding decrease in quality or output levels above competitive levels are considered to determine the relevant market for these products. If a significant number of buyers would switch to substitute products following the increase in price above competitive levels, these substitute products would be included in the definition of the product market.

Products may be viewed as substitutes even if they do not have similar physical or other characteristics. Their prices also need not be similar. For example, if two products serve the same function but one is of a higher price and quality than the other, they might be included in the same market. This is because even though one product is of a higher price and quality than the other, a price increase in the product of higher quality could be such that buyers no longer feel that the quality difference between the two products outweighs their price differential. Hence a price increase in one product could lead to buyers switching to the other product.

In defining the relevant product market, the Commission is also assessing whether a hypothetical monopolist could profitably sustain prices above competitive levels. The more quickly buyers can switch, the greater the constraint on the exercise of market power. Depending on the case, products for which buyers take longer than one year to switch in response to a price increase are generally not included in the same market.

The Relevant Geographic Market:

The relevant geographic market comprises the area in which firms concerned are involved in the supply of products or services and in which the conditions of competition are sufficiently homogenous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas. If buyers will travel further afield to buy products when their local prices are increased, then the geographical spread of the market is wider and vice versa. If sellers from afar will now supply to local markets because the local price has risen or corresponding competitive terms have improved in the focal area, then the geographic market is also wider than the situation where only local sellers are willing to supply.

The geographic scope of the market can be defined using the same framework used to analyse the product market while emphasising on the three particular categories of issues:

- Demand-side issues (usually for defining retail markets);
- Supply-side issues (usually for defining wholesaling and manufacturing markets); and
- Imports.

The process for defining the geographic market begins by looking at a relatively narrow geographic area, which usually refers to the focal area, by asking if a small but significant increase in the price of a product (5%- 10%) in one area would lead to buyers switching to sellers in neighbouring areas. If a significant number of buyers are likely to switch to other sellers, this would restrain the ability of a hypothetical monopolist to charge higher prices in its area. These neighbouring areas would be included in the market definition.

In addition, the potential for businesses in neighbouring areas to supply to buyers should also be considered. As in the product market definition, these sellers should be considered if they can respond in the short run, (for example, within one year) without incurring significant costs.

The costs of transportation should also be considered. If buyers and sellers face high transportation costs, then the geographic market will be smaller than when transport costs are low. The higher the costs of transportation, the smaller the geographic market is likely to be.

Significant imports of a particular product may indicate that the market is wider than Seychelles, although this is not always the case. Imports could come solely from the international operations of domestic sellers, in which case they may not act as an independent constraint on domestic firms.

When examining imported products, if the Commission concludes that products bought on the internet are close substitutes for domestic products, then the overseas suppliers are part of the relevant market.

On the other hand, a lack of imports does not necessarily imply that the market could not be a regional or a wider international market. The potential for imports may still be an important source of supply-side substitution should prices rise. This possibility could constrain the exercise of market power by existing sellers.

Temporal Market

Another dimension that may be relevant in some markets is time. Examples of how the timing in the production and purchasing of products can affect markets include:

- Peak and off-peak services (for example, tour packages during peak season (school vacations) and off-peak season (school term)): In these cases, it may not be possible for buyers to substitute between a period of time. Some buyers may not view peak and off-peak services as substitutable.

- Seasonal variations (for example, summers versus winter months in industries such as tourism or for products such as produce and fruits): A time dimension is appropriate as the market for these products may only exist to a limited extent during certain periods.

- Innovation/Inter-generational products (for example, mobile phones and computers): Consumers may choose to defer expenditure on present products because they believe innovation will soon produce better substitutes or they may own an earlier version of the product, which they consider to be a close substitute for the current generation.

To some extent, the time dimension is simply an extension of the product dimension, for example, the product can be defined as the supply of tour packages at a certain time of the year.

Complements market

Apart from identifying groups of substitutes, markets can also be defined to include groups of complements. Complements are groups of products that are consumed or produced together. They are included in the same market when competition in the supply of one product constrains the price charged for the other. This is most common in secondary markets, also known as aftermarkets.

Secondary Markets (After Markets)

Secondary products are products that are only purchased if the buyer has already purchased the primary product. This situation often arises in the case of durable products which need to be maintained. For example, car parts can only be used for a particular car brand. The question in determining the relevant market is, therefore, should cars and their parts be considered as separate markets, or a combined car and parts market?

Sellers of durable products sometimes have a monopoly or high market share in the supply of secondary products or services and might be perceived as exploiting this dominant position in the secondary market. However, as any exploitation of a seller's market power in the secondary market could affect its position in the primary market, the secondary market alone may not be the relevant market. For example, an increase in the price of spare parts for a car might affect a buyer's decision whether to buy that particular brand of car. So, the seller might be constrained in exercising its market power in the secondary market.

There are three possible market definitions for secondary products:

- A system market -including the primary and secondary products.
- Multiple markets -where there is one market for the primary product but separate markets for secondary products for each brand of primary product.
- Dual markets -one for the primary product and one for all brands of secondary product.

Determining the market for secondary products depends on the facts of the case. A system market may be appropriate when buyers take into account the whole-life cost of the product before buying. This means that the buyer will look at both the price of the primary product and the secondary product before deciding which product to buy. Another factor to consider is how often the primary product is to be replaced and whether there are any costs involved from changing sellers.

Where the conditions for a system market do not apply, multiple markets or a dual market definition may be appropriate. The former is likely where, having purchased a primary product, buyers are locked into using only a restricted number of secondary products that are compatible with the primary product. For example, buyers might be restricted to purchasing certain types of inkjet cartridges that are compatible with their printers.

A dual markets definition is appropriate where secondary products are compatible with all primary products (and are so perceived by buyers). For example, buyers can purchase any brand of paper to use with their printers.

Two-sided market

Two-sided markets on the other hand occur where there are two distinct customer groups that have inter-related demand. One or both groups impose a positive externality on the other group.[1] For example credit cards. The groups in this case are retailers and consumers. As more consumers have and use credit cards, retailers also benefit from accepting them.

Other Approaches to Market Definition

Many markets contain differentiated products, for example, products that are differentiated by features such as brand, location, or quality. Hence, there are no clear

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[1] Bishop, S. and Walker, M. (2010) *The Economics of EC Competition Law: Concepts, Application and Measurement*. University edn. London: Thomson Reuters (Legal) Limited ,para 3-042

boundaries in defining the market, even within the same area at the same time. The market definition would vary depending on the facts of the case. Therefore, even if two products do not lie within the same market for one case, this does not rule out the possibility that in another case, they will be in the same relevant market.

In some cases, sellers may bundle distinct products, A, B, C, and D to be sold together. An example could be furniture sellers bundling distinct pieces of furniture to be sold as a bedroom or dining room set, or sellers bundling different stationery items to be sold together, such as pencils, erasers, rulers, staplers etc. Depending on the case, distinct products may be included in the relevant market due to "bundling". Buyers' views would be important in assessing the appropriate frame of reference.

5. CALCULATION METHOD

The hypothetical monopolist test (SSNIP Test)

The Commission uses the hypothetical monopolist test (SSNIP Test) to define the relevant market. The test (in essence, a "price-elevation" test) tries to identify all the products that buyers regard as a reasonable substitute for the focal product. Once those substitute products are identified, all those enterprises that could potentially supply the focal product and substitutes can be identified. These are the competitors that actually constrain the exercise of market power.

In essence, the test seeks to establish the relevant market by including in the market all the products and their sellers that constrain the exercise of market power and then, determine if a hypothetical monopolist that controls this defined market would be able to act without constraint.

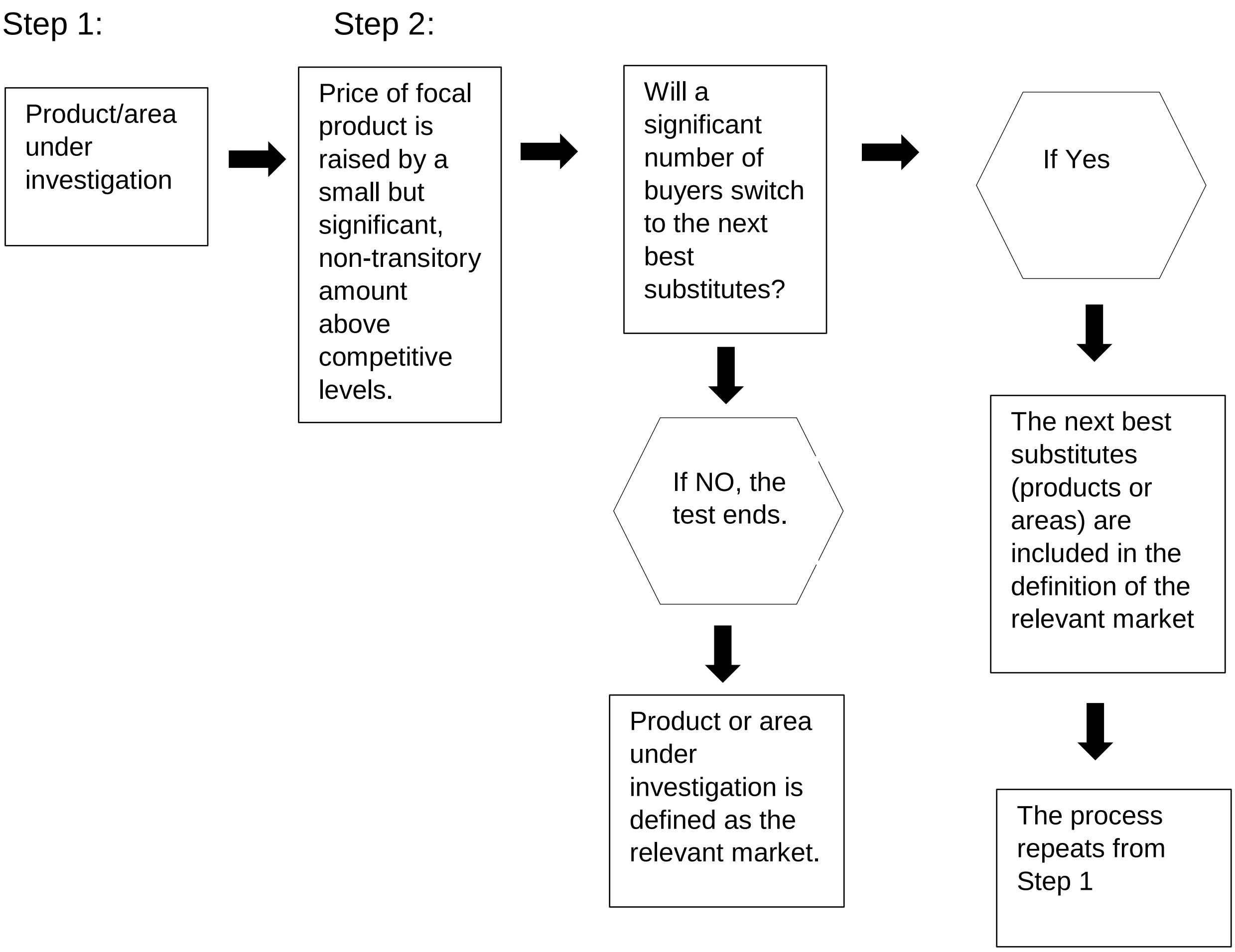
The relevant market is therefore the smallest product group (and geographical area) such that a hypothetical monopolist controlling that product group (in that area) could profitably sustain "supra-competitive" prices, i.e. prices that are at least a small but significant amount above competitive levels. That product group (and area) is usually the relevant market for competition law purposes.

The test starts with a narrow definition of the product and geographic market. This would normally be the focal product or the area in which the focal product is sold. Using this narrow definition, the following question is asked: “whether a significant number of buyers will switch to other products (or areas), that are the next best substitutes if the price of the focal product is raised by a small but significant, non-transitory amount above competitive levels?”

If the answer is yes, these other products (or areas) should be included in the definition of the market because these other products (or areas) potentially constrain the exercise of market power. The group of products (or areas) is widened to include those products (or areas) and their sellers and the same question is asked again.

This question is repeated and the market is widened until the point is reached when a significant number of buyers do not respond to the small but significant increase in price by switching to other products (or areas).

The relevant market containing the principal constraints on the exercise of market power is then used to assess the impact of that agreement or conduct under investigation or to assess whether an enterprise is dominant in that market. The following diagram illustrates this process



An increase of 5% to 10% above the competitive price will be used for the test. The actual percentage increase used may vary depending on the particular facts of each case.

It should be emphasised that defining a market in strict accordance with the test's assumptions is rarely possible. Even if the test could be conducted precisely, the relevant market is in practice no more than an appropriate frame of reference for competition analysis. The test provides a conceptual framework within which evidence on competitive constraints can be gathered and analysed.

A practical example of this test can be provided by its application to a merger of, for instance, soft drink bottlers. An issue to examine in such a case would be to decide whether different flavours of soft drinks belong to the same market. In practice, the question to address would be if consumers of flavour A would switch to other flavours when confronted with a permanent price increase of 5% to 10% for flavour A. If a sufficient number of consumers would switch to, say, flavour B, to such an extent that the price increase for flavour A would not be profitable due to the resulting loss of sales, then the market would comprise at least flavours A and B. The process would have to be extended in addition to other available flavours until a set of products is identified for which a price rise would not induce a sufficient substitution in demand.

One of the main shortcomings of the SSNIP test is that when using the test it may happen that the relevant market is defined too broadly. This is known as the Cellophane Fallacy after the Du Pont Case.[2] In this case, Du Pont asserted that cellophane was not a separate relevant market since evidence showed that it competed with packaging materials such as aluminum foils and wax paper. The US Supreme Court failed to recognise that a high own-price elasticity may mean that a firm already has market power.[3]

Gathering Evidence/ Information

The Commission will often contact the main customers and the main companies in the industry to enquire into their views about the boundaries of product and geographic markets and to obtain the necessary factual evidence to reach a conclusion.

The Commission might also contact the relevant professional associations, and where appropriate, companies active in upstream markets, to be able to define, insofar as necessary, separate product and geographic markets, for different levels of production or distribution of the products/services in question. It might also request additional information from the enterprises involved.

Where appropriate, the Commission will address written requests for information to the market players mentioned above. These requests will usually include questions relating to the perceptions of companies about reactions to hypothetical price increases and their views of the boundaries of the relevant market. They will also include requests to provide the factual information the Commission deems necessary to reach a conclusion on the extent of the relevant market.

The Commission might also discuss with marketing directors or other officers of those companies to gain a better understanding of how negotiations between suppliers and customers take place and better understand issues relating to the definition of the relevant market.

[2] U.S. v. EI du Pont de Nemour and Co 351 US 377 (1956)

[3] Bishop, S. and Walker, M. (2010) *The Economics of EC Competition Law: Concepts, Application and Measurement*. University edn. London: Thomson Reuters (Legal) Limited. Para 4-018.

Where appropriate, they might also carry out visits or inspections to the premises of the parties, their customers, and/or their competitors, to better understand how products are manufactured and sold.

Evidence to define markets - Product dimension.

The type of evidence relevant to the Commission uses to reach a conclusion on the product market, can be categorised as follows:

An analysis of the product characteristics and its intended use allows the Commission, in a first step, to limit the field of investigation of possible substitutes. However, product characteristics and intended use are insufficient to conclude whether two products are demand substitutes.

Functional interchangeability or similarity in characteristics may not provide in themselves sufficient criteria because the responsiveness of customers to relative price changes may be determined by other considerations also.

For example, there may be different competitive constraints in the original equipment market for car components and spare parts, thereby leading to a distinction between two relevant markets.

Conversely, differences in product characteristics are not in themselves sufficient to exclude demand substitutability, since this will depend to a large extent on how customers value different characteristics.

The type of evidence the Commission considers relevant to assess whether two products are demand substitutes can be categorised as follows:

- Evidence of substitution in the recent past. In certain cases, it is possible to analyse evidence relating to recent past events or shocks in the market that offer actual examples of substitution between two products. When available, this sort of information will normally be fundamental for market definition. If there have been changes in relative prices in the past (all else being equal), the reactions in terms of quantities demanded will be determinant in establishing substitutability.

- New product information. Launches of new products in the past can also offer useful information when it is possible to precisely analyse which products lost sales to the new product.

- Quantitative test-There are several quantitative tests that have specifically been designed to delineate markets. These tests consist of various econometric and statistical approaches: estimates of elasticities and cross-price elasticities for the demand of a product, tests based on similarity of price movements over time, the analysis of causality between price series and similarity of price levels and/or their convergence. The Commission will take into account the available quantitative evidence capable of withstanding rigorous scrutiny to establish patterns of substitution in the past.

- Views of customers and competitors. The Commission will often contact the main customers and competitors of the companies involved in its inquiries, to gather their views on the boundaries of the product market as well as most of the factual information it requires to reach a conclusion on the scope of the market. Reasoned answers of customers and competitors as to what would happen if relative prices for the focal products would increase in the focal geographic area by a small amount (for instance 5%-10%) are taken into account when they are sufficiently backed by factual evidence.

- Consumer preferences. In cases of consumer goods, it might be difficult for the Commission to gather the direct views of end consumers about substitute products. Marketing studies that companies have commissioned in the past and that are used by companies in their own decision-making concerning the pricing of their products and/or marketing actions may provide useful information for the Commission's delineation of the relevant market. Consumer surveys on usage patterns and attitudes, data from consumers' purchasing patterns, the views expressed by retailers, and more generally, market research studies submitted by the parties and their competitors are taken into account to establish whether an economically significant proportion of consumers consider two products as substitutable.

- Barriers and costs associated with switching demand to potential substitutes. These can prevent the Commission from considering two prima facie demand substitutes as belonging to one single product market. It is not possible to provide an exhaustive list of all the possible barriers to substitution and switching costs.

  These barriers or obstacles might have a wide range of origins, and in its decisions, the Commission may be confronted with regulatory barriers or other forms of State intervention, constraints arising in downstream markets, need to incur specific capital investment or loss in current output to switch to alternative inputs, the location of customers, specific investment in the production process, learning and human capital investment, retooling costs or other investments, uncertainty about quality and reputation of unknown suppliers, and others.

- Different categories of customers and price discrimination. The extent of the product market might be narrowed in the presence of distinct groups of customers. A distinct group of customers for the relevant product may constitute a narrower, distinct market when such group could be subject to price discrimination. This will usually be the case when two conditions are met:

a) it is possible to identify clearly which group an individual customer belongs to at the moment of selling the relevant products to him (for example citizens and foreigners), and
b) Trade among customers or arbitrage by third parties should not be feasible.

Evidence to define markets - Geographic dimension.

The type of evidence the Commission considers relevant to reach a conclusion as to the geographic market can be categorised as follows:

- Past evidence of diversion of orders to other areas. In certain cases, evidence on changes in prices between different areas and consequent reactions by customers might be available.

- Quantitative Test. Generally, the same quantitative tests used for product market definition might as well be used in the geographic market definition, bearing in mind that international comparisons of prices might be more complex due to a number of factors such as exchange rate movements, taxation, and product differentiation.

- Basic demand characteristics. The nature of demand for the relevant product may in itself determine the scope of the geographical market. Factors such as national preferences or preferences for national brands, language, culture and lifestyle, and the need for a local presence have a strong potential to limit the geographic scope of competition.

- Views of customers and competitors. Where appropriate, the Commission will contact the main customers and competitors of the parties in its inquiries, to gather their views on the boundaries of the geographic market as well as most of the factual information it requires to reach a conclusion on the scope of the market when they are sufficiently backed by factual evidence.

- Current geographic pattern of purchases. An examination of the customer's current geographic pattern of purchases provides useful evidence as to the possible scope of the geographic market.

- Trade flows/pattern of shipments. When the number of customers is so large that it is not possible to obtain through them a clear picture of geographic purchasing patterns, information on trade flows might be used alternatively, provided that the trade statistics are available with a sufficient degree of detail for the relevant products.

- Barriers and switching costs associated to divert orders to companies located in other areas. Barriers isolating the national market have to be identified before concluding that the relevant geographic market in such a case is national. Perhaps the clearest obstacle for a customer to divert its orders to other areas is the impact of transport costs and transport restrictions arising from legislation or the nature of the relevant products. Access to distribution in a given area, regulatory barriers still existing in certain sectors, quotas, and customs tariffs might also constitute barriers isolating a geographic area from the competitive pressure of companies located outside that area.

- Significant switching costs in procuring supplies from companies located in other countries constitute additional sources of such barriers.

  Based on the evidence gathered, the Commission will then define a geographic market that could range from a local dimension to a global one.

The paragraphs above describe the different factors which might be relevant to define markets. This does not imply that in each case it will be necessary to obtain evidence and assess each of these factors. Often in practice, the evidence provided by a subset of these factors will be sufficient to reach a conclusion.

6. CALCULATION OF MARKET SHARE AND ASSESSMENT MARKET POWER.

After defining the relevant market, the Commission is then able to initiate the second stage of the competitive assessment to evaluate the level or intensity of competition in that market and this includes an assessment of market shares. On that basis, the total market size and market shares for each supplier can be calculated based on their sales of the relevant products in the relevant area. These information are often available from market sources, such as studies commissioned to industry consultants/ regulators and/or trade associations. When this is not the case or when the information available is not reliable, the Commission will usually inquire with each supplier in the relevant market to provide its sales to calculate the total market size and market shares.

Sales are usually the reference to calculate market shares. There are nevertheless other indications that depending on the specific products or industry in question, can offer useful information such as, in particular, capacity, the number of players in bidding markets, etc. As a rule of thumb, both volume sales and value sales provide useful information.

Depending on the type of anti-competitive conduct being investigated, the Commission will also assess the market share of the enterprise against the threshold established in the Fair Trading Act 2022 to determine whether the requirement is met. certain circumstance when the threshold is not met, the Commission can also take into consideration the market power of the enterprise. Market power refers to the ability of an enterprise to increase prices profitably above the competitive price for a sustained period. The degree of market power will depend on the circumstances of each case.

In view that the competitive price is extremely difficult to identify in practice, determining whether an enterprise enjoys market power usually requires an indirect assessment focused on certain factors which include;

The ability of the enterprise to restrict a potential competitor from entering the market.

Depending on the evidence obtained the Commission will conclude that an enterprise has market power if it is able to restrict/limit competition or exclude new competitors from entering the market. Exercising exclusionary power may be a way of reducing the degree of competition in the market and allowing the remaining enterprise to raise its prices. As a result, any new entrants might be deterred from entering due to the likelihood of facing an aggressive response from the remaining enterprise.

Vertical restraints may also create a barrier to entry where the supplier or manufacturer has exclusive purchasing agreements with the retailers downstream as it might restrict the ability of any new manufacturer or supplier to compete in that market.

Financial Position of the enterprise

An enterprise's financial position or its financial performance may provide evidence that it possesses market power. The Commission may consider the financial position of the enterprise in comparison to its competitors in the market. Access to funds is necessary if an enterprise attempts to increase its prices above competitive levels for a sustained period. Depending on the other available evidence, the Commission might view that an enterprise has market power if it can consistently set prices above an appropriate measure of cost or persistently earned an excessive rate of profit. High prices or profits alone are not sufficient proof that an enterprise has market power. However, consistent high returns, relative to those which would prevail in a competitive market of similar risk and rate of innovation, may suggest that market power does exist especially if those high returns did not stimulate new entry or innovation.

Countervailing buyer power

Countervailing buyer power exists where buyers have a strong negotiating position with their suppliers, which weakens the potential market power of a supplier. Countervailing buyer power does not simply refer to the size of the buyers, i.e. the idea that large buyers can exercise buyer power, but requires the buyer to have access to alternative sources of supply. For example, in a situation where the supplier wants to raise its prices to a buyer and that buyer has no alternative options except that supplier, then the supplier will most likely be able to raise its prices and exercise market power. Therefore, when assessing countervailing buyer power, the Commission will look at the ease buyers can switch to alternative suppliers at little cost to themselves while continuing to meet their needs.

Barriers to entry or Expansion.

Barriers to entry are factors that can prevent or impede potential entrants from a market by affecting the expected sunk costs of entry and/or the expected profits for new entrants once they are in the market, or by establishing physical, geographic, or legal obstacles to entry. Hence in determining whether barriers to entry exist the Commission, for example, will look at the sunk costs associated with a commitment to entry; the relative ease of obtaining the necessary inputs and distribution outlets; how regulation affects the prospect of entry, and the cost of operating at the minimum viable scale. In a market where entry barriers are low, an enterprise will not necessarily be able to sustain prices above competitive levels as this would attract new entry and this would then drive the price down. Barriers to entry are closely related to barriers to expansion and can be analysed similarly. The same factor which may create barriers to entry may also affect the ability of an enterprise to expand its market shares.[4]

Sunk costs

Sunk costs are costs that cannot be recovered on exiting an industry and hence serve to commit a firm or firms to stay in the market. Entry will occur only if the expected profit from being in the market exceeds any sunk costs of entry. There are three important aspects of sunk costs that influence entry and exit decisions:

First, sunk costs increase the risk of entering an industry because they cannot be recouped upon exiting. **Second,** sunk costs create a cost asymmetry between entrants and incumbents. Once costs are sunk they are no longer a portion of the opportunity costs of production, and hence, an incumbent will require a lower return on costs in order to stay in an industry than will be required to enter. **Third,** sunk costs can serve as a commitment by incumbent firms not to exit the industry. Thus, sunk costs are central to the calculations of potential entrants because if entry involves sunk costs enterprises may be deterred if they are unlikely to be recouped, and incumbent firms may be able to exploit this fact strategically in a variety of ways.

It is useful to consider the extent to which sunk costs give an incumbent an advantage over potential new entrants and to what extent sunk costs might affect entry barriers. The mere existence of sunk costs in any particular industry, however, does not necessarily mean that entry barriers are high or that competition within the market is not effective.

[4]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284400/oft415.pdf

Access to Essential Facilities

The essential facility doctrine has its antecedents in US antitrust; the first case is considered to have been the United States v/s Terminal Railroad Association of St Louis,[5] although the term was not used in that case. A facility will be viewed as essential only where it can be demonstrated that access to it is indispensable to compete downstream or in a related market, and where duplication is impossible or extremely difficult owing to physical, geographic, economic, or legal constraints (or is highly undesirable for reasons of public policy).

The market definition will be important in determining if a particular facility is essential. An asset will not be regarded as an essential facility, if other similar facilities compete within the same relevant market (i.e. if there are potential substitutes), or if the facility is not indispensable to the provision of the product in question.

The Commission's assessment of whether a particular facility is essential will be on a case-by-case basis.

Generally, if a rival does not have access to an essential facility, it cannot enter the market. The Commission will apply the essential facility doctrine with caution and recognize the importance of limits. Demanding that a dominant firm (private sector) should grant access to its facilities might be a major intervention on the part of the Commission and an excessive application of the essential facility doctrine can have harmful economic effects. This is not only because there is an element of expropriation in requiring one firm to grant access to its property to a competitor, but also because of the prospect that a third party might be able to demand a 'free ride' on the fruits of another's investment might deter the latter from investing in the first place.

There will be circumstances in which difficulties accessing inputs or resources constitute an entry barrier without those assets or resources meeting the strict criteria required to be defined as "essential facilities".

Regulation

Regulation may affect barriers to entry. For example, regulation may limit the number of enterprises that can operate in a market through the granting of licences. Also, licences may be restricted so that there is an absolute limit to the number of

[5] 224 US 383 (1912); the scope of essential facilities doctrine has been raised by the Department of Justice and Federal Trade Commission as amici curiae, available at http://www.ftc.gov/ogc/briefs/02-682. pdf, in a case before the Supreme Court Verizon Communications v/s Law Offices of Curtis Trinko

enterprises that can operate in the market. In this case, a licence can be thought of as a necessary input before production can take place and so regulation will act as an entry barrier.

Sometimes regulation sets objective standards. Where these apply equally to all enterprises, such as health and safety regulations, they might not affect the costs for new entrants any more than they affect the costs for incumbents. However, regulation can lead to entry barriers when it does not apply equally to all enterprises. For example, incumbents might lobby for standards that are relatively easy for them to meet, but harder for a new entrant to achieve.

Economies of Scale

Economies of scale exist where average costs fall as output rises. In the presence of large economies of scale, a potential entrant may need to enter the market on a large scale (in relation to the size of the market) to compete effectively. Large-scale entry might require relatively large sunk costs and might be more likely to attract an aggressive response from incumbents. These factors may in some circumstances constitute barriers to entry.

Attaining a viable scale of production may take time and so require the new entrant to operate in the market for some time at a loss. For example, a new entrant at the manufacturing level might need to secure many distribution outlets to achieve a viable scale. If perhaps due to long-term contracts, many input suppliers or distributors are locked-in to dealing with the incumbent, the new entrant might not be able to achieve an efficient scale of production over the medium term. This could deter entry.

Even when entry is not completely deterred, entrants may take time to achieve efficient levels of production, obtain the relevant information, raise capital and build the necessary plant and machinery. In this case, even if entry occurs, the incumbent could nevertheless retain market power for a substantial period of time.

Network Effects

Certain markets are characterized by 'network effects', which arise where the value of a product increases with the number of other customers consuming the same product. The telecommunications sector is a good example of an industry characterized by network effects; the more customers that are connected to a particular telephone network, the more valuable the network is to each customer.[6]

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[6] See OFT Economic Discussion Paper 3 (OFT 377) Innovation and Competition Policy (Charles River Associates, March 2002).

Network effects may have positive effects on competition since consumers become better off as a product becomes more popular. However, network effects also give rise to the possibility of one or a small number of firms dominating a market, in particular, because there may be 'tipping effects' where all the customers in a particular market decide to opt for the product of one firm or one particular technology.

Network effects, just like economies of scale, may make new entry harder where the minimum viable scale (e.g. in terms of users of the network) is large in relation to the size of the market.