Fair Trading Commission
Seychelles

FAIR TRADING COMMISSION OF SEYCHELLES

Guidelines on the Definition of Relevant Market

Contents

Fair Trading Commission Guidelines on the Definition of Relevant Market.

1. Introduction

1.1. These Guidelines provide information to all concerned parties on how the Fair Trading Commission defines relevant markets when investigating cases under the *Fair Trading Commission Act, 2009* and the *Fair Competition Act, 2009*.

1.2. The definition of relevant market is a fundamental step for of all investigations of alleged abuses of dominant position, restrictive agreements and competition-restricting concentrations conducted by the Fair Trading Commission.

1.3. The definition of relevant market is a tool to identify and define products which are the subject of competition, as well as to set the geographic area in which the concerned parties compete.

1.4. Market definition also allows the Fair Trading Commission to analyse market shares as a proxy of market power. Market power relates to the ability of firms to raise prices or to reduce quality levels compared to a competitive situation. Market shares can provide useful information about the presence of market power only when they are calculated with reference to well-defined markets. Once the relevant market has been defined, market shares can be measured.

1.5. The other aspects of competition analysis, including the potential for new entry into the market, will then be considered.

1.6. These guidelines are may be revised should the need arise. In applying these guidelines, the facts and circumstances of each case will be considered.

1.7. By rendering public the procedures the Commission follows when considering market definition and by indicating the criteria and evidence on which it relies to reach a decision, the Commission expects to increase the transparency of its policy and decision making in the area of competition policy.

1.8. Increased transparency will also enable companies to better understand what sort of information the Commission considers relevant for the purposes of market definition.

2. Purpose of Definition of Relevant Market

2.1. Market definition is a tool to identify and define the boundaries of competition between firms. It allows to establish the framework within which competition policy is applied by the Commission.

2.2. The main purpose of market definition is to identify in a systematic way the competitive constraints that the undertakings involved face.

2.3. The objective of defining a market is to identify those actual competitors of the undertakings involved that are capable of constraining their behaviour and preventing them from behaving independently of an effective competitive pressure.

2.4. It is from this perspective, that the market definition makes it possible, inter alia, to calculate market shares that would convey meaningful information regarding market power for the purposes of assessing dominance.

2.5. Market definition can be used to identify relatively quickly, cases where agreements do not have an appreciable adverse effect on competition or where undertakings clearly will not possess market power because they face significant competition. In such cases no further action by the Fair Trading Commission will be necessary.

3. Basic Principles of Market Definition

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

3.2. For competition law purposes, a relevant market is defined to include those suppliers among whom there is close competition. The focus is upon 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.

3.3. Firms face three types of competitive constraints: demand substitutability, supply substitutability and potential competition.

Demand Substitution

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

3.5. Firms are not able to maintain prices above competitive levels if their customers can easily switch to alternative substitute products or alternative geographic areas, therefore making the price increase unprofitable.

3.6. Basically, the exercise of market definition consists in identifying the effective alternative sources of supply for the customers of the undertakings involved, both in terms of products/services and geographic location of suppliers.

Supply Substitution

3.7. 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. This requires that suppliers be able to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices.

3.8. 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 companies involved. Such an impact in terms of effectiveness and immediacy is equivalent to the demand substitution effect.

3.9. These situations typically arise when companies market a wide range of qualities or grades of one product; even if for a given final customer or group of consumers, the different qualities are not substitutable, the different qualities will be grouped into one product market provided that most of the suppliers are able to offer and sell the various qualities under the conditions of immediacy and absence of significant increase in costs described above.

3.10. 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.

3.11. When supply side substitutability would imply the need to adjust significantly existing tangible and intangible assets, additional investments, strategic decisions or time delays, it will not be considered at the stage of market definition.

Potential Competition

3.12. The third source of competitive constraint, potential competition, is not taken into account when defining markets, since the conditions under which potential competition will actually represent an effective competitive constraint depend on the analysis of specific factors and circumstances related to the conditions of entry.

3.13. If required, this analysis is only carried out at a subsequent stage, in general once the position of the companies involved in the relevant market has already been ascertained, and such position is indicative of concerns from a competition point of view.

4. Market Definition

4.1. A market is commonly understood to consist of both buyers and sellers of a product in a certain geographical area. However, the term "market" has a specific meaning for competition law purposes. The essential task in market definition is to define all the products on the demand side that buyers regard as reasonable substitutes for the product under investigation ("focal product"), and then to identify all the sellers who supply the focal and substitute products, or who could potentially supply them -this is the relevant market.

4.2. This exercise of market definition includes defining the geographical reach of the relevant market, which may extend beyond the area under investigation and in which the focal product is sold ("focal area").

Relevant Product market

4.3. A 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.

4.4. Product market definition starts by considering the products which the parties to an agreement produce, or the products which are the subject to a complaint. The effects of a price increase above competitive levels are considered in order to determine the relevant market for these products.

4.5. 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.

4.6. Products may be viewed as substitutes although 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 a higher quality could be such that buyers no longer feel that the quality difference between the two products outweigh their price differential. Hence a price increase in one product could lead to buyers switching to the other product.

4.7. The important issue is 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.

Relevant Geographical Market

4.8. 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.

4.9. The geographic market refers to the area over which substitution takes place. 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, then the geographic market is also wider than the situation where only local sellers are willing to supply.

4.10. The geographic scope of the market can be defined using the same framework used to analyse the product market, while putting emphasis on 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.

4.11. The process for defining the begins by looking at a relatively narrow geographic area, which usually refers to the focal area, by asking if a small (5%- 10%) but significant increase in the price of a product 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.

4.12. In addition, the potential for undertakings 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.

4.13. 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.

4.14. Significant imports of a particular product may indicate that the market is wider than Seychelles, although 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 undertakings. When imported products, including products bought on the internet are close substitutes for domestic products, the overseas suppliers are part of the relevant market.

4.15. 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

4.16. 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:

4.17. 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 time periods. Some buyers may not view peak and off-peak services as substitutable.

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

4.19. 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 .

4.20. 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

4.21. 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 after markets.

Secondary Markets (After Markets)

4.22. 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?

4.23. 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.

4.24. 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.

4.25. 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.

4.26. Where the conditions for a system market do not apply, a multiple markets or a dual markets definition may be appropriate. The former is likely where, having purchased a primary product, buyers are locked in to 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.

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

Other Approaches to Market Definition

4.28. Many markets contain **differentiated products**, for example products that are differentiated by features such as brand, location or quality. Hence, there are no clear 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 the purposes of one case, this does not rule out the possibility that in another case, they will be in the same relevant market.

4.29. 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 bedroom or dining room sets, 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)

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

5.2. 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.

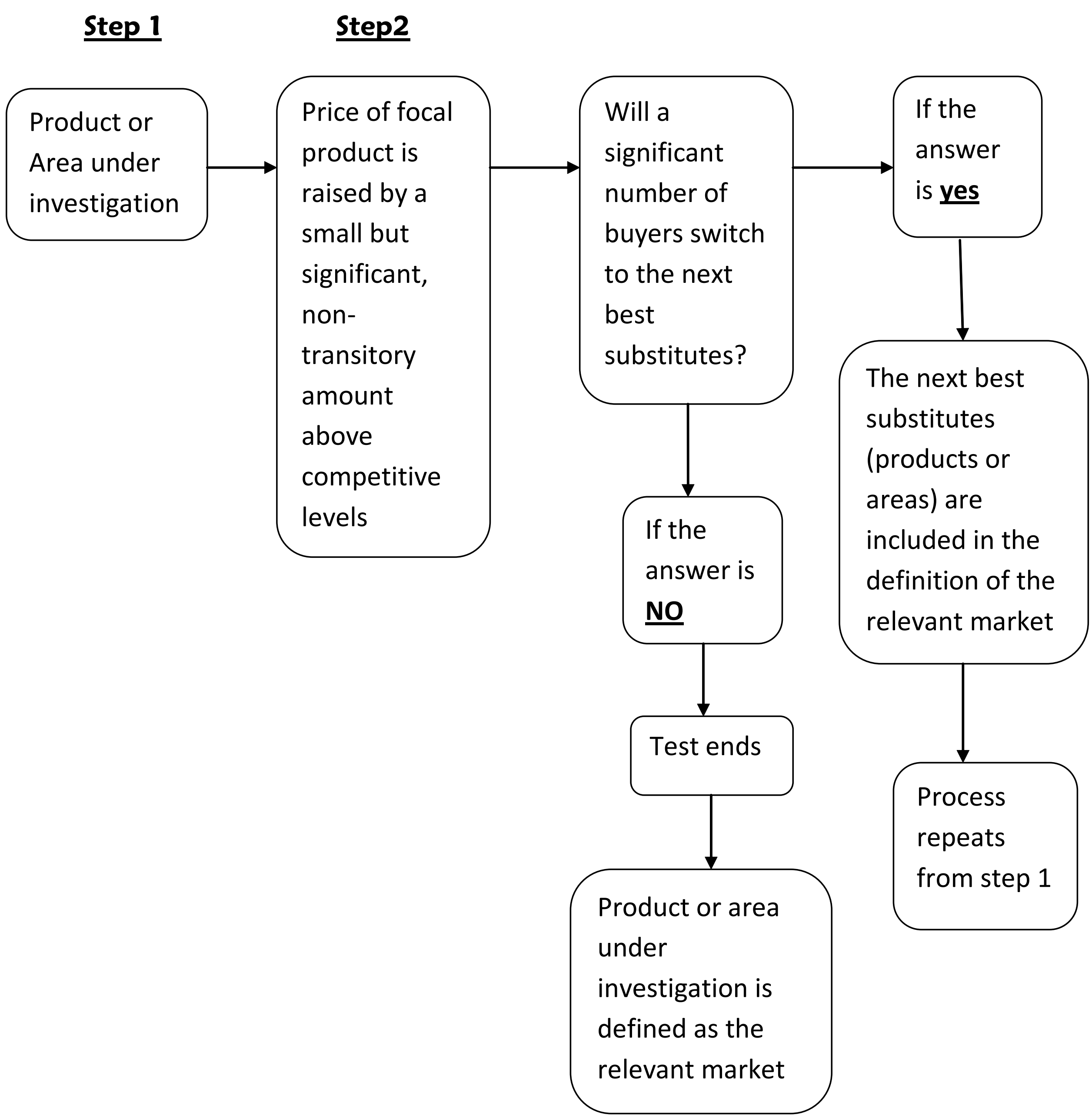
5.3. The relevant market is therefore the smallest product group (and geographical area) such that a hypothetical monopolist controlling that product group (in that area) could profitably sustain "supra competitive" prices, i.e. prices that are at least a small but significant amount above competitive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

5.4. 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?”

5.5. 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.

5.6. 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).

5.7. 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 undertaking is dominant in that market. The following diagram provides an illustration of this process.



5.8. 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.

5.9. 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.

5.10. 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.

Calculation of Market Share

5.11. The definition of the relevant market in both its product and geographic dimensions allows to identify the suppliers and the customers/consumers active on that market. On that basis, a total market size and market shares for each supplier can be calculated on the basis of their sales of the relevant products in the relevant area.

5.12. In practice, the total market size and market shares are often available from market sources, i.e. companies estimates, studies commissioned to industry consultants and/or trade associations. When this is not the case, or also when available estimates are not reliable, the Commission will usually ask each supplier in the relevant market to provide its own sales in order to calculate total market size and market shares.

5.13. 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.

6. Gathering Evidence/ Information

6.1. When a precise market definition is deemed necessary, 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.

6.2. The Commission might also contact the relevant professional associations, and where appropriate, companies active in upstream markets, so as 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 to the undertakings involved.

6.3. 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.

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

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

Evidence to define markets - Product dimension.

6.6. The type of evidence relevant to reach a conclusion as to the product market can be categorised as follows :

6.7. 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.

6.8. Functional interchange-ability 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 in spare parts, thereby leading to a distinction of two relevant markets.

6.9. 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.

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

6.11. **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.

6.12. **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.

6.13. There are a number of **quantitative tests** that have specifically been designed for the purpose of delineating 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 for the purposes of establishing patterns of substitution in the past.

6.14. **Views of customers and competitors**. The Commission will often contacts the main customers and competitors of the companies involved in its enquiries, 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 of 5%-10%) are taken into account when they are sufficiently backed by factual evidence.

6.15. **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 as to 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 consumer's 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.

6.16. **Barriers and costs associated with switching demand to potential substitutes**. There are a number of barriers and costs that might 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 of switching costs.

6.17. 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 in order to switch to alternative inputs, the location of customers, specific investment in production process, learning and human capital investment, retooling costs or other investments, uncertainty about quality and reputation of unknown suppliers, and others.

6.18. **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 citizen 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:

6.19. **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.

6.20. Generally, the same **quantitative tests** used for product market definition might as well be used in 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.

6.21. **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 life style, and the need for a local presence have a strong potential to limit the geographic scope of competition.

6.22. **Views of customers and competitors**. Where appropriate, the Commission will contact the main customers and competitors of the parties in its enquiries, 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.

6.23. **Current geographic pattern of purchases**. An examination of the customers' current geographic pattern of purchases provides useful evidence as to the possible scope of the geographic market.

6.24. **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.

6.25. **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 from the nature of the relevant products. Access to distribution in a given area, regulatory barriers still existing in certain sectors, quotas and custom tariffs might also constitute barriers isolating a geographic area from the competitive pressure of companies located outside that area.

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

6.27. On the basis of the evidence gathered, the Commission will then define a geographic market that could range from a local dimension to a global one.

6.28. The paragraphs above describe the different factors which might be relevant to define markets. This does not imply that in each individual 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.