Market power and abuse: competition and regulatory intervention

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Dr Gunnar Niels, Director

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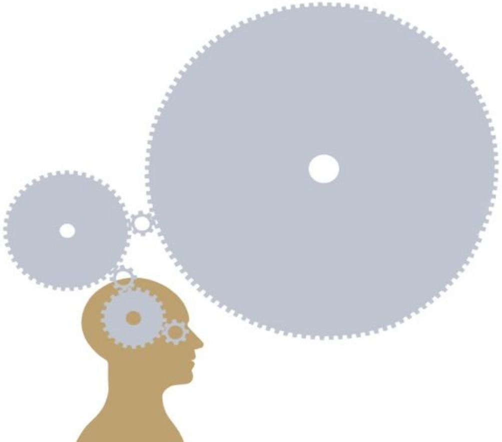

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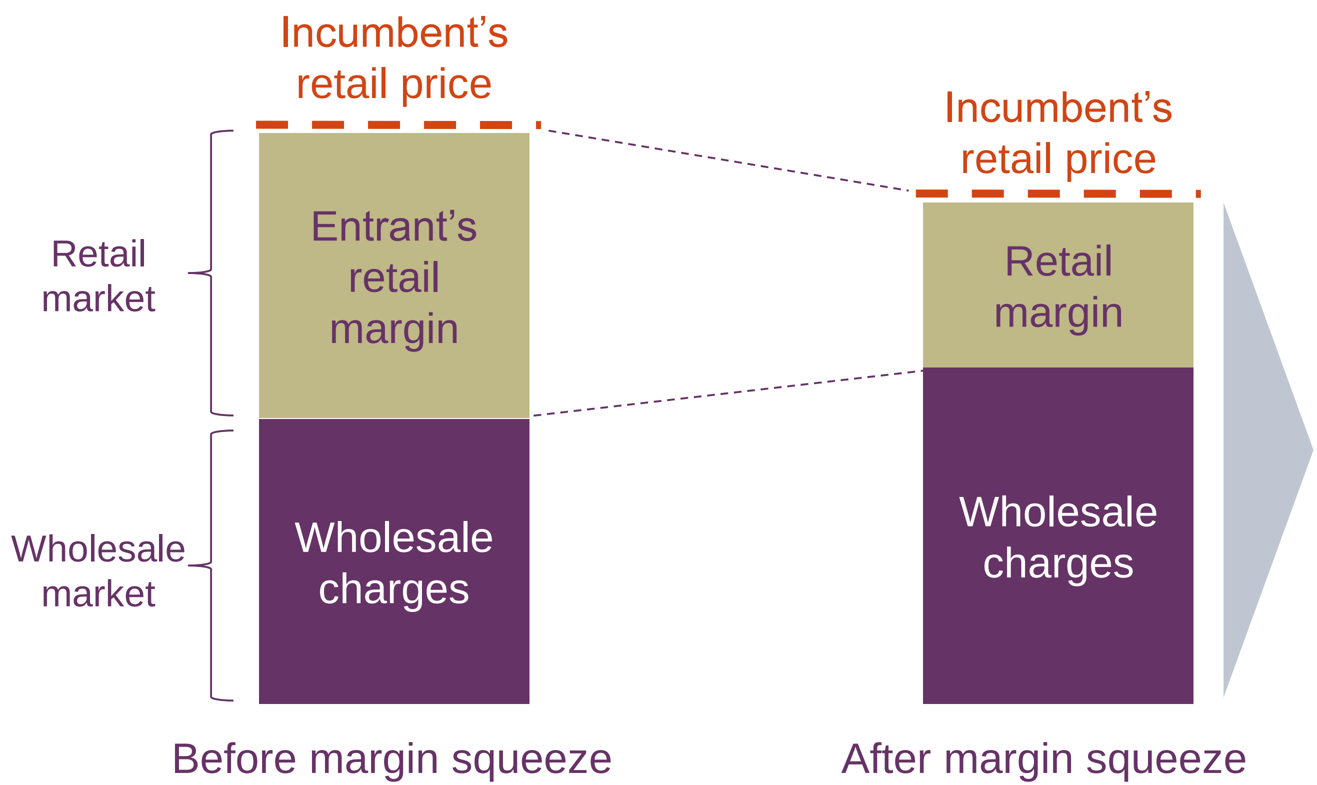
Overview

- margin squeeze assessment
- behavioural economics and abuse of dominance
- if nothing else works, regulate price?

Margin squeeze: competition law and regulation



Retail price is lowered and/or wholesale charges increased so that an efficient entrant's retail margin is 'squeezed'

Principles of margin squeeze analysis

- whose costs?
  - the equally efficient versus reasonably efficient operator
- what costs?
  - long-run average incremental costs (LRAIC) versus more ‘entrant-friendly’ approaches allocating more common costs
- what products?
  - multiple products considered separately or jointly
- over what time period?
  - period-by-period or discounted cash-flow analysis

Principles largely established in the *Telefónica* decision; still scope for manoeuvring for competition authorities and regulators

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Ex ante regulation versus competition law

- margin squeeze tests and retail minus regulation seek to prevent margin squeeze through ex ante regulation
- regulatory objective to promote competition has led to a broader margin being applied in regulatory settings

> ‘[the margin imposed on BSkyB] was likely to be somewhat higher than the margin that might be derived under a competition law test, but it is nonetheless entirely consistent with our objective of ensuring fair and effective competition’
>
> Ofcom (2009), ‘Pay TV phase three document: Proposed remedies’, June 26th, para 9.208.

- economic rationale for wider margin stems from dynamic benefits of promoting third-party access; competition law test more in line with the efficient component pricing rule
- ex ante regulation does not exempt dominant firm from competition law scrutiny

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Behavioural economics: business practices exploiting consumer biases

- old marketing tricks
  - ‘was €2, now €1’
  - ‘while stocks last’

- partitioned, add-on or drip pricing
  - plays to anchoring and loss-aversion bias → you feel you already own the product
  - ebay: low price with high shipping charge more attractive

- product differentiation and multiple attributes
  - experiments: buyer confusion → higher prices
  - works with consumers, but not with robots!

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Behavioural economics: pockets of market power

- disciplining by consumers
  - biases can result in customer inertia
  - learning may not always work (eg, complexity, infrequent purchasing)
- naive versus sophisticated consumers
  - latter often protect former, but may not work with add-ons or drip pricing
- disciplining by rivals: more competitors does not necessarily improve outcome

Firms may have a greater and more persistent degree of market power than previously thought → what does this mean for competition policy?

The payment protection insurance (PPI) case: a precedent on narrow markets?

- PPI: popular retail insurance product, sold alongside personal loans, credit cards, overdraft facilities and mortgages
- most lenders offered PPI only in combination with the credit product; stand-alone PPI volumes were low (most important alternative: no PPI; 60–80%)
- consumer surveys showed awareness and shopping around, but considered insufficient competitive pressure
- CC: relevant market is an individual distributor's sales of a particular type of PPI $\rightarrow$ each distributor held an effective monopoly over the sale of PPI to its own credit customers

Source: Competition Commission (2009), 'Market investigation into payment protection insurance', January 29th.

If nothing else works, regulate price?

- mobile call termination
- mobile roaming charges
- credit card interchange fees

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Contact:

Dr Gunnar Niels

+44 (0) 1865 253 000

gunnar.niels@oxera.com