The market share/dominance fallacy

How narrower markets widen the disconnect between market shares and market power

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Introduction

The European Commission ("the Commission") explains that "the concept of 'relevant market' in Union competition law is different from the use of the term 'market' in [...] business contexts".[2] Such an antitrust market includes only products between which consumers would switch in response to a "small but significant non-transitory increase in price" to the extent that such a price increase would be unprofitable for a hypothetical monopolist supplier.[3] Within such an antitrust market, a supplier holding a so-called dominant position has "the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers".[4]

In this article, we discuss the friction between (i) defining a monopolist as an entity capable of implementing a "small but significant" increase in price, and (ii) assuming that this monopolist, or a supplier with a lower market share, has the power to act independently "to an appreciable extent". We further explain how this friction is particularly acute for narrowly defined antitrust markets.

Framework for assessing dominance

The Court of Justice of the European Union explains that "the definition of the relevant market is carried out in order to define the boundaries within which it must be assessed whether an undertaking is able to behave, to an appreciable extent, independently of its competitors, its customers and, ultimately, consumers and therefore whether it holds a dominant position".[5] As the stated purpose of defining the relevant market is to enable the assessment of dominance, the principles for defining the relevant market should logically reflect the definition of dominance. To test that proposition, we first briefly summarise the principles for (i) defining the relevant product and geographic market, and (ii) assessing dominance.

Defining the relevant product and geographic market

Product market

The Commission's approach to defining the relevant product market is based on demand substitution and supply substitution. The strength of any competitive constraints originating from demand and/or supply substitution "can be assessed by asking whether a hypothetical monopolist in the candidate market would find it profitable to implement a small but significant non-transitory increase in price (the 'SSNIP test')".[6]

The SSNIP test starts from the narrowest meaningful definition of a relevant product and asks whether a hypothetical monopolist of this product could profitably impose a 5-10% lasting price increase.[7] If a "sufficiently significant" number of consumers (i.e. not all customers) would switch to alternative products (demand substitution) to make the price rise unprofitable, the market definition must be expanded to include those substitutes.[8] This process continues iteratively until a group of products is identified for which a SSNIP would be profitable, thereby defining the relevant market.[9] While the SSNIP may not be applied econometrically in practice due to data limitations, it remains the conceptual foundation for the Commission's approach to market definition.[10]

The Commission recognises that: "The substitutability of products from the perspective of suppliers (supply substitution) can be relevant for market definition where suppliers use the same assets and processes to produce related products that are not substitutes for customers, and where this leads to similar conditions of competition across the range of such related products […], provided the constraining effect of supply substitution across the range of products is equivalent to that of demand substitution in terms of effectiveness and immediacy."[11] Otherwise, competitive constraints from supply substitution may be included in the competitive assessment instead.[12]

Geographic market

The Commission defines the relevant geographic market as the area in which firms compete under sufficiently homogeneous conditions of competition, and which can be distinguished from neighbouring areas with appreciably different conditions.[13] In assessing the geographic scope, the Commission considers both demand and supply factors. From the demand side, it looks at whether "customers in two areas consider mostly the same suppliers as alternatives and can readily switch purchase volumes between them".[14] From the supply side, the "Commission assesses whether suppliers are able and willing to offer their products on competitive terms throughout the candidate market, or whether there are barriers or costs that make it impossible or unattractive for a supplier to serve customers on competitive terms in areas that it does not currently serve".[15]

Assessing dominance

Market shares are commonly regarded as a starting point for the assessment of dominance.[16] Market shares above 50% are typically treated as *prima facie* evidence of dominance,[17] while low shares (below 25%) generally signal an absence of dominance.[18] In the 2024 Draft Article 102 Guidelines, the Commission hypothesised that only market shares below 10% typically exclude the existence of dominance.[19] Beyond market shares, the Commission also considers qualitative factors such as barriers to expansion and entry and countervailing buyer power when assessing dominance.[20]

Disconnect between market shares and dominance

Market share plays a crucial role in the Commission's dominance assessment across different types of investigations such that "save in exceptional circumstances" a market share at above 50% is considered "evidence of the existence of a dominant position".[21] We explore below the robustness of this assumption as a matter of economics. Specifically, we explain below that (i) there exists a disconnect between the SSNIP test principles used for defining antitrust markets and authorities' reliance on market shares of 50% implying dominance, and (ii) that this disconnect raises further challenges in relation to narrowly defined markets.

The SSNIP-dominance disconnect

Antitrust markets defined by reference to the SSNIP principles do not imply commercial freedom as specified in the Commission's definition of dominance even for a monopolist.[22] Specifically, as the SSNIP test establishes the boundaries of a market within which a hypothetical monopolist is capable of increasing prices by up to 10%, it follows that a real world monopolist would have the commercial freedom to pursue a price increase of that magnitude, nothing more.

It may of course be the case that the real-world monopolist only encounters binding competitive constraints for conduct equivalent to a price increase much higher than 10%. However, this is untested under a market definition based on the SSNIP standard. Without any additional evidence on out-of-market constraints, the only conclusion one can draw from an antitrust market defined under the SSNIP standard is that a real-world monopolist has "the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers"[23] as long as this conduct does not go beyond the equivalent of a 10% price increase.

Importantly, the concept of dominance is not limited to monopolists. Precedent suggests that firms can be dominant with market shares as low as 40%.[24] It stands to reason that a supplier with a market share of less than 100% enjoys less commercial freedom than a monopolist. If the commercial freedom actually tested within the definition of antitrust markets only extends to a monopolist's conduct equivalent of a 10% price increase, a supplier with a share of supply of less than 100% within a given antitrust market would not even be able to implement a 10% price increase. Without any additional evidence on out-of-market constraints, there is therefore no basis in economics for presuming that a supplier with a market share of 50% is dominant.[25] This is *a fortiori* the case for suppliers with even lower market shares.

Also importantly, we are not aware of any basis for a presumption that conduct such as (i) refusal to supply (effectively, pricing prohibitively), (ii) exclusive dealing, (iii) loyalty rebates, or (iv) bundling or tying have an effect equivalent to a price increase of at most 10%, or even less for a supplier that is not a monopolist. A market power assessment based on whether a monopolist could implement a 10% price increase is therefore not in itself sufficient to support the full range of theories of harm that competition authorities may wish to consider.

The 5-10% price increase hypothesised in the SSNIP test has no obvious commercial basis and is therefore a purely legal concept.[26] The Commission accordingly explains that "the concept of 'relevant market' in Union competition law is different from the use of the term 'market' […] in business contexts".[27] There is nothing inherently wrong about a legal definition of a relevant antitrust market that differs from the lived commercial reality of the firms whose conduct is subject to scrutiny. However, the consequence is that dominance cannot be inferred from market shares alone under the antitrust standard for defining relevant markets. This is *a fortiori* the case when regulators find "the existence of an overall market" but still consider "the possibility of identifying different competitive dynamics in some market segments".[28]

The narrow market challenge

For the reasons set out above, a market defined based on the SSNIP test requires an assessment of out-of-market constraints for a competition authority to be able to assess dominance. The Commission explains that it "takes into account all competitive constraints (whether effective and immediate or not) in the competitive assessment".[29] Whereas the Commission refers to such potential competition as "more remote" than competition from products and suppliers included in the relevant market,[30] all that this means is that it would require conduct equivalent to a price increase of more than 10% to trigger these constraints. In practical terms, the remoteness of out-of-market constraints will be fact specific and may not be material, as set out below.

Barriers to entry of a commercial nature may include "a wide variety of factors such as economies of scale and scope, government regulations, […] intellectual property rights, ownership of resources where the supply is limited due to for instance natural limitations, essential facilities, a first mover advantage or brand loyalty of consumers created by strong advertising over a period of time".[31] This may have important implications for the closeness of out-of-market constraints from entry. For example, a potential entrant may encounter greater entry barriers related to economies of scale if faced with a broad national market than with a narrow local market (for example, it requires more time and capital to become a national retailer than to open a single local outlet). Relatedly, a potential entrant with a large existing business of a certain geographic footprint may benefit from the associated economies of scale and scope to overcome barriers to entry into a new location.

As "demand substitution constitutes the most effective and immediate disciplinary force on the suppliers of a given product" and "supply substitution is only relevant for market definition in specific cases",[32] the SSNIP framework may lead competition authorities to identify even quite narrow local geographic markets. For example, the Commission has defined the relevant geographic market based on local consumer catchment areas.[33] However, the narrower a particular geographic market is, the easier it may be for an existing out-of-market supplier to use its existing economies of scale and scope, intellectual property, brand awareness, access to finance etc. to enter such a market. The more prevalent the presence of such out-of-market constraints are, the more unlikely it is that a high market share within the relevant market translates into dominance.

The point above has potentially interesting implications, e.g. for the assessment of mergers. For example, industry consolidation creating suppliers more capable of surmounting barriers to entry into local markets may strengthen out-of-market constraints that deny suppliers in local markets the ability to translate market share into market power. Also, competition authorities contemplating the merits of narrower local antitrust market definitions will need to consider the possibility that doing so may imply stronger out-of-market constraints essential to assessing market power.

The same conceptual reasoning similarly applies to product market definition; the more products that are excluded from the relevant antitrust market in the market definition stage, the greater the universe of out-of-market constraints that may cap potential market power. Such constraints may not only be in the form of existing products that would become substitutable with those included in the market in response to conduct akin to a price increase of more than 10%, they may also come in the form of suppliers with capabilities partially overlapping those required to provide the products included in the market.[34] And the better resourced these out-of-market suppliers are, the better able they may be to develop any capabilities they may currently lack to compete in the relevant market.

Implications

As antitrust markets only capture constraints that bind for conduct equivalent to a 10% price increase, an analysis of market shares alone only allows a competition authority to conclude that a monopolist would enjoy the commercial freedom equivalent to such a price increase. A monopolist's ability to implement a "small but significant" price increase does not imply "the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers". As a supplier with a weaker market position than a monopoly would enjoy even less commercial freedom, there is no basis for any presumption that a 50% market share implies dominance.

Without a direct link between market share and dominance, out-of-market constraints become instrumental for establishing dominance. However, the strength of out-of-market constraints differs according to the scope of the antitrust market considered; the narrower the antitrust market, the stricter the possible out-of-market constraints. The evidential value of market shares for the assessment of market power thereby weakens the narrower the definition of the relevant antitrust market.

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[2] Commission Notice on the definition of relevant market for the purposes of Union competition law (C/2024/1645) (the "2024 Market Definition Notice"), paragraph 19.

[3] 2024 Market Definition Notice, paragraph 29.

[4] Case 27/76 United Brands Company v Commission EU:C:1978:22, paragraph 65.

[5] Case T-136/19, Bulgarian Energy Holding and Others v Commission EU:T:2023:669, paragraph 85.

[6] 2024 Market Definition Notice, paragraph 29.

[7] 2024 Market Definition Notice, footnote 53.

[8] Case T-699/14, Topps Europe Ltd v European Commission EU:T:2017:2, paragraph 91.

[9] See the Commission's Notice on the definition of relevant market for the purposes of Community competition law (97/C 372/03), paragraphs 15-20. See also the 2024 Market Definition Notice, paragraphs 32-37.

[10] Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (2002/C 165/03), footnote 26.

[11] 2024 Market Definition Notice, paragraph 32.

[12] 2024 Market Definition Notice, paragraph 36.

[13] 2024 Market Definition Notice, paragraph 12(b).

[14] 2024 Market Definition Notice, paragraph 41.

[15] 2024 Market Definition Notice, paragraph 70.

[16] Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, paragraph 13.

[17] Case C-62/86 AKZO Chemie BV v Commission of the European Communities, paragraph 60.

[18] EC Merger Regulation (EC) 139/2004, recital 32.

[19] European Commission's 2024 Draft Guidelines on the application of Article 102, paragraph 26.

[20] 2024 Market Definition Notice, paragraph 106.

[21] Case C-62/86, AKZO v Commission EU:C:1991:286, paragraph 60.

[22] Case 27/76 United Brands Company v Commission EU:C:1978:22, paragraph 65.

[23] Case 27/76 United Brands Company v Commission EU:C:1978:22, paragraph 65.

[24] See United Brands v Commission (Case 27/76) and British Airways v Commission (Case T-219/99).

[25] Case 27/76 United Brands Company v Commission EU:C:1978:22, paragraph 65.

[26] The SSNIP test emerged from efforts to provide a more objective and economically rigorous method of defining relevant product and geographic markets in competition law. It was first developed by the DOJ and the FTC in the 1982 and 1984 Merger Guidelines, and later adopted in the EU (DOJ's 1982 Merger Guidelines (1982), DOJ's 1984 Merger Guidelines, The European Commission's 1997 Market Definition Notice).

[27] 2024 Market Definition Notice, paragraph 19.

[28] 2024 Market Definition Notice, footnote 113.

[29] 2024 Market Definition Notice, paragraph 17.

[30] 2024 Market Definition Notice, paragraphs 17 and 23(c).

[31] European Commission, Guidelines on the application of Article 81(3) of the Treaty (2004/C 101/08), paragraph 166.

[32] 2024 Market Definition Notice, paragraphs 23(a) and 23(b).

[33] REWE/Plus Discount (Case M.5112), paragraphs 18-20; LIDL/ PLUS ROMANIA (Case M.5790), paragraphs 14-17.

[34] See 2024 Market Definition Notice, paragraphs 36 and 61 with regards to supply substitution.