



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

**DAF/COMP/WD(2008)17
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ROUNDTABLE ON MARKET STUDIES

-- Note by Lithuania --

This note is submitted by the Lithuanian Delegation to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 11-12 June 2008.

JT03245909

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MARKET STUDIES

PAST EXPERIENCE AND PRACTICE OF THE COMPETITION COUNCIL OF THE REPUBLIC OF LITHUANIA

1. Background

1. Article 19 of the Law on Competition (thereof - the LC) defines the powers of the Competition Council of the Republic of Lithuania (thereof – the CC) one of which is to investigate markets. However, contrary to a case investigation where the criteria for its initiation are very strictly defined in the LC, the ability of the CC to initiate a market study is not legally constrained. Such flexibility in turn can result in higher number of market studies conducted; however, there is not an extensive record of this being done by the CC in the past. Over the last five years, the competition authority has initiated several market studies in banking sector, in retail of consumer goods sector, and a more general study of price changes in the food markets.

2. As practice of the CC shows, it can be useful to initiate a market study when facing noticeable changes in a market, such as significantly increased concentration and a steep rise of prices. It is not possible to draw definite conclusions on competition problems merely on the basis of these changes. Therefore, in such cases market studies can be used as a tool to take a closer look at the competitive situation in the market, as well as a way to collect the evidence and information that would be sufficient to process a case if it is necessary. Of course it can also lead to a conclusion that there are no particular competition concerns in a market.

3. For example, in 2004, after joining the EU, Lithuania experienced a quite sharp rise of food product prices that reoccurred in summer of 2007. Such processes in the markets of basic commodities considerably affect all the consumers, and especially the low income households; thus in Lithuania it was also followed by a wave of public debate as well as the official request issued by the Government for the responsible ministries to determine what factors caused price changes in food sector. Similarly, the CC set a task to establish if the price changes in various levels of supply chain were more likely to be explained by the changes in economic environment, such as increased costs, lower reserves or supply (e.g. due to increased exports) or by anticompetitive behaviour of undertakings in the markets. The following analysis disclosed price parallelism of certain milk products as well as the fact that the relevant undertakings were regularly and frequently exchanging the confidential and detailed information about their sales through the association. Consequently, the CC initiated a case investigation of possible collusive behaviour in the milk market.

4. The CC took similar approach when initiating a study in the retail market of consumer goods in 2003 and conducted repeated analyses in 2004 and in 2006. From 2004 such regular retail market studies constituted a part of “The Plan of Measures to Ensure the Publicity of Finances of Major Retail Companies and the Equal Competition Conditions for the Retailers” initiated by the Government. These actions were a follow-up to the significant changes that began around the year of 2000 in a retail sector. The market statistics revealed a clear tendency of increasing overall turnover but decreasing number of enterprises active in the market and persistently growing role of four major national retail chains. The last data of 2006 showed that the market turnover increased by 10.2 percent in total, however, the major part of such

increase came from the increased sales of the supermarkets (amounting to 15.4 percent), and not of the smaller, retail chains-independent retailers (which grew only by 1.8 percent). Moreover, the number of shops of smaller independent retailers displayed the decrease of 2.3 percent, while number of supermarkets increased by 7.9 percent.

5. Increasing share of retail chains might have been the result of simply higher efficiency due to economies of scale and scope, store size or brand positioning efforts. The fact that total number of retailers decreased though the total turnover increased is more likely to indicate that these retailers exited the market because of inefficiency. On the other hand, it could also mean that retail chains are strengthening their position in the market through their purchasing power upstream and so leaving the smaller retailers worse-off. The complaints from suppliers and smaller retailers about the abuse of a market power by retail chains were occasionally appearing in the media however none of these complaints were officially submitted to the CC. Therefore, the CC decided to conduct a market study that could provide with the missing information as well as enable to make reasonable conclusions on the competitive situation in the market.

6. Some sectors in Lithuania, e.g. the financial sector, have been very quickly developing in the last decade, and it is possible that the CC or the consumers do not yet have the needed experience and knowledge of peculiarities of these specific markets to indicate that some possible competition restrictions are present. In such cases, of course, it can be useful to look at the practices of the other institutions that are more experienced. For example, the market of retail banking remained uncharted area for the CC until very recently. In 2006, following the sector inquiry on retail banking initiated in mid 2005 by the European Commission, the CC conducted two closely related market studies of retail banking sector.

7. The findings on the demand side in the market for current accounts indicated that the mobility of the customers is quite low despite the fact that all commercial banks open and close current accounts for free. The inquiry has identified that main factors constraining consumer switching are administrative costs and inconveniences that customer faces when changing a bank. On the lending market the switching is more costly procedure, as the lending facilities cannot be directly transferred to another bank and can be only refinanced by another loan. The special fee up to 3 percent applies to the debt that is repaid before the term, besides, the customer has to bear other costs, e.g. credit refinance fee, mortgage fee, charges for notary or real estate assessment services. On the other hand, the information about the solvency and riskiness of the customers is available to all credit institutions without major restrictions, therefore the banks do not become less willing to take on new customers, and this, in turn, reduces the bank's interest to lock-in the existent clientele.

8. On the supply side, some entry restrictions to the market of banking services exist but they are of a very general nature and include formal requirements to banks, licensing procedure and standard minimum capital required. A license issued to a branch of the foreign bank is governed by the same provisions of the Law on Banks that are applied to domestic credit institution. There are no actual barriers for new participants to enter the Lithuanian payment systems. The two existing common settlement systems in the country – LITAS and KUBAS - operate on an „open membership“ principle, apply no membership fee, and do not impose any special legal or technical conditions that could restrict the entry of new members.

9. The transactions with payment cards are mostly carried through two international payment card systems operating in Lithuania – VISA and MasterCard that determine interchange fee of participants, licensing and other conditions of membership. There are some domestic payment card systems but they operate only on a very limited scale. The license fee for the joining of the MasterCard system is EUR 50,000 - 150,000, and that for the VISA – up to EUR 545,000. In addition banks pay fees for licenses to issue the relevant individual products. The fee policy could have played a role in the decision making of

smaller banks many of which have chosen to join only one payment card system. In the period of 2003 – 2005 only 2 new smaller banks entered the market but did not have any tangible impact on its structure.

10. Demand-side statistics showed an observable increase in the payment card usage, both in units and in the number and value of transactions. The merchant charges have been gradually decreasing but did not become lower than interchange fees that stayed constant over the period under review. Such tendencies could indicate that there is no evident market power of the acquirers and that the competition for the merchants between them has intensified. The payment card purchasing fee for the cardholders has been also significantly reduced by smaller banks or kept stable by the major banks. The fact that the revenue from card issuing activity grew faster than the number of issued cards could indicate that the high demand of payment cards allowed for the issuers to maintain high fees for the customers. However, no particular competition concerns were found during a study.

2. Implementing a market study

11. The market studies conducted by the CC are relatively straightforward in terms of the techniques applied. The data gathering process is usually based on forming the questionnaire in accordance with the objectives of a market study and sending it out to the market participants and related parties, such as suppliers, customers, industry associations, or market regulatory bodies. Although the amount of data can vary depending on the length of the questionnaires used and the number of replies received, the analysis itself is limited to the fairly simple aggregation of the answers by undertakings and publicly available official data in order to arrive at some common conclusions. As a result, market studies are not very resource-intensive, i.e., usually there is one or two persons directly responsible for the implementation of a particular market study. Besides, although there are no legal time constraints imposed on the duration of a market study, in practice the results are ready in a period from two to nine months.

12. Such basic analysis methods may not be sufficient if a more comprehensive market study is initiated, yet so far they have met the needs of the CC. In addition to that, the simplicity of market studies is obviously advantageous as it allows to devote more resources of the institution to the case investigations, as well as it is less time consuming for the undertakings involved in it, that is the ones that have to prepare the answers to the questionnaires and in other ways cooperate with the CC. Following this, it requires very little coordination and supervision of a staff assigned to a study, allowing more flexibility in its planning and implementation.

13. In a similar fashion, a market study is not a strictly planned process and a detailed written and officially approved plan of it is not required. However, the person or a team usually presents to the Council the outline of a market study at the moment of its initiation. The outline can include main objectives of a planned study, as well as the markets in question, the type of information required, the possible sources of such information depending on their reliability and availability, or the methods to collect the information. Thus, the team should make a preliminary study on publicly available official data as it is most reliable and accurate. Also, the team should identify the other sources of needed information that may not be official but is most trusted or least biased and that may have to be collected through additional written requests to the undertakings.

14. In general, the outline gives a view on the scope and depth of a particular market study; however, one should note that it is non-finite and can change over time depending on the findings. For example, during the study of price changes in food sector in 2004 and 2007, the primary task of the CC was to identify if there were enough external factors that could explain the price changes. Once the CC detected the information exchange between the milk producers, it expanded the study to the analysis of the structure as well as the ability and (or) incentives of undertakings to act unilaterally in the relevant markets. It would have been costly to initiate such an extended study in all the other markets in question (e.g. markets of

meat or crop products) as it would have required much more detailed information and analysis, including definition of the relevant markets upstream and downstream (production, wholesale, retail) of numerous food products, calculation of the relevant market shares, as well as identifying a market power of each undertaking. The primary study also showed that the increases in wages, energy costs and prices of inputs explained the major part of the price changes for crop, flour, bread, meat and poultry products. The other market specific factors further contributed to the price increases, for example, the prices of crops in the national market were also affected by the growing demand of crops in China and India as well as smaller crop yield in Europe and Australia due to climatic conditions.

15. When appropriate, the CC enhances its market studies by cooperating with other institutions. For example, it is a common practice to ask the Department of Statistics for assistance in gathering the official published data in a more efficient and quicker way. Similarly, during the analysis of price changes in food sector, the CC cooperated with the Ministry of Agriculture, which administered the national database of information about agricultural and food markets. Under commission of the Government, the Ministry of Agriculture was simultaneously conducting the price change analysis based on the aggregated national data. It provided the preliminary findings to the CC, so that the comparison of average price, cost, or demand movements with the movements of prices, costs and turnovers of specific undertakings allowed detecting any divergences from the general tendencies that could reflect possible competition distortions.

3. Data

16. Market studies are based on both the official aggregated data and the individual empirical data but it should be emphasised that the latter type is usually of particular interest and importance for arriving at conclusions about the possible competition problems. This is especially true when the qualitative information is analysed, for example, typical contracts between supplier and buyer, business terms and conditions, etc. Thus the major bulk of information upon which the market study is made, is obtained through written requests for information addressed to the market participants and related parties. According to Article 19 of the LC, the CC is empowered to oblige the undertakings to submit the information required for market investigations, while Article 41 states that a fine up to 1 percent of the gross annual income can be imposed on the undertaking if it fails to provide requested information, or provides incomplete or incorrect information. Nonetheless, the reliability of the data obtained from the undertakings that are at the same time an object of a study should be well addressed.

17. Article 22 of the LC states that any commercial secrets provided by undertaking to the CC in the absence of the undertaking's consent, must be used only for the purpose the information was provided. It should be said that usually the undertakings ask to treat most of the submitted data as commercial secrets therefore Article 22 must be applied. It is reasonable to expect that the undertakings have fewer incentives to influence the findings of a market study than those of a case investigation. Therefore, the commitment by the CC not to use the obtained data without undertaking's permission elsewhere, e.g. for the investigation of infringement, decreases the likelihood that the data provided is biased. However, there are several ways how the CC could perform the test of soundness of individual data.

18. First, as it was noted above, one can look for clear deviation of individual information from the official average data. Second, one can check if data, and in particular the qualitative one, is robust to the source of it, i.e. if there are significant differences in the data depending on whether it was gathered from the suppliers, buyers or consumers. In case where the data from several sources show considerable degree of contradiction, the CC should at first judge which data sources have least incentives to manipulate the evidence and is most trusted and competent. It could also look for alternative data sources although at the moment they are either non-existent or very costly, if bought from market research and consultancy firms.

19. The credibility of information provided also depends on the type of the data. It is normally considered that the data or documents that were created before the date of the request for data, such as internal accounting forms or reports, are more reliable than the documents or data that were created specifically for the above mentioned request. The subjective opinion or written responses to the request by the market parties are used for conclusions with more care as well as it is tested against the other existing evidence.

20. The ability of the CC to obtain individual data should be greatly enhanced in the nearest future (expected in mid 2008) after it is granted an access to the Inter-institutional Fiscal Data Storage (IFDS). IFDS is a database formed on a basis of tax declarations of legal persons, and it includes various financial indicators like turnover and cash flows, profit reports, or foreign trade of undertakings registered and paying taxes in Lithuania. Although IFDS would not cover qualitative information, like regulations present in the markets or common trading terms; it would be a comprehensive and official and therefore reliable source of quantitative information.

4. The use of market studies

21. There are few ways how market studies can be useful. First, market studies can reveal the evidence that is needed to initiate the case investigation and that otherwise is not in the disposition of the CC, as in the above mentioned case of milk market study. One can also expect that the likelihood of errors decreases once the CC conducts market study prior to processing a case because it allows collection of more information and means that more resources and time are devoted to the analysis of competition in the market. However, there are several issues arising when a market study is followed by an action of enforcement.

22. First, it can be difficult to determine how well the public should be informed about the initiated market study, its objectives, or results. Some transparency is necessary to ensure easy data collection from the undertakings and effective cooperation between them and the CC. To put it in simple words, the institution willing to obtain some data has to give an explanation what it needs it for and where the data is going to be used, otherwise it can create conflicting situation with the businesses and aggravate further cooperation. Publicly announced initiation of a market study also allows tracking what is being done by the other institutions, and prevents it from duplications of such work as well as it creates opportunities of coordination of the studies among the relevant institutions.

23. However, in certain situations the level of transparency should be limited. For example, if a market study has an objective to collect the evidence on suspected prohibited agreement or abusive behaviour, the CC should of course not state it directly in the written requests for data to the undertakings. Such statement, especially when it is not based on any appreciable evidence, would impede obtaining of unbiased data and information, as well as it would inflict public speculations and unnecessary tensions in the market. In such cases it seems sufficient to give general explanation to the undertakings without being too specific. For example, it was officially stated that the objective of the milk market study was to identify the main factors that caused price changes, although the CC as well had the intentions to find more evidence on the concerted practices and the information exchange between the major milk producers.

24. In a similar fashion, the institution should announce the results of market studies with care. For example, if the findings establish that there are enough grounds to suspect possible infringement of the LC, the public announcement of them should be scheduled after initiation of particular case investigation and after first investigative actions, like dawn raids. In general, it is also important that the results of market studies do not reveal any individual data, especially if it is considered as business secrets or any other type of confidential information, unless a permission of such data publication is acquired from the related undertaking before-hand.

25. The limited use of the evidence gathered during a market study that follows from Article 22 could be another troublesome issue in the following case investigations. As it was said before, such limitations decrease the likelihood of an undertaking providing biased data, however, it can become a time consuming process both for the CC and the undertakings if it means that additional permissions to use it must be acquired and sometimes - that the same data must be gathered once more.

26. Of course, market studies can also prove that there are no appreciable competition concerns in a market. Such information still can be of value to the CC, which has formal powers and a social duty to monitor the markets and to be able to identify competition concerns quickly. The relevant findings can be used to put an end to various public speculations about competition distortions thus releasing the possible tension between market participants and related parties and contributing to a more effective functioning of the markets in question. For example, one could also notice that a number of public complaints from suppliers and smaller retailers about the abuse of a market power by retail chains has somewhat decreased after the CC conducted the studies in several proceeding years and each time reconfirmed that there were no significant competition distortions identified.

27. The CC is granted special powers, which are defined in Article 4 of the LC, to examine the conformity of legal acts or other decisions adopted by public and local authorities with the requirements of the LC and to require the authorities to amend or revoke legal acts or other decisions restricting competition. Some of these acts and decisions are of regulatory nature therefore it is also possible to use the results of market studies in changing or lifting regulatory acts that are distorting competition. The CC also has a possibility to address the same issue through stating its position in a form of recommendations submitted to the relevant authorities. The obvious advantage of the latter approach is that it is less costly in terms of staff resources and time used when comparing to initiation of case investigation. However, it must be noted that recommendations sent to the authorities under market studies are not obligatory, contrary to the situation where the CC concludes that Article 4 was infringed and obliges the authorities to change their laws accordingly to the LC or to revoke them. Therefore, the recommendations are more likely to be sent in those cases where they concern sporadic decisions that have minor affect on competition. Previously the CC has taken this approach during case investigations concerning prohibited agreements or abuse of a dominant position. To illustrate, during the case of the information exchange between major milk producers, the CC discovered a decision by Minister of Agriculture defining recommended method of calculating raw milk purchasing price. The decision could have restricted the ability of milk purchasers to set the prices independently, though the actual scope of its application seemed to be very minor, and therefore the CC considered submitting a written recommendation to the Ministry of Agriculture to overturn it instead of initiating an investigation of infringement under Article 4.

28. Finally, market studies can act as an infringement-detering tool. In other words, regular monitoring of the markets, which has been done by the CC, for example, in the retail market, as well as the awareness of market participants that they are under a close surveillance, can diminish their incentives to seek extra profits by infringing the LC. On the other hand, market studies together with the actions of competition enforcement are considered as a competition advocacy tool, informing undertakings and clarifying for them “what is good and what is bad” in competition sense.