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Executive Summary of the hearing on Market Concentration

Annex to the Summary Record of the 129th Meeting of the Competition Committee held on 6-8 June 2018

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This Executive Summary by the OECD Secretariat contains the key findings from the discussion held during the 129th Meeting of the Competition Committee on 6-8 June 2018.

More documents related to this discussion can be found at www.oecd.org/daf/competition/market-concentration.htm

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Executive Summary of the Hearing on Market Concentration

By The Secretariat*

From the discussion at the roundtable, the delegates' and experts' written submissions, several key points emerged:

1. Concentration is a way to quantify the structure of a market. These can be based on different measures of firms' activity within a market. There are also different summary statistics that can be used to compare the concentration of one market to another, or to track concentration of a market over time. Recently changes in the concentration of industries have been identified in a number of countries, and this has led some to question whether competition is less intense than it used to be and whether a policy response is required.

The concentration of different firms' shares of activity within a market represent the structure of that market. Firm activity can be measured using a number of different pieces of information. It may for instance be the number of products or services produced, the number that are sold, the revenue gained from those sales, or the volumes that could be produced given the capacity of the firm.

To compare the concentration of one market to another, or to track concentration of a market over time, it is often useful to develop a single summary statistic for the market. Concentration ratios express the market share of the largest firms in a market. However they are not informative on the distribution of market shares within those firms, or the distribution of shares outside those firms. As such where data permits, the Herfindahl-Hirschman index (HHI) offers a better representation of market structure. This calculates the square of the market share of each firm in the market, and sums the resulting numbers. It gives a score that can range from close to zero to 10,000. However, in markets where firms have minority shareholders in common, further adjustments to HHI are necessary to accurately describe the market's structure.

We heard that industry concentration has been changing in a number of different countries. For instance industry concentration is rising in most of the 13 US industry sector classifications, though the change is relatively small in services, manufacturing, and wholesale, while it is larger in financial services and retail. In Japan, Germany and France there also appears to have been a slight increase in concentration. However there is not a similar change in Italy, Spain or the UK.

2. Market concentration should not be confused with market power or competitive intensity, which is what matters for consumers. While it can be an indictor of market power, it has a number of weaknesses. Moreover where, in the absence of an average market concentration statistic, the concentration of an industry is measured, the imprecision of the measure means that in itself it says very little about whether or not competitive intensity is changing.

* This Executive Summary does not necessarily represent the consensus view of the Competition Committee. It does, however, encapsulate key points from the discussion, the issues paper, and the panellists' presentations.

Measuring concentration within a market of substitutable products can provide an indication of changes in market power, particularly if the products are largely homogenous. However a concentrated market need not be an uncompetitive one, it may be the result of intense competition leading to innovation or low prices that has allowed a small number of firms to build volume and forced less efficient firms out of the market. Similarly, if markets are not defined on the basis of substitutability then apparently un-concentrated markets may feature market power. For example, products might be highly differentiated or consumers reluctant to switch. Market concentration is therefore at best an imperfect indicator of market power, it is never the end of the story.

Unfortunately, since there are so many markets within each industry, it is largely impractical to calculate, and track, an average market concentration statistic for an industry. When policymakers seek to understand changes in market power within an industry or across an economy they do not have access to an average market concentration statistic. Instead they find industry concentration statistics that are produced from administrative census data. However, these measures are constrained by the classifications adopted for the purposes of the census. These often do not distinguish between stages of the supply chain, location of sale, and do not consider the substitutability of the products. As a result we heard that census data classifications are typically more than a 100 times the size of a relevant antitrust market. They may therefore suggest increases in concentration where there are none, and where market concentration has in fact declined.

While industry concentration is therefore not a reliable indicator of the degree of competition in a given sector, it can help identify changes in industry structure, for example, the changing role of SMEs. In contrast, examination of market concentration can provide insight on the changing structure of markets, and this may provide a better indicator of changes in market power. However, this requires the use of well-defined markets that consider the local nature of some markets, the multi-sidedness of others and the appropriate unit of measurement.

3. Fortunately there are other indicators of market power that are easier to calculate than average market concentration, and more meaningful than industry concentration measures. Recent changes in these indicators have broadly coincided with changes in industry concentration, suggesting that while industry concentration may not be reliable, in this instance the observed increase was not misleading; on average, market power does appear to have increased in many countries.

The observed changes in industry concentration have led researchers to explore trends in other indicators of market power. These include estimates of price mark-ups, profitability measures, output, and rates of entry and exit. These do not rely on market definition, and so they can be collected without first defining relevant markets, or relying on administrative industry classifications. While they each have their own measurement challenges they collectively therefore offer a more promising route for policymakers looking for insights on broad trends in market power.

We heard that profitability and mark-ups have increased across Europe and the US. Meanwhile entry rates have fallen in the US, Germany, France, and a number of other countries, while they appear to have increased in the Italy, Spain and the UK. In Japan profitability has fallen in Japan and there has been a good deal of churn in the leading firms within each industry which has slightly increased over time. Output growth has in many countries remained below historic trends. These indicators, taken together, therefore suggest that on average, market power has increased in many countries.

4. The causes of increasing market power however remain unclear. While it might reflect a reduction in competitive intensity, it might equally reflect the outcome of intense competition. Moreover even if we accept that on average competition has been reduced, it is not clear what has driven that reduction, and hence what policy changes are required.

If competition is effective we can expect that firms will compete to be more efficient and more innovative and to obtain market power. Observing efficient, innovative firms with temporary market power is therefore to be expected in competitive markets. However while the creation of short term market power is a necessary and desirable feature of a market, the long term possession of such power indicates a market that is failing.

The sustained increase in average profitability and mark-ups in some countries suggests that the increase in market power may not be entirely benign, and may instead reflect diminished competition. That might suggest that a policy response is required. However, since it remains unclear what might be driving a loss of competition it is therefore unclear which policies need to change and how dramatically. For instance, to the extent that anti-competitive rules and regulations and subsidies are distorting the level-playing field and creating market power it may be that we need to create or strengthen tools to address a lack of competitive neutrality. In contrast, if consumers are becoming less sensitive to changes in price then pro-active demand-side measures may be necessary.

Alternatively we heard that increased market concentration, while not the only cause, might be one important contributor to the reduction in competition, and that more rigorous enforcement might be required. For example, it was argued that ex-post assessment suggested merger decisions were sometimes too cautious. For instance the UK identified that it had tended to be overly generous to merging parties in the weight it placed on the prospects of future entry, while others identified permitted mergers leading to price rises. It was also argued that increases in common ownership that did not trigger merger review had increased concentration, and that rules against exclusionary conduct had in effect been relaxed during this period, thereby increasing the risks for agencies taking exclusionary cases.

5. Uncertainty on the role that market concentration may have played in reducing competition, means that dramatic reform of competition law and policy to focus on market structure would be a mistake. Equally, crude regulatory solutions remain unattractive. More promising are efforts by agencies to rebalance the risk they run of under and over-enforcing, and reforms that allow agencies to look at the full range of possible features of a market that might have reduced competition, and require and equip them to resolve these issues.

Since it is unclear how important merger control has been in contributing to a loss of competition, and in the absence of a reliable relationship between market structure and competitive intensity, focusing competition law and policy on structure and not effect would be a mistake (as would regulatory solutions such as market share caps). Instead a more proportionate policy response is to maintain a focus on effects, but to increase the vigour of merger control and antitrust enforcement.

The identification of higher mark ups in itself requires increased vigilance, since they increase the incentive for merging firms to raise prices after a merger, and for dominant firms to exclude rivals. However, Agencies will also be aided in their efforts by measures to make them less cautious about the risk of over-enforcing, and more concerned about the consequences of under-enforcing. For instance options might include the development and/or strengthening of structural (or non-structural) presumptions. We heard that ex-post assessments are already helping agencies to use past cases to calibrate the risks of under and over-enforcement. These should continue and as suggested, might usefully be extended to evaluating the predictions of agencies.

Given the uncertainty as to the causes of any reduction in competition, the most sensible response is to undertake market studies which take a holistic view of the market and can be used to diagnose the particularly problems in a given market (and accurately measure concentration in that market). To have an impact these studies need to require and equip agencies to address the problematic features they identify, for instance they will be difficult to conduct without information gathering powers.