

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

**The Concept of Potential Competition – Note by Colombia**

10 June 2021

This document reproduces a written contribution from Colombia submitted for Item 2 of the 135<sup>th</sup> OECD Competition Committee meeting on 9-11 June 2021.

More documents related to this discussion can be found at  
<https://www.oecd.org/daf/competition/the-concept-of-potential-competition.htm>

Please contact Mr Antonio Capobianco if you have questions about this document.  
[Email: Antonio.CAPOBIANCO@oecd.org].

**JT03476960**

## Colombia

1. The following document lays out Colombia's Superintendence of Industry and Commerce (henceforth, SIC) approach to the notion of potential competition. The purpose is to contribute to the clarification of the concept and to provide our experience assessing potential competition within the merger control procedures conducted by the SIC. Starting with a background on relevant elements from Colombia's applicable merger control regime, followed by the description of barriers to entry, and an account of the concept of potential competition on the basis of a relevant merger case to illustrate how and in which contexts it has been addressed, this document will provide information as to the ambit of the SIC's work on the matter.

### 1. Background

2. In accordance with the provisions of Article 4 of Law 155 of 1959, as amended by Article 9 of Law 1340 of 2009, companies engaged in the same economic activity or participating in the same value chain, and that meet the following criteria, shall be obliged to inform the SIC of the operations they plan to carry out for the purpose of merging, consolidating, acquiring control, or integrating, whatever the legal form of the planned operation:

1. When, jointly or individually considered, have had during the fiscal year prior to the projected transaction operational income greater than the amount that, in legal monthly minimum wages in force, has been established by the SIC, or,
2. When at the end of the fiscal year prior to the projected transaction they had, jointly or individually considered, total assets greater than the amount established by the SIC in minimum legal monthly salaries in force.
3. In the events in which the interested parties comply with any of the two previous conditions, but together have less than 20% of the relevant market, the operation will be deemed to be authorized. In the latter case, the SIC must only be notified of this operation. The SIC established through the Resolution No. 77896 of 2020, the operational income and assets to be taken into account from January 1, 2021 to december 31 2021 in Sixty Thousand Minimum Monthly Legal Wages In Force (60,000).

### 2. Assessing barriers to entry

4. According to the Guidelines for the analysis of mergers (pre-evaluation procedures) of the SIC, barriers to entry can be defined as factors that delay, reduce, or prevent the entry of new companies into a given market, thus, facilitating the exercise of market power. These barriers can be of two (2) types: structural and artificial. On the one hand, structural barriers, arising from basic market conditions such as costs, demand, technological requirements, among others, may occur in: (i) presence of economies of scale; (ii) existence of high sunk costs and slow recovery; (iii) existence of a competitor (or a reduced group of competitors) that controls an essential and irreplaceable asset to produce a good or service; (iv) when market competitors have access to advanced technology that is difficult to access for an incoming competitor or for lagging competitors; and (v) when there are network economies in the market.

5. On the other hand, legal barriers, which are governmental provisions, such as the requirement of operating licenses, the protection of intellectual property rights, limitations to the participation of companies in the market, among others.

6. An analysis of a merger transaction by the SIC will consider assessing barriers to entry when the participation quotas are high enough to suggest that there may be signs of market power and a likely degree of obstruction of competition. This analysis, then, will be aimed at determining whether entry for new competitors is feasible in terms of probability and opportunity. Thus, in such scenarios, the SIC will pinpoint those barriers that may prevent, hinder, or delay the entry of competitors into the relevant market; first, from a structural standpoint –which will consider not only the intervening parties but the market in general–; and second, by reviewing the existence of artificial barriers, which are those that companies may have generated prior the proposed transaction or that may result from the transaction itself, and that may lead to an undue restriction of competition.

7. The SIC also classifies barriers to entry as exogenous and endogenous. Exogenous barriers refer to those that are inherent to market conditions and cannot be controlled. For example, the existence of firms with cost advantages, product differentiation, trademarks, capital and initial investment requirements, switching costs, access to distribution channels, economies of scale, legal barriers, etc. Endogenous factors are those created by established companies through their market strategies and competitive behavior. The most common barriers to entry analyzed by the SIC are the following:

- a. Legal barriers: are those that are originated via regulations that create a cost disadvantage for companies interested in entering the market, such as permits, licenses, among others.
- b. Size of sunk costs: these are the costs that agents must incur to enter the market but cannot recover upon leaving it. Generally, when their value is high, they act as a means of discouraging the entry of new competitors. An example of these costs are the costs of starting up a business. It is important to mention, that endogenous sunk costs depend on the strategy chosen by the entrant and the incumbents, such as investment in advertising or the creation of a distribution network.
- c. Time of entry/opportunity: the SIC evaluates the time it has taken for other entrants to become actual competitors. This time may be increased if companies are required to learn how to use specific assets and develop efficient distribution networks. Generally, a period of less than one year is acceptable for achieving effective market entry.
- d. Scale of entry: is considered a barrier when for the companies intending to enter the market it is only profitable to do so with a high production capacity and by selling many units.
- e. Brand identity: some products are identified and recognized by the consumer or user through the brand, to such an extent that he/she would not shift his/her consumption to similar products of other brands while maintaining brand loyalty, which generates a barrier to entry for new competitors. The analysis of brands becomes important in asset purchase operations, due to its implications in licensing and use of brands.
- f. Technological requirements and capital investments: the SIC shall understand capital investments as the minimum investment for a potential competitor to be able to develop the same activity offering the same products. If the technological requirements are too high, the entry of new competitors into the market may be prevented or delayed.

- g. Transportation costs: the impact of high transportation costs often limits the size of the geographic market. Similarly, difficulties of access to distribution in each area, such as regulatory barriers, quotas, tariff quotas and customs duties, can also constitute barriers that isolate a geographical area from the competitive pressure of companies located outside it.
  - h. Access to sources of supply: this refers to the links that market participants have, in addition to trade, with suppliers of inputs and raw materials. These linkages are studied to determine whether access to sources of supply of inputs and raw materials becomes restricted to any extent.
8. It is important to note that barriers to entry do not present themselves in the same way or with the same intensity in all markets, sectors, or types of activities. Notwithstanding, when applicable, the analysis of barriers to entry should lead to determine if as a result of the transaction the companies participating in the transaction could act independently from their competitors and, whether they are able to alter the price, supply and other competitive factors, without being disciplined by new entrants. For example, the SIC analyzed a proposed transaction between *Protabaco* and *Coltabaco*, in the market of cigarettes, by which Phillip Morris International (owner of *Coltabaco*) would end up controlling *Protabaco*. Under Resolution No. 29937 of 2010, the SIC addressed whether the following aspects could end up constituting potential barriers to entry into the different segments of the market as a result of the transaction: upfront investment, investment in advertising and brand loyalty, legal barriers, declining demand, and idle capacity. Regarding upfront investment, the SIC identified that the initial investment required to enter the market for manufactured cigarettes by setting up a facility in Colombia was considerably high. This meant that it was unlikely for any player to enter the market as a counterweight to the two intervening companies without sufficient capacity. On the other hand, investment in advertising and brand loyalty was an expense that potential competitors had to necessarily undertake to enter the cigarette market and position their brands successfully. Also, as for legal barriers, the SIC reflected on whether the regulations in force at the time of the transaction regarding tobacco advertisements were barriers to entry. It concluded affirmatively, as they limited their access to the traditional media through which they advertise their products, as well as their ability to respond to consumer preferences.
9. Lastly, the SIC argued that it was relevant to analyze both declining demand and idle capacity. The behavior of demand in a mature market, such as the cigarette market, and the impact of advertising and health regulations made this market rather unattractive. This was reflected in the fact that demand for cigarettes had been dropping at an annual rate of almost 4% since 2000. The SIC found that the companies' combined capacity was very high, indicating an apparently satisfied demand and the potential of the resulting entity to supply an increase quickly and economically in the demand for cigarettes. Based on this, it was determined that this change in capacity constituted a significant barrier to entry.

### 3. Potential competition

10. Besides conducting an analysis of barriers to entry, some cases require the SIC to review the potential competition in the market under analysis. In this sense, the SIC bears in mind those companies that, although they are not competitors of the firms to be merged, they are nevertheless capable of adjusting their production to offer the products or provide the services involved in the merger transaction, in the event of possible changes in factors affecting demand (such as price).

11. The objective of looking into potential competitors is to establish whether, in the event of an increase in the price of a product or service, the manufacturers of other products can reorient their production facilities -in the short term and at a reduced cost- towards the production of the good relevant to the merger transaction, hence neutralizing a possible price increase.

12. Some of the factors that the SIC has considered when establishing whether to include in the definition of the relevant market the companies that are able to compete with the intervening companies, after the proposed transaction comes into place are, for instance:

- a. information on the costs of adjusting the productive process and variable marginal benefits that such companies would obtain
- b. information on the production process, common stages for different products and the surplus production capacity that would be generated
- c. information on the distribution systems of the different suppliers and the speed with which they can increase the volume of sales of a product
- d. evidence of frequent changes in production capacity in the face of price and profitability variations
- e. evidence of similar profit margins for different products

13. When the SIC analyzed the merger between *Protobaco* and *Coltabaco*, it identified two segments within the cigarettes market in Colombia, the high-price cigarette segment, in which the intervening parties participated alongside *British American Tobacco*, this last sharing an important market quota with *Coltabaco*; and, the medium-low segment, in which both *Protobaco* and *Coltabaco* shared an important portion of the market vis-à-vis the *British American Tobacco*. The intervening parties argued that *British American Tobacco* could have the ability to exercise competitive pressures in the medium-low segment of the market, hence, it should be considered a potential competitor. However, the SIC established that a possible entrant to the cigarette market in Colombia, as was the case of the *British American Tobacco*, could not be an actual participant of a different segment of the cigarette market. It was also argued that only regional and international companies involved in the manufacture of a related or complementary product, and that companies manufacturing the same product in a market geographically different from the Colombian market could be considered as potential competitors. Therefore, the SIC established that the companies that could be considered as potential competitors in the context of this transaction had to meet the following requirements:

1. Possess the operational and financial capacity to enter the market; and,
2. Be certain and prompt in their intention to enter the domestic cigarette market.

14. The SIC noted that for an intention to be deemed relevant for the analysis of potential competition by the Authority, there should be proof of evidence such as opening of representative offices, the preparation of market studies, and the request for permits, among others. In addition, an analysis of the characteristic market conditions was included, which allowed to understand that there were relevant aspects that could've discouraged the entry of potential global and regional competitors, for example: the decreasing conditions in market demand, the market growth prospects, the possible effects of laws that could eventually tax cigarettes more aggressively and impose changes in their advertising.