

III Our approach

- 3.1 In this section we describe the methodology we adopted for defining the relevant market(s) and for assessing the potential impact on these, and related, markets.
- 3.2 Our approach is consistent with a recently published OFT/Cabinet Office report on impact assessments¹⁰. The report stated that the Government is required to “include the identification and assessment of potential competition concerns or benefits” of proposed regulations (which in practice, equates to policy proposals)¹¹. In the context of this report, we effectively treat the BBC’s proposed Digital Curriculum ‘project’ as a possible new public policy and apply the same conceptual framework.

Market definition

- 3.3 We have been asked by the BBC to define the relevant markets in which its proposed Digital Curriculum service would compete. The purpose of this analysis is to help the reader understand more about the nature of the markets impacted by the service and provide the basis from which to undertake aspects of the market impact assessment.

The theory and principles of market definition

- 3.4 A recent OFT discussion paper concluded that it is appropriate to examine competition issues that arise from e-commerce using the existing competition policy framework¹². The approach set out below is consistent with the methodology outlined in the recent OFT/Cabinet Office report¹³.
- 3.5 The term ‘relevant market’ is a precise concept used in competition policy investigations. It relates to a specific test of demand and supply-side substitutability to establish the boundaries of a market. It sets the stage for all aspects of competition policy analysis as it establishes the competitive constraints under which a company or organisation (the so-called “undertaking”) operates and it identifies those competitors who are able to exert competitive pressure on the undertaking in question.
- 3.6 In competition law terms, market definition enables market shares to be calculated and provides input into the question of whether an agreement has an appreciable effect on competition¹⁴. The practice of UK and European competition authorities defines markets with respect to the:
 - product market i.e. the goods and services that are included in the market; and
 - geographic market i.e. the locations in which trading are considered part of the relevant product market.
- 3.7 A third dimension to market definition is time – products and services are often provided on the basis of the time period in which they can be used. One obvious example is peak and off-peak travel services.
- 3.8 The “best practice” approach to defining the relevant product and geographic market is via the application of the “hypothetical monopolist test” or the “small, significant non-transitory increase in price test” (SSNIP test) which focuses on the degree of substitution between products/services and/or markets.
- 3.9 Starting with the smallest set of products and the narrowest geographical area, the product market test asks whether the ‘hypothetical monopolist’ can increase its profits by increasing the price¹⁵ of its product(s) within this area. If the hypothetical monopolist would be prevented from increasing profits above competitive levels because of consumer substitution to other products (demand-side substitution) or because suppliers of other products could substitute to the production of its product

¹⁰ “Guidelines for competition assessment: a guide for policy-makers completing regulatory impact assessments”, February 2002.

¹¹ Op.cit, executive summary.

¹² “E-Commerce and its Implications for Competition Policy”, Economic Discussion Paper 1, Office of Fair Trading, August 2000.

¹³ The OFT/Cabinet Office report applies the guidelines set out in the European Commission notice and the UK Competition Act technical guideline on market definition (see OFT 403, Market Definition).

¹⁴ “The role of market definition in monopoly and dominance inquiries”, Economic Discussion Paper 2, Office of Fair Trading, July 2001.

¹⁵ It is generally accepted that a price increase of 5-10% sustained for about one year is acceptable for this test..

(supply-side substitution), those substitutes can then be added to the potential market. The test is then applied again based upon available evidence for more goods until an above normal profit can be sustained and a distinct set of products can be defined. The same principle applies to geographic markets. This distinct set of products is then defined as the relevant market.

3.10 There might also be ‘chains of substitution’ to consider when defining markets. This is the case when the price of one good constrains the price of another product, which in turns constrains the price of a further product. In certain cases, the existence of chains of substitution might lead to the definition of a relevant market where products or areas at the extreme of the market are not directly substitutable.

3.11 Whilst market definition involves identifying groups of substitutes, markets can also be defined to include groups of complements (consumed or produced together). Complements are included in the same market when competition to supply one product constrains the prices charged for the other – this is common in secondary markets such as the market for spare parts and servicing. The fundamental question is whether consumers (producers) take into account the costs of both the primary and secondary products when making their respective decision.

Applying the principles of market definition in practice

3.12 Market definition is not a simple exercise. The measurement of the competitive constraints requires an assessment of the empirical evidence of actual and potential substitution. However, it is often impossible to undertake any analytical market definition tests for this purpose, primarily due to a lack of data availability. This is certainly the case in this instance, because of:

- the ‘proposition’ status of the BBC’s Digital Curriculum service;
- the nascent and dynamic nature of the online sector; and
- the shortage of data and time we had available to conduct a full survey or other detailed analytical tests that could form the basis of a SSNIP test.

3.13 Nonetheless we have applied the principles that underpin the SSNIP test as a conceptual framework within which to consider evidence of competition. In practice, this ‘second-best’ approach has been adopted in a number of European Commission decisions and Court rulings¹⁶. Consequently, we have focused on analysing evidence on the following:

- product characteristics and intended use;
- the characteristics of supply and demand;
- consumer groups;
- switching costs/barriers to entry; and
- likely attitudes of consumers, and evidence of past substitution.

3.14 This evidence has been gathered from interviews, information supplied by the BBC, information obtained from the global PwC research network, and from publicly available documents.

Market impact

3.15 To some extent all markets are dynamic in the sense that the market changes over time. Innovation and development are important forms of dynamic competition leading to benefits for consumers, and it is an important objective of competition policy that this should not be stifled. Markets that are ‘mature’ and change slowly are more suited to a static assessment of competition – involving an assessment of market power based in part on market shares in the relevant market. This is the ‘traditional’ approach described above. In sectors characterised by innovation and development, and

¹⁶ “Guidelines for competition assessment: a guide for policy-makers completing regulatory impact assessments”, OFT 355, OFT, February 2002. The European Commission states that it does not have a hierarchy of sources of information or evidence when defining markets, and instead follows an ‘open approach’. (See Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9/12/1997 for further details).

rivalry between firms over time, this approach may be less appropriate to use on its own¹⁷. This is the case, in our view, for the markets in which the BBC's proposed Digital Curriculum service would operate.

3.16 The assessment of competition in dynamic markets must also consider the entry conditions and whether the firm that gains an advantage through innovation acts anti-competitively to sustain any market power by excluding rivals. These key factors in the dynamic framework have guided our assessment of the market impact. Our approach is consistent with the 'first principles' approach outlined in a recent OFT report on 'Innovation and Competition Policy'¹⁸, which states that:

"...the 'first principles' approach centres on an examination of the competitive effects of the conduct at issue... market power and market definition have a role in antitrust analysis, their proper roles are part of and in reference to the primary evaluation of the alleged anti-competitive conduct and its likely market effects. They are not valued for their sake but rather for the role they play in an evaluation of market effects"

3.17 In line with the aforementioned OFT/Cabinet Office report and with due regard to the criteria applied by DCMS in its Public Service Approval Guidelines, we answer the following questions in this report:

- is the proposition sufficiently different from the probable supply in the market to constitute a significant innovation/development;
- what would be the impact on relevant, and related, markets resulting from the introduction of the service; and
- would the BBC's proposed Digital Curriculum service impact competition adversely in the market?

¹⁷ For example, a market definition is typically less stable over time in dynamic markets and hence at any given point in time market shares on their own will not necessarily be a good indicator of sustainable market power. Furthermore, market shares also tend to be unstable in dynamic markets.

¹⁸ "Innovation and competition policy", Economic Discussion Paper 3, March 2002, OFT 377. Quote derived from Salop, S. (2000), "The first principles approach to antitrust, Kodak and Antitrust at the Millenium", Antitrust Law Journal, Vol. 68 (no. 1), pp. 187-202.