The Relevant Market Concept and its Lack of Clarity in Mexican Competition Legislation

por Adriaan Ten Kate sr.
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1. Introduction

1.1 Background of the relevant market concept

The relevant-market concept arose from antitrust case law in the U.S. at the middle of the twentieth century and has played, since then, an ever more important role in merger analysis, on one hand, and in the assessment of anticompetitive conduct, on the other.¹ More recently it has also been used in investigations of substantial market power in order to determine the need to impose ex ante regulations in some specific sectors. In all these applications the determination of relevant markets is a first step in the assessment of the market power specific agents may have.

The use of the concept has not been limited to competition analysis in the U.S.; most other jurisdictions have followed the example and have introduced the term “relevant market” sooner or later in their competition law enforcement. Some relatively recent competition regimes, among which the Mexican, have even incorporated the term in the official text of their competition codes, so turning it from just an analytical tool into a jurisdictional prerequisite.²

It should be realized that the meaning of the relevant market notion in antitrust is much more specific than what one may expect from the combination of the two commonly used words, relevant and market. Therefore, one may not assume that its meaning is readily understood from common language. Moreover, in spite of the importance the concept has acquired in the analysis of competition cases, the theoretical literature is almost silent about it. In fact, it is difficult to find any reference to it in textbooks of microeconomics or industrial organization and it is virtually impossible to find a satisfactory description of what it means.

¹ For an extensive description of the emergence of the relevant market concept in antitrust analysis see Gregory J. Werden (1992); The History of Antitrust Market Delineation, Marquette Law Review, Vol. 76, p. 123.

² To my knowledge, the Mexican competition law of 1992 is the first competition code which mentions the relevant market concept explicitly.
Even so, it was not until 1982 that the Department of Justice of the United States came up with a formal definition of an “antitrust market” in an official document of the government of that country (the Merger Guidelines) and it was not until the Horizontal Merger Guidelines of 1992 (in the following the Guidelines), not only subscribed by the Department of Justice but also by the Federal Trade Commission, that a formal distinction was made between markets, on one hand, and relevant markets on the other. In many other jurisdictions, even in those where the term relevant market appears explicitly in the text of their competition codes, there is at most a specification of the cases for which relevant markets must be determined and of the factors that should be taken into account to define them, but there is no explanation of what the term means.

1.2 The hypothetical monopolist approach

The approach adopted by the Guidelines to define relevant markets conceptually is known as the hypothetical monopolist test. It is an unusually cumbersome definition full of conditions and qualifications, which requires several readings before capturing its idea. The full text is:

A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a “small but significant and non-transitory increase in price”, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test.

I present this definition textually, not so much to inform the reader about what a relevant market is, but rather for curiosity. A first question is whether in any field of science there is any definition of a concept, which is so long, so vague and so complex as this definition of the relevant market. A second question is whether those who thought that the concept is sufficiently clear from common language had anything in mind which is similar to this definition.

This hypothetical monopolist test can be split up in two parts. The first is the question whether the hypothetical monopolist would impose a small, but

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4 The Mexican competition law, for example, mentions in Article 12 the criteria that should be taken into account to determine relevant markets, but it does not define the concept.
significant and non-transitory increase in price. This is commonly known as the SSNIP test. The second refers to the no-bigger-than-necessary requirement. One could call it the size test.

Shortly ago, in August 2010, a new version of the Horizontal Merger Guidelines was published, in which the hypothetical monopolist definition of the relevant market was seriously toned down.\(^5\) In the new Guidelines the purpose of the hypothetical monopolist test is no longer to define a unique relevant product market for each product, but rather to establish a lower bound; i.e. to ensure that products that cannot be left out, are not left out. By dropping the no-bigger-than-necessary requirement there is no upper bound anymore. As a consequence, each product can have multiple relevant markets.\(^6\) In the following I stick to the relevant market definition as given in the hypothetical monopolist test of the Guidelines of 1992.

To conceive a market as a group of products and a geographic area is unique for competition analysis. In no other field the term market has such a meaning. In common language a market is rather a (real or virtual) place where competitors of certain products go to attract customers looking for competitive prices. For sure, in economic theory a market usually refers to certain products and a geographic area, but the emphasis is rather on the type of transactions and the trading mechanisms, not so much on the reach of competitive pressure.

In its product dimension a relevant market is formed by a group of products among which there is effective competition. I.e., when a supplier of one of the products increases the price of that product, consumers can switch to other products of the group. In that sense the products of the group exercise a price discipline upon each other and it is precisely this price discipline that the hypothetical monopolist test pretends to embody. Only by putting the control of the products in the hands of a single supplier, the hypothetical monopolist, the price increase becomes profitable. Therefore, close substitutes of the product under consideration must be included in the group, whereas more distant substitutes, complementary and unrelated products must be excluded.

A more extensive analysis of the hypothetical monopolist approach goes beyond the scope of this article, but there is little doubt that the definition of the relevant market of the Guidelines leaves many questions unanswered. To give just a few examples: How likely is likely? How small is small? How

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\(^6\) In the new Guidelines there is no description either of how to get to the relevant product market in concrete cases, as there was in the 1992 Guidelines; i.e., the procedure of starting with one product and adding next-best substitutes until the SSNIP test is satisfied is no longer there. Such a procedure would implicitly lead to the smallest market.
significant is significant? How nontransitory is nontransitory? What to do when the monopolist would impose a significant price increase for one product but not for another? What is assumed about the terms of trade for the same products outside the geographic area?  This without considering the multiple difficulties faced when this definition is put into practice in concrete competition cases. Even so, until now there are no alternative definitions of the relevant market enjoying an acceptance similar to that of the hypothetical monopolist test.

### 1.3 Discretionary powers and legal uncertainty

This situation would not be so problematic if there were international consensus on how to proceed on the subject matter. Unfortunately, there is not. In other jurisdictions that have adopted similar approaches to market definition as the U.S., some key elements are interpreted differently, which may lead to different relevant markets for the same case. The most serious aspect of this situation is that it is often the definition of the relevant market that determines the outcome of the assessment. Excluding a product from the market renders the conduct illegal or the merger anticompetitive; including it, competitive concerns may dissipate. Therefore, it is not surprising that market definition remains one of the most controversial issues in competition analysis.

This lack of clarity on the relevant market concept and on how to determine such markets in practical cases, together with its crucial importance in the resolution of those cases, grants enormous discretionary powers to most competition authorities, particularly to those that do not only have investigative but also adjudicative powers. In the absence of administrable rules the authorities can often define relevant markets at will in order to decide a case one way or the other. It could be objected that those powers are at least limited to a certain extent by the record of past decisions, but even there it is often argued that relevant markets may depend on the specific conduct at issue.

The other side of the coin is the legal uncertainty that arises from this lack of clarity, not just in Mexico but in most jurisdictions around the world. At the start of an investigation, be it for alleged anticompetitive conduct, be it for a merger, on few occasions is it possible to foresee with any degree of certainty how the authorities in charge are going to define the relevant markets. An immediate consequence is that entrepreneurs often do not

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know whether their daily conduct of business is or is not in violation of the competition rules.

1.4 Purpose and organization

The purpose of this article is to describe in a language accessible to those who are unfamiliar with the sophistications of modern economic theory the conceptual elements of the relevant market notion, on which there is a reasonable degree of consensus between different jurisdictions. I call them the basic principles. I also mention some differences of interpretation between jurisdictions.

A subject that goes beyond the scope of this article is the degree of substitution necessary to ensure that one product cannot stay out of the relevant market of another. This is precisely the questions that the SSNIP test pretends to answer, probably the most controversial question of all. In this article I confine myself to more fundamental questions, questions that have to be answered before proceeding to the SSNIP test.9

Given the fact that the Mexican Competition Commission (the Commission) has provided little guidance about market definition since it was initiated more than 17 years ago, it is quite possible that this authority does not share all the points of view set out in this article. In this case the article should be considered as an invitation to the Commission to express itself clearly about the criteria it follows in defining relevant markets.

In the next section I consider markets and relevant markets from a conceptual point of view. First I describe the basic principles of the “antitrust market”, on which there is consensus. Then I consider the phenomenon of substitution, both on the demand and on the supply side, and the role such substitution plays in determining relevant markets. Special attention is given to the possibility of self-supply. The third section considers the way in which those basic principles, including substitution, are applied to arrive at relevant markets in concrete cases. In that section I also discuss the level of detail of product specification and the consequences this level of detail may have for the resulting relevant markets. Section 4 analyses what the Mexican federal competition law has to say about relevant markets.

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markets.\textsuperscript{10} The article is concluded with some general observations on the Mexican competition legislation following from the main text.

2. The Relevant Market in Theory
2.1 The dimensions of the market

It is generally accepted that, for purposes of competition analysis, markets and particularly relevant markets, have two dimensions: a product (service) dimension and a geographic dimension. In its product dimension a (relevant) market is a single product or a group of products that are substitutes of each other. For example, a market, or relevant market, could be a single product, such as cement, or the group of products of all alcoholic beverages. Likewise, in its geographic dimension a (relevant) market is a geographic area where the products are produced or sold and where there are possibilities of substitution between different locations in the area, for example, when suppliers can easily move the products from one place to another within the area. In its geographic dimension a (relevant) market might be the metropolitan area of Mexico City, the State of Sinaloa, Mexico as a country or the world as a whole, to give just a few examples.

A third dimension that is sometimes distinguished is that of clients. This happens when the suppliers of a market, defined as a group of products in a geographic area, can charge different prices to different groups of customers, usually for the impossibility of arbitrage among the different groups. An example of such price discrimination is the differentiation of tariffs between residential and commercial end users of telephony networks. In such cases a separate market can be defined for each group. Another example is splitting up markets according to distribution channels.

A fourth dimension that only applies occasionally is that of time. This dimension becomes important when products are perishable and only produced in specific seasons, to be able to distinguish between high and low season markets. It is also important for some services that are consumed at the time they are produced, to separate peak from off-peak demand. Also in this case it is the possibility to discriminate prices and tariffs that justifies the segmentation of markets.

It should be noted that there is one dimension missing in this list, and it is left out on purpose. It is the dimension of suppliers. In any market the products that constitute that market, are \textit{products}, no matter who produces them. It is not possible to include a product in a market on the condition that it be produced by a specific supplier, or by a specific group of suppliers, and exclude the same product when it is produced by others. Such

\textsuperscript{10} \textit{Ley Federal de Competencia Económica}, Diario Oficial de la Federación (DOF), 24/12/1992. The most recent versión was published in the DOF, 28/06/2006.
proceeding would ignore competition between included and excluded suppliers, competition that is effectively taking place in the market.

That does not mean that the suppliers of the products “of” the market are not “in” the market. The suppliers are in the market as participants, not as constituent parts. A market “is” a group of products in a geographic area, and eventually for a group of customers and for a period of time. Once that group of products and the geographic area is determined, it is possible to establish the list of actual or potential participants, not before.

To conceive a (relevant) market as a group of products in combination with a geographic area is far from obvious. As already observed before, both in common language and in economic theory the market concept has quite different interpretations. Also the market dimensions described above are typical for competition analysis.

In this article I confine the analysis mainly to the product dimension of markets. Sporadically I mention the geographic dimension and that of clients, but the time dimension is left out completely. This is in order not to unnecessarily complicate the discussion. Moreover, most of the arguments can seamlessly be transferred to the other dimensions.

2.2 Substitution on the demand side

The products that constitute a market in its product dimension are presumably substitutes of each other. There are, however, two different kinds of substitution: substitution on the demand side and on the supply side. In this subsection I consider demand-side substitution, in the next supply-side substitution.

Product A is a substitute of product B on the demand side when consumers switch from product B to product A upon a price increase of the latter product. For a product to be a substitute of another product it is not necessary that all consumers switch; it may be sufficient when only some consumers do so, particularly if they are strong consumers.

Sometimes two products are considered substitutes when they have the same function for the consumers. Interpreting substitution in this way, the possibility of substitution between products depends on the specific function that is chosen, and due to the fact that most products have different functions at the same time, this approach is unsatisfactory. When the function is to slake thirst all beverages are substitutes; when the function is to forget one’s sins, alcoholic beverages and soft drinks are no substitutes any more. Moreover, the substitutability between products depends on relative prices. Even though air transport and transport over land bring people or merchandise from one place to another (same function), tariff
differences often inhibit substitution. In competition analysis it is economic substitutability that matters, not functional substitutability.

Moreover, substitutability between products is a matter of degree. Product A is a close substitute of product B when many consumers switch from the latter to the former upon a price increase of the latter. Products are distant substitutes when consumers are more resistant to change. Ultimately it is the closeness of substitution that determines whether different products belong to the same relevant market.

When two products are substitutes on the demand side, the presence of one product exercises a price discipline upon the other, because when the suppliers of one product would increase price, they would lose customers to the suppliers of the other products. As a consequence, such a price increase may result unprofitable. It is precisely this price discipline that brings different products together in a single relevant market. Evidently, the closer the substitutes, the stronger will be the price discipline.

The idea underlying the relevant market concept is to put all close substitutes together in a single relevant market and to leave out more distant substitutes, complements and unrelated products. When the hypothetical monopolist then gains control over all products and increases the price of one of them, lost sales on that product are at least partially recaptured on other products in the group and a price increase that would be unprofitable for a producer of the product alone, may become profitable for a producer of all of them. To achieve profitability no close substitute can be left out; otherwise the supplier of that substitute could defeat the price increase by attracting customers.

In the Guidelines of 1992 a market is defined as a group of products such that a hypothetical monopolist could profitably impose a small, but significant price increase, and a relevant market is the smallest group that satisfies this test. In this way the hypothetical monopolist approach implicitly defines the degree of substitution necessary to put products in the same relevant market. Moreover, it is clear that markets are broader than relevant markets. If a product is excluded from a market, the resulting group may still be a market, but a relevant market minus one product is no longer a relevant market. However, as mentioned before, I do not elaborate further on the degree of substitutability in this article.

It should be noted that what is substituted on the demand side are products, not producers or suppliers. Evidently, when one product is substituted by another, usually there is also a substitution between suppliers, but it is still the product that counts for the purpose of market definition, not the suppliers. In its product dimension a market is a group of products, not of suppliers. My insistence on this point becomes clear in the next subsection on supply-side substitution.
2.3 Substitution on the supply side

There are two kinds of substitution on the supply side: substitution between products and substitution between producers. Substitution between products is the traditional way to conceive the phenomenon and refers to products that are candidates to be incorporated in the market for being substitutes of the products that are already in that market. Substitution between producers rather refers to the possibility that producers that are actually not offering the products of the market can switch their production facilities to the production of the products in the market, so exercising price discipline upon the products in the market from behind the screen. This latter form of substitution rather represents potential competition and entry. Given the fact that it does not add any new product to the market, it cannot play a role at the market definition stage, but should be treated at the stage of assessing market power.

As to my knowledge, competition agencies have not distinguished between these two kinds of substitution at the supply side explicitly, which has given rise to considerable confusion. Several competition and regulatory authorities have referred to the two types just as supply-side substitution, as if they were the same. Below I spell out the differences and their implications in more detail.

2.3.1 Substitution between products

Product A is a supply-side substitute of product B when product A is produced with productive equipment that can be switched without major adjustment costs and quickly to the production of product B. An often cited example is that of paper of different qualities, which for many uses are no close substitutes on the demand side, but can be produced with the same machinery using different qualities of cellulose.\(^\text{11}\) In this case there is the possibility of substitution between products, which may be a reason to classify different qualities of paper in the same relevant market.

This type of supply-side substitution makes it possible to avoid an excessive fragmentation of relevant markets. Shoes of a specific size are no demand-side substitutes of shoes of a different size, but because they can be made with the same equipment the different sizes are supply-side substitutes, which allows to classify them all in a single relevant market. Similarly, a telephone call between two end users is no demand-side substitute of a call between two other users, but because it is the same networks that transmits the calls, there is a single relevant market for all such calls. Otherwise there would be a separate relevant market for each pair of users, which would make the relevant market concept unmanageable for practical purposes.

\(^{11}\) The example is taken from: European Commission, COMMISSION NOTICE on the definition of the relevant market for purposes of Community competition law, OJ C 372, 9/12/1997, para 22.
Also at the supply side substitution can be close or more distant. The closeness of substitution depends on the costs that have to be made and the time required for the transformation of the equipment from the production of one product to the other. When those costs are high or when the time required is considerable, the substitution is insufficiently close to classify the product in the same relevant market.

It should be underscored again that we are talking here about substitution between products. One product is a substitute of the other, no matter who produces them. Maybe product A is produced by a firm different from the firm that produces product B, but that is not a necessary condition for the products to be supply-side substitutes. It is quite possible that both products are produced by the same firm, as in our examples of papers and shoes.

**2.3.2 Substitution between producers**

Supply-side substitution between producers stands for the possibility that other producers, different from those that are active in the candidate market, can offer the products of the candidate market quickly and without major investments. The lower the costs and the shorter the time, the closer is the substitution. In this case there are not necessarily other products whose production equipment is converted to the production of the products of the candidate market, but there are other producers that can enter the market without major obstacles.

Evidently, when the installations to produce a product can easily be adapted to produce another, its producers can easily enter the market of the other product – i.e., there is a considerable overlap between the two types of substitution -, but there are two important differences. The first is that substitution between products can occur within a single company. I.e., it is not necessary that the producer of one product be different from the producer of the other.

The second is that in the case of substitution between producers there is not necessarily a relation between the products the entering firm offers in other markets and the products of the market it enters. Maybe the firm simply has the necessary permits and the know-how required to easily and quickly enter the market, but that its installations are used to produce a wide range of completely unrelated goods. In such cases it is not possible to identify among all those goods the one that permits the substitution. There is a substitute producer, but there is no substitute product. Therefore, substitution has no relevance at the market definition stage where the search is for products to be aggregated to the candidate market.
2.4 Supply-side substitution at the market definition stage

Without a doubt demand-side substitution is the main factor to be taken into account for the purpose of market definition and there is ample consensus about it. Supply-side substitution on the other hand, in this case substitution between products, may or may not be taken into account for market definition. If it is taken into account, close supply-side substitutes are incorporated in the product dimension of the market; if not, it is only demand-side substitutes that form the market. There are important differences between jurisdictions, however. In the U.S. Guidelines, for example, supply-side substitution is explicitly ignored at the market definition stage, but accounted for at the stage of the assessment of market power. In most other jurisdictions the authorities are less outspoken about this matter.

The difference between including supply-side substitution at the stage of market definition and leaving it until the next stage can be illustrated with the following example. Let us assume that the product that gave rise to the investigation is copper wire; that alumina wire is not a close substitute of copper wire on the demand side; but that alumina wire producers can easily switch their equipment to the production of copper wire.\footnote{12} When supply-side substitution is admitted at the market definition stage, the above described situation would lead to a relevant market with both copper and alumina wire in it. When it is not admitted, only copper wire would be in the relevant market, but the potential participation of alumina wire producers in that market would be taken into account at the later stage of market power assessment. In the latter case market shares would have to be measured in capacities, not in actual sales volumes or values.

In such cases both ways to account for supply-side substitution usually lead to the same result as regards market power. However, occasionally there may be circumstances in which this is not the case. Jonathan Baker identifies five such circumstances in which the inclusion of supply-side substitution at the market definition stage may lead to erroneous conclusions about the harmful effects of mergers.\footnote{13}

Therefore, it is not surprising that the competition authorities in the jurisdiction that has given rise to the relevant market concept, that of the U.S., reject this possibility categorically. According to the Guidelines “Market definition focuses solely on demand substitution factors [...] Supply substitution factors [...] are considered elsewhere in these Guidelines in the identification of firms that participate in the relevant market and the


\footnote{13} Ibidem, p. 129.
analyses of entry.” Werden explains the reasons why supply-side substitution is not considered until the market power stage in an article celebrating the tenth anniversary of the 1982 Merger Guidelines.

The Guidelines do not distinguish explicitly between supply-side substitution between products and between producers. That is of little importance because both of them are treated at the stage of assessing market power stage. Instead, the Guidelines distinguish between committed and uncommitted entry, where uncommitted entry, (quick and easy entry) is considered with the identification of potential participants, and committed entry (not so quick and costly entry) is considered under the analysis of entry barriers.

The European Commission does not distinguish either between the two types of supply-side substitution, at least not explicitly. Implicitly it does, however. In its “Notice on the definition of the relevant market for the purposes of Community competition law” it states: “The competitive constraints arising from supply side substitutability other than those described in para 20-23 […] are taken into account at the assessment stage of competition analysis.” (emphasis mine). It turns out that the type of substitution set out in paragraphs 20-23 is precisely what I have called substitution between products. On this type of substitution the Commission states: “Supply-side substitutability may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy.” That is, supply-side substitution between products, when it is effective and immediate, is considered while defining the market, whereas substitution between producers is analyzed at the assessment stage.

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17 Ibidem, para 20.

18 In its guidelines on market analysis in the telecommunications sector the European Commission is confused about the two types of supply-side substitution and even suggests to consider substitution between producers at the market definition stage. This in spite of its repeated assertions that markets are defined in accordance with the principles of competition law. See European Commission, Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, OJ C 165 (11/07/2002). Paragraph 52 of these guidelines states: “In assessing the scope for supply substitution, National Regulatory Authorities may also take into account the likelihood that undertakings not currently active on
In Mexico the Commission has never pronounced itself about the subject matter, but from the way it is treated in many investigations one understands that supply-side substitution is admitted at the market definition stage. However, the Commission does not make a distinction between substitution between products and between producers and acts as if it were possible to consider substitution between producers at the market definition stage.\(^\text{19}\)

### 2.5 Self-supply

As already mentioned before, the products that constitute the relevant market in its product dimension do not depend on who is the supplier. Therefore, following the basic principles of the concept, products produced by customers for their own consumption, as well as self-supplied services, must by definition be included in their respective relevant markets. Even where products or services produced by their customers are slightly differentiated from those offered in commercial transactions, they must be included in the market for being close substitutes on the demand side. In such cases it should be recognized that self-supply is a real alternative which exercises an effective price discipline on the products bought in the market place. A similar price discipline occurs with outsourcing, which is the reverse of self-supply.

For example, a merchandise manufacturer can pay a transport company to bring that merchandise to its clients, or he can transport it with his own means. When external tariffs increase, it becomes more attractive to do it by himself and that possibility disciplines external tariffs. The word self-supply may be somewhat misleading, but for the manufacturer, as customer of the services, transporting the merchandise with his own means is a substitute for the relevant product market may decide to enter the market, within a reasonable time frame, following a relative price increase [...]. In circumstances where the overall costs of switching production to the product in question are relatively negligible, then that product may be incorporated into the product market definition.\(^\text{19}\) (emphasis is mine.) It is funny to see that first it is about substitution between producers (“undertakings not currently active on the relevant product market may decide to enter”) and the suddenly it is about substitution between products (“that product may be incorporated into the product market definition”). It remains unclear what that product would be.

\(^{19}\) In its recent declarations of substantial market power in the wholesale markets of call origination and termination, among others, the Commission states that “Supply-side substitution requires the provision of the relevant services by economic agents (different from the provider of the relevant services) that are able to provide those services in the short run and without incurring in considerable investments.” (translation is mine.) See, for example, CFE, DE-04-2007, para 6.32, which forms part of the market definition section. That is, the Commission defines supply-side substitution as a substitution between producers, but even so it treats this kind of substitution at the market definition stage.
for buying it from others. I.e., self-supply is a substitute on the demand side. The closeness of substitution depends on relative costs, but whenever self-supply occurs in reality, it is clear that substitution is feasible and, applying the basic principles of the concept, it should be included in the relevant markets of the external products or services it replaces. It may, however, create serious problems of measurement because self-supply is much less visible than transactions in the market.

Self-supply is also illustrative of the difference in the meaning of the word market between competition analysis and common language. In common language self-supply is often set against market transactions. For example in the Mexican national accounts a distinction is made between market production and non-market production, the latter standing for self-supply.\(^{20}\) In competition analysis, on the other hand, what matters is whether products or services are substitutes, not whether they are exchanged in commercial transactions between independent agents.

3. Market Delineation in Practice
3.1 The anchor product

In practice the product dimension of relevant markets is build up starting from a specific product, usually the product giving rise to competition concerns. In the following I call it the anchor product. In fact the relevant market obtained from the anchor is "the" relevant market of that product. As a result every product has its own relevant market and every relevant market is referred to its anchor.\(^{21}\)

In principle it is possible that two different products have the same relevant market and this is even likely to a certain extent when those products are close substitutes. However, even then it is possible that the relevant market of one of them does not cover exactly the same products as that of the other. It may be that both products belong to the relevant market of the other, but that in spite of that a third product belongs to one of the relevant markets and not to the other.\(^{22}\)

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\(^{21}\) As mentioned before, in the 2010 version of the Horizontal Merger Guidelines this is no longer the case.

\(^{22}\) Consider the case of four products A, B, C and D, whose closeness of substitution is determined by their distance in the alphabet. Then it may well be that B’s relevant market is A-B-C while C’s relevant market is B-C-D. That is, B and C are in each other’s relevant market, but B’s market is still different from that of C.
The relation between relevant markets and anchor products has received little attention by scholars on the subject. Werden states: “The Guidelines also notably departed from case law in delineating a single relevant market for each product [...]. Curiously, that aspect of the Guidelines’ approach has received no attention from the commentators.”23 Ten Kate and Niels attribute this lack of attention to the fact that this relation between relevant markets and anchor products is not mentioned explicitly in the formal definition of relevant markets.24

3.2 The procedure25

The first step of the procedure is to estimate whether a SSNIP for the anchor product is profitable for a hypothetical monopolist of that product.26 Usually a five percent increase is considered significant. As mentioned before, in this article I do not consider the way in which the SSNIP test is applied; I rather assume somewhat heroically that the test delivers a unique answer: yes or no. If the answer is yes, the relevant market is the anchor product; if it is no, one goes to the next step.

In the second step the best substitute of the anchor product on the demand side is added to the group and the SSNIP test is repeated for the broader group and for a monopolist who controls both products.27 If the SSNIP is profitable, the relevant market is formed by the two products; if not, the next-best substitute is added to the candidate market. This process continues until the SSNIP test is satisfied. The resulting group is the relevant market of the anchor product in its product dimension.

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24 Véase Ten Kate and Niels (2009), supra note 7, p. 308.

25 Some authors refer to the procedure as an “algorithm”. See for example, Gregory J. Werden (2002), *Market Delineation Algorithms Based on the Hypothetical Monopolist Paradigm*, U.S. Department of Justice, Antitrust Division, EAG Discussion Paper 02-8, 2002. I prefer to speak about the “procedure”, because the term algorithm suggests much more mathematical rigor than the set of little precise rules to determine relevant markets allows for.

26 Sometimes the question of the test is not whether a SSNIP is profitable, but whether a profit-maximizing monopolist would impose a SSNIP. The Guidelines are unclear about it. In the formal definition it is the second question that matters, but in the procedure of application it is the first. See Ten Kate and Niels (2009), supra note 7, p. 304.

27 The SSNIP test for two or more products can be interpreted in different ways. One way is to establish whether a SSNIP for the anchor product is profitable for a monopolist controlling all products. Another is to check if a SSNIP for all products is profitable for such a monopolist. The Guidelines are equally unclear about that question.
When supply-side substitution is admitted at the market definition stage, which is not the case in the Guidelines, it is necessary to apply a similar process to add close substitutes on the supply side. As far as I know, in jurisdictions that admit supply-side substitution for market definition, no criteria have been established to measure the closeness of substitution quantitatively, but in principle there are no reasons to assume that the hypothetical monopolist test would not work there in the same way.

Although a relevant market may be formed by a long chain of products, in most practical applications only a few products suffice to end the process. Moreover, in many cases the simple fact that a specific substitute must be included is already sufficient to dissipate any competition concerns. In such cases it is not even necessary to determine the exact boundaries of the relevant market beyond that substitute.

### 3.3 Product detail

Another issue that has received little attention in the literature is the detail with which products are specified, even though this may be of crucial importance for the outcome of the market delineation exercise. One may ask: Is passenger cars a product? Or should one distinguish between luxury and popular cars? Or even between different makes, models and colors? It is endless.

Evidently, when different varieties are close substitutes, grouping them together does not make much difference. Specifying the anchor product in much detail would lead to the addition of the other varieties to the market anyhow. But when the degree of differentiation is notorious, product detail may matter. For example, specifying the anchor product as “tables” the relevant market would include from the outset all kinds of tables (wooden, metal, plastic, office, home, garden, etc.), even though most of them are no close substitutes neither on the demand nor on the supply side. Therefore, anchor products should be defined in sufficient detail so as not to mix up in one and the same relevant market quite different products that are no substitutes.

On many occasions the level of product detail is closely related to the possibility of supply-side substitution. I already mentioned the example of shoes of different sizes, which are no substitutes on the demand side, but pretty close supply-side substitutes. Therefore, if supply-side substitution is not admitted at the market definition stage, the relevant markets for shoes should by principle be split up by size. This is never done in practice as the number of markets would become endless, but by specifying the anchor product generically – just shoes – supply-side substitution enters underhand.
A similar situation, which I already mentioned earlier, is that of telephony calls. A call between two subscribers is no substitute of a call between another couple of subscribers on the demand side. Therefore, taking the prescriptions literally relevant markets should be segmented according to user pairs. However, by specifying the anchor products generically by “telephone calls” the possibility to distinguish between routes is eliminated from the outset and substitution on the supply side slips in through the backdoor.

Another argument against such over-fragmentation of relevant markets, an argument that equally applies to shoe sizes and telephone calls, is that prices or tariff are uniform. As a general rule, the prices of shoes do not depend on their size and tariffs for telephone calls are uniform, at least within a local area. Where tariffs are differentiated, there are arguments to separate relevant markets.

The purpose of the foregoing examples is to show that the level of product detail, particularly that of the anchor product, may have an important influence upon the outcome of the market delineation exercise. Sometimes competition agencies are hardly aware of the fact that their relevant markets, presumably obtained with uniform and objective criteria, critically depend on the detail of their product specification.

3.4 Assessment of market power in stages

In this subsection I briefly describe the process of assessing market power, which consists of two stages: that of market definition and that of assessing power in that market. This illustrates at the same time the differences between the two types of supply-side substitution.

The stage of market definition contains the following steps: (i) the identification of products that should be included in the relevant market (it is in this step that supply-side substitution between products can be taken into account or not) and (ii) the determination of the geographic area in which they are produced or sold. When other dimensions (clients, time) are considered, relevant markets can be segmented accordingly.

The second stage consists of: (iii) the identification of actual participants, (iv) the identification of potential participants (in case there is supply-side substitution between producers), (v) the estimation of actual or potential shares in terms of sales or production capacities respectively, and (vi) the consideration and analysis of additional aspects, such as buying power, entry barriers, access to essential inputs, among others.

All these steps have a logical order. The geographic area cannot be determined before first knowing what the relevant products are. A list of actual participants cannot be made before knowing the products and the
geographic area. The list of potential participants cannot be made before knowing the actual participants, because they must be different. Shares cannot be estimated before knowing the participants. Finally, the analysis of additional elements is only done for those participants that have high shares. Only entry barriers could be evaluated directly after the first stage, but it is preferable to postpone it until the end of the exercise because the previous steps could make the effort redundant.

In the following diagram the steps to be taken in the two stages are presented schematically. Only the determination of the geographic area has been left out.

At the first stage the starting point is the anchor product and the candidate market is formed by adding close substitutes on the demand side. The necessary closeness of substitution is defined by the SSNIP test. If supply-side substitution between products is admitted at that stage, there is a second round of adding close supply-side substitutes. Until now the only criterion to add or not to add has been whether substitution is easy and quick, but in principle an adapted SSNIP test could do the job. The relevant market of the anchor product is obtained after adding the qualifying substitutes.
At the second stage a list of actual and potential participants is made up. When supply-side substitution between products was admitted at the first stage, some of the potential participants have become actual participants. Then the shares of the participants are determined. If there are potential participants the shares are expressed in production capacities. If there are high shares, barriers for potential entry are assessed together with some additional aspects to strengthen or mitigate the presumption of market power of high share participants.

5. The Relevant Market in the Mexican Competition Regime

In the Mexican Federal Law of Economic Competition (FLEC) each of the cases for which it is necessary to define relevant markets are spelled out, as well as the elements that must be considered to determine those markets. However, there is no definition of what a relevant market is. In the complementary regulations (RFLEC) there are more details on the elements to be considered to determine substantial market power, but there is nothing additional about the definition of markets.28

In Article 10 of the FLEC there is a description of different types of conduct which are considered relative monopolistic practices, provided the economic agents involved in such conduct have substantial power in the relevant market. Thus, it is necessary to determine those markets to establish whether the conduct is legal or illegal. Likewise, according to Article 18, paragraph I, in order to determine whether a merger must be allowed or not it is necessary to determine the involved relevant market. Then, Article 23, paragraph V establishes that the Commission has the faculty to resolve on competition conditions, effective competition and substantial power in the relevant market, with respect to other laws, regulations, among others. This is usually in order to empower regulatory agencies to impose additional regulatory measures. Therefore, also in such cases relevant markets must be determined. In fact, only for absolute monopolistic practices (horizontal arrangements), there is no need to define a relevant market, although even in those cases it may be argued that a relevant market is needed to decide whether the arrangements are horizontal.

Article 12 mentions the “criteria” that must be considered to determine a relevant market, but those criteria are not really criteria in the proper sense of the word.29 It is rather a set of elements or factors that should be taken into account without there being any indication of how to proceed in case of conflict. Still, in many of its resolutions the Commission has argued that it


29 According to Webster's New World Dictionary, a “criterion” is a rule or test by which something can be judged. In this sense a criterion is not “considered”, but “applied”.

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has determined the relevant markets in strict accordance with the criteria of Article 12 of the FLEC. This kind of reasoning ignores the fact that Article 12 does not even contain the minimum requirements necessary to determine a relevant market in concrete cases.

Regarding the dimensions of the relevant market, neither in the FLEC nor in its regulations this characteristic is mentioned. Where Article 12, paragraph I refers to “the possibilities to substitute the good or service by others”, those who are familiar with competition analysis, know that it is about the product dimension and where paragraphs II and III of the same article mention distribution costs and the costs of customers to go to other markets, one understands that it is about the geographic dimension, but those who are not familiar would have to guess.

As regards the substitution possibilities mentioned in Article 12, if there are such possibilities, the substitute goods and alternative areas should presumably be included in the relevant market, but that is not explicitly mentioned either. A non-familiar would have to read much of the foregoing pages of this text to know that. Moreover, it should be realized that substitution is a matter of degree. Article 12 does not mention this feature and does not establish criteria (in the proper sense of the word) to decide whether substitution is sufficiently close to include a good in the relevant market of another. In fact, the FLEC grants the Commission almost complete discretionary powers to decide.

In Article 12 there is not either a distinction between substitution on the demand side and on the supply side, but the text suggests that it is mainly about demand-side substitution. Supply-side substitution is not mentioned as such and the only terms from which one might derive that it is included are “technological possibilities” (as supply-side substitution in the product dimension) and perhaps “distribution costs” (as supply-side substitution in the geographical dimension). Although the FLEC is not clear about it, from its proceeding in many cases one may conclude that the Commission admits supply-side substitution at the stage of market definition.

However, there is confusion about the way in which the Commission conceives supply-side substitution. Occasionally it interprets supply-side substitution as the possibility that other firms, not currently active in the market can enter easily, i.e. as substitution between producers, and nonetheless treats it at the market definition stage. This confusion has its origin in the fact that the FLEC does not make clear how to use the substitution possibilities it mentions in the determination of relevant markets in practice.

30 Supra note 18.
5. Final observations

In this article I have argued that it is not at all easy to establish the necessary criteria to define relevant markets in concrete competition cases and that the so-called criteria mentioned in the Mexican FLEC are no criteria in the proper sense of the word, but rather factors that should be taken into account. Even so the Commission has stated in many of its resolutions that relevant markets were determined in strict accordance with the criteria established in Article 12 of the FLEC, as if it were an operation manual. By doing so, it fails to admit its discretionary powers to determine relevant markets at will. This is the more serious because, until now – i.e. more than 17 years after its institution –, it has not made public the criteria it applies to determine relevant markets.

The fact that the FLEC does not come up with a definition of the relevant market concept suggests that its designers assumed that the meaning of the concept does not require further explanation. In this article I have argued that the concept is not at all understood from common language and that the absence of a conceptual definition in the law, together with the confusion about the way in which the Commission delineates relevant markets in concrete cases, has generated an abysmal legal uncertainty. On few occasions it is possible to predict with any degree of precision how the Commission is going to define relevant markets in the investigations it carries out, and there is an ample cry for more clarity about the subject matter.

It is interesting to note that in the so-called “chewing gum war” the relevant market notion was appealed, for not being clearly defined in the law, in a constitutional recourse against the first resolution of the case. The appeal went all the way up to the Supreme Court which, in March 2004, granted protection to the affected party for other reasons than the lack of definition of the relevant market concept. Regarding the relevant market issue it resolved that the concept had sufficient support in international experience to not give rise to the alleged legal uncertainty. It is at least surprising that in a state of civil law, as the Mexican, national Justice does not require more precision for a concept so controversial and so crucially important for the resolution of cases, as that of the relevant market, with reference to a confuse international experience full of contradictions.

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