FRAMEWORK FOR COMPETITION EVALUATION AT THE MICROECONOMIC LEVEL

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Abstract

Fair competition on the market is essential for the economic and social development and to alleviate poverty. However, the anticompetitive practices and the policies are common and they decrease the possibilities of innovation and economic growth. The governments of the developing countries must identify and locate the anticompetitive arrangements and practices, both in the public and in the private spheres. The framework is intended as a flexible instrument of diagnosis, with sets of questions grouped by themes, being perceived as a convenient and easily used introduction to the manner in which this task can be approached. These measures must analyse the state of competition in each selected sector: identification of markets and competitors, examination of market structure, aspects related to the barriers to the entry on the market, aspects regarding the anticompetitive factors considering the legitimate interests and the main beneficiaries, as well as the governmental policies of identification or the institutions which limit competition.

Keywords: microeconomics, competition, evaluation framework

JEL classification: D20, D25

Introduction

The evaluation of competition should analyse the power of competition on the relevant market and to identify any factors that hinder the efficiency of competition. The key-aspects are: market structure, entry barriers and anticompetitive behaviour. In the case when competition is considered to be limited, the probable resulting damage should be estimated.

What should be done when a decision has been made to make a competitional evaluation of a sector? This depends on the nature of the existing law and on the capacity of the existing institutions. Some aspects raise by this study might be sensitive to particular situations and those who make such evaluations will have to approach in a constructive manner the different levels of technical sophistication. This framework presumes a basic introduction of the topic, particularly in order to develop the decision-making factors.

How to select the sectors and markets to be evaluated? The sectors selected for the evaluation of competition should be both important for the economy and for the consumers, and should have the characteristics which suggest a limited competition. When a selection is made, two questions appear:

1. The sector is important to the economy, because:

- has it a significant contribution to the national product;

- is it connected to other sectors/industries as supplier of inputs and services;

- does it make possible higher profits through innovation, improving the distribution and business processes;

- do the nature and type bestow importance, such as a public enterprise or a mixt public-private enterprise;

- is it significant for investments and for the levels of productivity?

2. The sector is important to the consumers, because:

- does it supply goods or services that are essential, or which matter significantly for part of the consumption expenditure;

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- does it affect, directly or indirectly, the quality of people's life;

- does it contribute to poverty alleviation?

If the answer to both questions is "no", the sector should not be further investigated. If the answer to one or to both questions is "yes", the possibility of limited competition within the sector might be evaluated using the following questions: - are there indicators of consumer or company concern regarding the price or availability of the products of a particular sector, or regarding the access to sources of supply? Mass-media reports can be a good source of information regarding such concerns, such as those of the consumer organisations and professional associations.

- is there a history of the anticompetitive behaviour in the sector? The type of anticompetitive commercial exchanges often goes on for long periods and the past behavioural patterns might indicate possible current problems;

- are there barriers to the entry or expansion of new potential, large suppliers? There is the possibility that the new suppliers coming on the market reduce the price demanded by the existing suppliers. When the new entry is difficult, competition will be weakened, sometimes it is easy fir enterprises to enter a market, but it is difficult for them to expand enough as to act as constraint on the behaviour of other companies from the market. Besides the natural obstacles, the practices of the dominating companies and/or the inadequate governmental policies and statutes, rules and regulations, may delay the entry on the market.

- are there barriers to the ways of maximal support of the businesses? Some factors can limit the capacity of the companies to compete actively. These barriers might include the policies of the professional associations or of the government, regulations which limit advertising, which impose control over the prices, which give preferential treatment for the traditional operators, or which impose quality standards which are higher than the references developed by independent evaluations. Some companies might be responsible for the behaviour which limits the capacity of other companies to run;

- can the real or potential mergers within a sector lead, lead to a significant reduction of the number of suppliers? Most mergers don't affect competition, but there are some advantages for the consumers, by a more efficient production followed by lower prices. However, the decision of a company to overtake a competitor might be due to the desire to reduce competition. If the new entry in this sector is little probable, the increase of the concentration of owners might increase the concerns about competition.

- are the strong legitimate interests susceptible of opposing strongly the competition within a sector? This might mainly for those having strong financial interests to go on with the current pattern of production and distribution.

- has there been within a sector, a long-term pattern of high market concentration? If yes, it is necessary to identify the reasons for this.

The number of sectors which can be evaluated depends on the available funds. It is better to make a lower number of proper evaluations, than a larger number. The evaluations should attempt to get relevant results, through questionnaires, by interaction with market actors, as well as from secondary sources such as mass-media reports. There might be advantages gained by grouping studies of similar sectors, such as the industry network, where the understanding of the network of externalities produced by a study might also be useful for another study.

1. Methods of Evaluating the Competition

The characteristics of the competitive industries include a wider range of selecting products, the entry and exit of companies, changes in company ranking and in their market share, development of products and active innovation. The competitive industries also are susceptible of showing prices which respond to the changes in market conditions, such as changes of the production costs. An industry must not display all these characteristics in order to be branded as competitive, but the lack of many of these characteristics might suggest a lack of com petition.

A way to evaluate the intensity of competition is to acknowledge that it only reflects the competition between the current competitors, as well as the threat from the new entries, the threat of competition, of replaceable products, of products under development, the purchasing power as well as the negotiation power of the companies supplying inputs on the market (Porter, 1980). Most of these factors are directly or indirectly reflected within this framework.

1.1. Identification of the Relevant Markets and of the Competitors

After a sector has been selected for evaluation, the first step is to identify the relevant “market” within that sector, since there might be several distinct markets. These markets should be examined separately because the level of competitions might vary significantly from one market to the other. The relevant market is a group of products (goods or services) which most of the buyers consider that re reasonably and mutually replaceable, given the prices and conditions of sales. The markets have geographical limits which depend on the value of the product, cost and availability of transportation, etc. the markets include wholesales and retail sales. The next step is to identify the existing competitors.

The main suppliers must be identified by their name. If there are many small suppliers, they should be grouped accordingly. If a possible problem of competition refers to buyers’ behaviour, they should be identified similarly. If particular buyers always buy from particular suppliers (they buy particular products from articular suppliers), the market might be less competitive than it seems because, for in stance, the products from different suppliers are not replaceable for other, or because market sharing takes their place. If the buyers procure things from more than one supplier, or change suppliers, the market is more likely to be competitive.

There also are companies that might easily enter the market by adjusting the range of products or b expanding the geographical area they cover, with no important new investments, which might put constraints on the behaviour of the traditional operators. Last but not least, the imports are a realistic alternative for the buyers, taking into account the single characteristics of the products, the time of delivery, the customs taxes and the transportation taxes.

1.2. Examination of Market Structure

The next step is to examine the structure of the markets from that particular sector. This presumes the identification of the relative importance among the main suppliers on the market. If a small number of suppliers account for a large proportion of the offer, the market might be very concentrated.

The market share is usually measured by the value of sales, but the amount of sold goods or the capacity of the suppliers can also be relevant. The available information on the market share can be problematic when they don’t refer to relevant markets. When the size of a market is evaluated, the information should be sought by most of the participants (both sellers and buyers), by the relevant professional associations, by the consumer organisations and by any relevant governmental agencies. The high concentration doesn’t necessarily show a high market power and a competitive problem; other aspects should be taken into consideration.

The level of market concentration and of change in time is also of interest. If there is a single important supplier, this might suggest the existence of significant entry barriers or an aggressive behaviour on behalf of that supplier. Other explanations are possible too.

If there were few entries, or even no entry, for a long period, this might suggest the existence of high entry barriers, or that the potential new entries fear an adverse response from the traditional suppliers. The results of the past entries can be significant. The problems of interest refer both to the new companies that remained on the market; to how successful were they in gaining a market share and to how much they needed to get to a significant size. Nevertheless, other possibilities of entry on a limited market must also be taken into consideration. For instance, there might be a natural monopoly, or there might be n significant increase of the market size, or the government might have not given the licence to enter the market.

The buyers might have a power of negotiation which to reduce the capacity of the sellers to abuse of their market power. This constraint is probably higher when a single buyer matters for a substantial part of the sales of an individual company. The buyers, in order to have the possibility to constraint the suppliers, must have a credible alternative source of supply (including the possibility of self-supply). Under certain circumstances, the state enterprises dominate a sector, and there can not be a single buyer or a single seller, which is the government itself. The situations of dominating power of the state often exist in sectors such as electric power and water supply.

If the concern relays to the market behaviour of the buyers, rather than of the sellers, a single seller or a small number of sellers matter for much of the trade, the market power of the sellers might limit the capacity of the buyers to abuse of their market power. Last but not least, if the suppliers of significant inputs necessary to any seller have high negotiation power, this might limit the market power of the seller.

2. Aspects Regarding the Barriers to Market Entry

In order for a market to remain competitive, there must be a possibility that new companies enter the market and for the existing companies to develop or leave the market. If there are barriers which prevent the entry or delay it considerably, or if the entry would be costly, the existing suppliers might increase the prices above the competitive level. The actual entry or the probability of entry may restrain the market power of the companies. Even if the market share is high, this could not take the prices above the competitive levels if the new suppliers want to entry the market. However, if the threat of a new entry is to pose significant restraint, it has to be possible, in good time and sufficient. If the entry is to be "probable", it has to be commercially feasible. If the entry is to be "sufficient", it should have an enough large scale so as to challenge the traditional companies to change their market behaviour. Except for the case in which the possible entry would be "in good time" (achievable within a reasonable time interval), it would not be possible to influence the behaviour of the traditional companies. The new potential entries might include foreign companies and this would raise the problem of the manner in which the policies regarding the foreign direct investments affect the possibility of competition. If there are gender-based barriers, these make even more difficult (if not impossible) the entry of women on particular markets, which could significantly reduce the level of competition on those particular markets.

The entry barriers can be defined in several ways. One classification includes three categories: natural, strategic and regulatory. The type of barriers might also be a problem in specific situations, such as the cultural practices or religious affiliation.

The *natural barriers* result from the resources or technology required to become supplier for the market. They might include the existence of large scale economies such as the industrial networks (telecommunications, natural gases, oil, broadcasting, and electric power distribution). Other natural barriers include the problems which the newcomers might have in obtaining access to technology, raw materials or distribution channels. Another example is the case in which the market entry would presume large "irrecoverable costs" (the costs that cannot be recovered if the company decides to leave the market).

The *strategic barriers* result from the actions of the existing suppliers, intended to deter the new entries. They might include:

a) Establishment of additional capacities;

b) „Linked grouping and sales" for the newcomers, either to compete for grouped products, or to compete for a single product. However, there are good arguments for this pattern whether it is cheaper to manufacture products grouped or separately.

c) Exclusive long-term contracts, exclusive suppliers and distribution agreements. They might be sometimes justified, but exclusivity makes the market more competitive than otherwise;

d) Individual or collective, acting in a manner that shows the company or companies that they might act in an aggressive or greedy manner if the new entry took place, such as through reactions to the price.

The *barriers and regulatory policy* of entry on particular markets might exist at any governmental, national, state or local level. There are solid grounds of the public policies for restrictions, such as: health and safety problems, national security, or even short-term "industrial policy" to develop the incipient industries or specific geographical areas. However, the reasons for the restrictions that limit competition need objective justification. There are regulatory barriers that restrict competition; the prejudice obtained by the loss of competition should be compared with the benefits required by the existence of the barriers. There should not be feasible alternative ways to accomplish the policy objectives that would cause smaller damages from the loss of competition.

The *type-based (gender) barriers*. Lawful competition presumes equal opportunity for everybody but, particularly in the developing countries, women are often disadvantaged in business.

3. Ways by which the Governmental Policies or the Institutions Limit Competition

Despite the extended privatization of the past two decades, the *state enterprises* are yet significant in the economies of many countries. If these enterprises engage themselves in commercial economic activities, they should do this, as much as possible, under the same conditions with other companies. This matter requires examination if the market competition is altered by the existence of a state enterprise. Another problem is whether the privatized state enterprises benefit of subsidies, explicit or implicit, that could make competition difficult for the existing private companies, and which might deter the entry of new suppliers on the market. If the state enterprise benefits of advantages, and these might seem to limit competition, it is important to have a perceptible effect on the level of competition so that the worry is justified.

The *public acquisitions* might account for a significant part of the trade within a particular economy, and the manner in which these acquisitions are done may rise substantial problems of competition. If a government is a major buyer of products, the manner in which it organises it acquisitions might limit the possibilities of the new competitors to enter the market. If the government is a major buyer of products, it might have a negative impact on the competition if there is no requirement for a minimal number of offers, or if there is a short period in which to answer the call for bids, or if the criteria for bidders favour the existing or large suppliers.

The *regulated sectors*. Regulation might be necessary from economic reasons when market structure makes it difficult or even impossible the development of the competitive markets, such as natural monopolies, or the situation in which the sectoral operations raise significant problems to the public policies. Generally, regulation can be justified if the competition cannot be accomplished through market forces (like in the case of natural monopolies, if a company can produce more efficiently than several others), if the competitive markets would not yield a socially-desirable outcome, or if the social and private services differ significantly (for instance, when there are externalities). Other reasons for sectoral regulation include the supply of a mechanism which to support the technical standards to guarantee the quality and safety, the access to essential facilities, as well as the provision of methods to encourage efficiency and the cost price. The regulatory authorities should try to promote competition, as much as the policy of the objectives and the nature of the sector make this possible. The technical progress might increase the possibilities for competition, making it possible the separation of the competitive markets from the non-competitive ones within a sector.

3.1. Considerations on the Legitimate Interests

In many situations there will be stakeholders that oppose the increase of competition on a particular market. Even if the identity and objectives are known, their power and influence should be reflected in the evaluation of the competition. The policy, including the financing of the political parties from sectoral benefits, might be involved. The stakeholders “can be of several types, including political decision-making factors (at all governmental levels), regulatory authorities, influential natural persons, traditional companies (state enterprises included), the newcomers, foreign companies, organisations of the civil society, groups of interest, consumers, external stakeholders, the academia and the mass-media. There might also be coalitions of interests. The range of interests of the stakeholders will be seldom stated in the documents circulating on the market, and it might be necessary to check and analyse the press articles and the information from other publications. The legitimate groups of interest might have enough influence on the formation of the governmental policies so as to determine them to act in favour of one group or another.

In the matrix below, “influence” refers to the power of the stakeholder that will affect the level of competition on the market, while “importance” refers to the level of priority which the researcher feels he/she has to give in order to meet the needs and interests of the stakeholders.

A- high importance, low influence	B- high importance, high influence
C- high importance, low influence	D- low importance, high influence

3.2. Aspects Regarding the Anticompetitive Behaviour of the Companies

Some factors aid making an image of the risk of anticompetitive practices. Any of these factors taken separately, doesn’t necessarily determine significant problems of competition, but taken together they might indicate situations in which problems are likely to appear. The factors that might limit the level of competition can be as follows:

a. horizontal – with effects between companies at the same point of a supply chain in one or several markets (between competitors);

b. vertical - with effects between companies at different points of the same supply chain (for instance, between producers and the retail sellers);

c. other factors - include factors beyond market structure and company behaviour, such as consumer behaviour and information.

The three main types of anticompetitive behaviour are those arising from secret agreements between competitors, abuse of dominant position of the enterprises with market power and some mergers and acquisitions. All three can raise both horizontal and vertical problems, and can also be affected by the horizontal and vertical structure of the markets or by information problems.

Company behaviour: horizontal aspects

a) Abuse of dominant position. A dominant company is that company which has enough market power to influence market price and decisions, without having to consider the probable reaction of the competitors. The existence of a dominant position is not necessarily harmful, but this high market power might be used in an abusive manner. The “abuse of dominant position” describes the situations in which a dominant company uses its market power to increase prices above the competitive level, or to prevent the small competitors to increase their market share, or to deter newcomers from entering the market. A company must have a high market share in order to be dominant on a market.

The abuse of dominant position might involve a behaviour that excludes competitors and a behaviour that exploits consumers. The consumers can be exploited when the prices are too high, while the competitors may suffer when the prices are too low because of the predatory pricing. To determine whether the prices are too high or too low, always requires a careful study.

The predatory pricing appears when a company with a dominant position, well-funded, sells its products below the cost price for a period of time, with the intention of compelling the smaller competitors from the market to exit the market, and when this happens, is raises the prices again. This tactics may also be used to deter a company from entering the market.

The types of behaviour of the dominant companies that can be used to exclude the competitors or to exploit consumers include: discriminatory prices (justified sometimes when the procurement costs are different), reductions when the procurement costs are the same, linking and grouping.

Other types of strategic behaviour include the establishment of large reserve stocks, which to flood the markets in response to entries. The traditional companies do this to increase their credibility, to block the entry or they may behave unpredictably or aggressively in order to make a strong reputation.

b) Complicity and cartels. Competitors reach, sometimes, agreements to limit the intensity of competition by setting the prices, by sharing the market, by boycotting the companies that would not cooperate with them, or by reducing the bids. Tacit agreements such as these are called cartels. The cartels might involve only internal companies, or a combination of internal and international companies, or just international companies („Global Economic Perspectives 2003", World Bank).

The cartels usually operate secretly, and their existence might be hard to prove. Many have never been detected. The "tacit understanding" is also possible. The tacit understanding occurs when the companies reach an understanding with no direct contact, simply on the basis of their expectations to the response of others regarding the changes of behaviour. This can lead to "parallel prices". However, in order to justify an understanding, the companies act in a collective manner and usually have to identify other factors that consolidate the conclusion based on parallel prices of the competitors.

One of the weaknesses of the cartel is the fact that it can be more profitable for a member when it cheats the agreement in order to make higher sales. For a cartel to survive, it must be possible that such actions are both detectable and punishable by the other parts in the agreement. Despite their vulnerability to "cheating" some understandings have been working for many years.

The factors that make more profitable the secret agreements are: market structure (several concentrated markets, less entries, similar costs and trans-property links between the competitors) and structure of the demand (lower purchasing power, stable demand, regular orders or biddings).

When the changes of price of the suppliers tend to follow similar patterns, practices appear which allow the suppliers to coordinate the changes of price (for instance, price announcements long before the actual date of change and/or exchange of information between the suppliers on subjects such as costs). The existence of "practices that facilitate" can provide a channel for the competitors to signal their price intentions, with no direct communication between them. These practices might weaken competition.

- Product nature: when there are very small differences between the products of the competitors, such as in the case of merchandises.

The factors that can help the cartels to keep working include situations that allow the cartel members to know the price changes of the competitors or the sold amounts, as well as to distinguish those coming from "cheating" because of the understanding, such as changes in consumer demand.

Other influences are:

- When there are exclusive territories (which reduce the competition between retailers for a particular brand), the producers of other brands might take advantage of the stability of the resulting price and share the market for own products.

- When several manufacturers sell through a single retailer, the retailer might facilitate the agreement.

- The professional associations sometimes play a role of facilitating the agreements. Any commercial or professional association seem to have a role in setting the prices. They can benefit of a wider community, as well as of their members. However, the trade associations try to prevent competitive prices in their industry. When an industry is submitted to price inspections, the governments often rely on the relevant professional and trade associations to apply and coordinate the inspections. After the checks are eliminated, the practice of competitors' consultancy over the prices might go on, even if it was thereafter branded as illegal. If the proposed price increases are announced by a trade association, this might show that the association plays a role in price-setting decisions. Sometimes, the professional associations will exclude from affiliation the eligible companies that lower their price.

c) Mergers. When there is a substantial increase of concentration by mergers of acquisitions, the dominance or agreement might be much more profitable. However, when there are few barriers to the entry on a market, or compensatory purchasing power, the anticompetitive influence resulting from the high concentration might be offset.

Company behaviour: vertical aspects

The domination, agreements and mergers can generate additional problems when there are vertical restrictions within the supply chains between the producers, wholesalers and retailers. Any supplier requires the retailers to sell below the minimal recommend price, or the discount levels are observed, so that the buyers are prevented from seeking sources of supply with lower prices.

Conclusions

Sometimes, the dominant position is desired or unavoidable, such as the instance when there are large scale economies, or the markets with strong network effects. Sometimes these markets are regulated by the governmental agencies and this leads to the possibility of regulation. The dominant position on the market may also result from the former state control or from favours.

The number of state owners and of those sanctioned by the marketing authorities was much reduced by the domestic economic liberalization and by the international trade negotiations. However, sometimes, the reforms have been incomplete and the removal of the legal monopolies of the marketing councils was followed by the private monopolies, many times being the object of governmental interventions.

The biddings with fake offers, both for the routine supplies and for the infrastructure projects are common in many countries. The governmental acquisitions are often big and bidding arrangements can have a strong impact on the efficiency of the governmental operations and on the capacity of supplying services to its people. When bidding arrangements occur, it means that the governmental agencies are not able to supply a lower amount of services or of infrastructure for any given budget.

The behaviour of the market enterprises suggests either that the suppliers coordinate their behaviour by agreements of tacitly, or that the large suppliers with market power use their anticompetitive domination in various ways.

If the products are complex or purchased rarely, the buyers don’t have enough information to make informed decisions about the purchases, including about the probable cost, which makes competition less efficient.

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