

## Market Definition by Survey

### Approaches, acceptability and pitfalls

The use of survey evidence in dominance cases has been given renewed significance by the UK Office of Fair Trading (OFT) in its *BSkyB* decision ([2003] UKCLR 240):

*'... the cellophane fallacy means that the Director cannot rely on evidence of switching to determine the relevant market, particularly in circumstances where the 'competitive price' cannot be determined. ...In the absence of meaningful switching data ... analysis of subscribers' preferences can inform market definition'.*

Evidence of strong consumer preferences drawn from survey evidence was used by the OFT to infer that the actual price was likely to be above the competitive price, and to define different relevant (pay TV) markets. Here different approaches to consumer surveys, and their pros and cons are discussed.

#### Survey approaches

Consumer surveys are recognised as a source of evidence on market definition under EU and national market definition guidelines - e.g. EC 97/C 372/03, para 40-41; OFT 403, para 3.6). There are two types of survey approaches - those soliciting evidence on past consumer decisions and behaviour (**revealed preferences**) and those using consumer responses to hypothetical questions (**stated preferences**). This *Casnote* is confined to the latter approach.

Stated preference surveys have been used in competition law proceedings, but frequently in cost-benefit analysis to value so-called 'intangibles'. It is therefore possible to draw on a well developed literature in the design and implementation of such surveys.

There are three main types of stated preference survey approaches which seem relevant market definition:

- ❑ **Price Reaction Surveys** - The EC *Market Definition Notice* states that survey evidence seeking to quantify the Hypothetical Monopolist Test (HMT) is acceptable: *'reasoned answers of customers and competitors as to what would happen if relative prices for the candidate products were to increase in the candidate geographical area by a small amount (for instance of 5% to 10%) are taken into account when they are sufficiently backed by factual evidence.'* For such survey evidence to be useful, the consumers' potential reduction in the quantity consumed must also be quantified. For some

products this is not a problem since the consumption decision is a binary one i.e. whether or not to buy a ticket; or to subscribe to a specific pay TV package. These yes/no responses can be aggregated over the sample to give the percentage response for the group (market) as a whole. In other cases some estimate of the reduction in the quantity demanded will need to be made, and reliable responses may be difficult to elicit from those questioned. If there are concerns about the reliability of responses to output effects, it is possible to use plausible assumptions together with sensitivity analysis, although this will be less satisfactory.

- ❑ **Preference Surveys** - It is not uncommon for consumer preference surveys to be submitted to competition authorities. This happened in *BSkyB*, and in EC, UK and US merger clearances of the *Royal Caribbean/PO Princess/Carnival Cruises* proposed transactions. Often these surveys show that a certain percentage of consumers in the sample have a strong or weak preference for a particular product or product grouping, or that the preferences overlap across statistical or marketing categories. In *BSkyB* the OFT stated that survey evidence which showed that consumers have strong preferences, while not conclusive proof of lack of substitutability, was 'strong evidence' that prices are likely to be above the competitive price, and that a separate relevant market could be defined. This was a rather strong conclusion which is discussed further below.

- ❑ **Conjoint Analysis** - Conjoint analysis is a marketing research technique, recently proposed and used to define markets in antitrust proceedings. It consists of first identifying the critical attributes/characteristics of the different products, and asking those surveyed to place 'valuations' on the different attributes. Those interviewed are asked to allocate a fixed sum - say a budget of 100 points - across each set of product options offered. The individual preferences of each interviewee are then extrapolated using a preference model to estimate the probability of a consumer choosing a particular product i.e. set of attributes. These are then aggregated to derive a demand curve for the product.

#### Issues raised by stated preference surveys

There are potential difficulties with survey evidence generally, and consumer preference surveys in particular:

- ❑ **Survey status** – A survey commissioned specifically as evidence for a competition investigation may have less evidentiary weight. The EC *Market Definition Notice* states that such surveys “.... will usually be scrutinised with the utmost care. Unlike pre-existing studies, they have not been prepared in the normal course of business for the adoption of business decisions” (para 41). The International Competition Network (ICN) also takes this position. In some investigations this will not be a problem as the surveys will have been commissioned for marketing purposes. For others it will be a concern, but it is legitimate to emphasise that the product/consumer substitutability issue in antitrust proceedings is more technically defined than that associated with marketing surveys, and that the Cellophane Fallacy renders other evidence unreliable.
- ❑ **Hypothetical nature** – There will always be concerns that stated preferences do not accurately reveal true preferences and the choices consumers will make in practice. It will be usual for such evidence to be challenged on the grounds of relevance, reliability and bias. The onus will therefore be squarely on those submitting such evidence to ensure that it is carefully undertaken, and subject to cross-checks to ensure its reliability and consistency. Here one can draw on techniques developed by economists and behavioural psychologists in cost-benefit analysis and experimental economics.
- ❑ **Cellophane Fallacy** – In *BSkyB*, the OFT dismissed revealed preference evidence because of the Cellophane Fallacy and the absence of data on the competitive price (see generally our August 1997 *Casenote*). It is not evident that stated preference surveys deal adequately with this difficulty. Price reaction surveys will not if the hypothetical price increase is based on the prevailing price. While it may be possible to use a lower price, this begs the question of what evidence there is that this approximates the true competitive price since the survey itself sheds no light on this. Second, price reaction surveys are subject to sample bias if the prevailing price is above the competitive price. This is because the sample will not include those consumers who do not buy the product but would if the lower competitive price were charged. Since the excluded potential consumers are those who are most price sensitive, this is a significant bias (see below). Such biases are also present in consumer preference surveys since those surveyed and their preferences will be influenced by the prevailing price. Careful consideration will have to be given to these factors in the design and implementation of stated preference surveys.
- ❑ **Marginal consumers** – Consumer preference surveys may not capture product substitutability properly. The fact that a majority or a large percentage of those surveyed have a strong preference for watching football, or consuming crisps, does not reveal information on whether those who have weaker preferences for the product would switch in sufficient numbers to defeat a price increase. Indeed, it is those consumers with weak preferences for the product who are most inclined to switch; and who have the greatest influence on market definition since they determine the response to any hypothetical price increase. Thus, paradoxically, the focus of a stated preference survey should be on consumers who have weak preferences (the marginal consumers), and are most likely to switch, and not as the OFT has contended, a core consumer group with strong preferences. This point goes not to the usefulness of such surveys but their interpretation, and the need to design them so that they capture the correct test for market definition.

#### Conclusions

The search for more rigour in market definition is important and recognised as such by the EC Commission and national competition authorities. It is a truism that all empirical approaches have advantages and disadvantages, and that regulators cannot avoid making judgments over the relevance of and weight to be given to the conflicting evidence generated by different empirical approaches. While stated preference surveys do not provide a complete solution to the difficulties which arise in dominance cases, they can be developed to deal with some of the difficulties raised above, and if properly undertaken provide useful evidence.

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