[Draft] Markets Guidance

[Draft] Markets Substantive Assessment Guidance

5 November 2024

Competition & Markets Authority

Contents

Page

1. Introduction

1.1 This guidance explains the substantive approach of the Competition and Markets Authority (CMA) to the analysis it conducts under the markets regime (Markets Substantive Assessment Guidance). It supersedes guidance on how the CMA undertakes its competitive assessment in markets cases set out in: (i) Market investigations and guidelines (CC3);[1] and (ii) How market studies are conducted (OFT519),[2] and replaces (iii) Market studies and market investigations: guidance on the CMA's approach (CMA3).[3,4] The CMA has also prepared guidance covering (1) what procedures it will follow (see Markets Procedural Guidance); and (2) how it exercises its powers to intervene in markets by accepting or imposing remedies (see Markets Remedies Guidance). This guidance should be read alongside the Markets Procedural Guidance and the Markets Remedies Guidance.

Purpose of this guidance

1.2 The Markets Substantive Assessment Guidance is applicable to the CMA's market studies and market investigations. It is guidance that forms part of the advice and information published by the CMA under section 171 of the Enterprise Act 2002 (the Act).[5]

1.3 The CMA will have regard to the Markets Substantive Assessment Guidance when conducting market studies and market investigations. Where it is appropriate to do so, the CMA may also take account of relevant aspects of the guidance when conducting market reviews.[6] In addition, the CMA will

---

[1] Guidelines for market investigations: Their role, procedures, assessment and remedies (CC3).
[2] Market studies: Guidance on the OFT approach (OFT519).
[3] Market studies and market investigations: Supplemental guidance on the CMA's approach (CMA3).
[4] This document does not seek to replace the markets guidance set out in: CC7, OFT1113, CC2com3, or OFT511. Further, it does not seek to replace the CMA's guidance relating to Super-complaints (OFT548 and OFT514).
[5] A list of the CMA's Markets Guidance (including the Markets Substantive Assessment Guidance) can be found on the following webpage [to be hyperlinked on publication of finalised guidance].
[6] These are reviews, pursuant to the CMA's functions under section 5 (and taking account where appropriate of those under sections 6 and 7) of the EA02, that sit outside the formal framework in Part 4 of that Act which applies to market studies and market investigations.

follow relevant judgments of the Competition Appeal Tribunal (CAT) and other courts in its application of the markets regime[7].

1.4 However, the assessment of markets is inevitably case specific and must take account of the particular market being analysed. The methodologies used to assess markets should not be applied rigidly and mechanistically, and the CMA will consider each market with due regard to the particular circumstances of the case (including the information available and the time constraints that apply).

1.5 Accordingly, whilst this Markets Substantive Assessment Guidance provides a framework for the assessment of markets, the particular circumstances of a sector, market or businesses, and the consumers participating in that market, are the critical factors in any case. The CMA will apply the Markets Substantive Assessment Guidance flexibly, departing from it where it considers it appropriate to do so.[8] While past case references are included in the guidance for illustrative purposes, practices and decisions naturally evolve over time and the cases referenced will not constrain the CMA's approach.

---

[7] The CMA's powers under Part 4 of the EA02 are commonly referred to as its "markets function" or the "markets regime".
[8] The CMA will typically set out its reasons for departing from guidance.

2. Market studies, market investigations and other markets functions

Purpose of the markets regime and the CMA's role

2.1 The CMA's statutory duty is to promote competition for the benefit of consumers.[9] As part of this responsibility, the CMA has functions and powers to examine markets that appear not to be working well for consumers.

2.2 The protection and promotion of consumers' interests is central to the CMA's work, including in performing its markets functions. When markets are working well, firms compete to win customers' business, which creates incentives to meet the existing and future needs of customers as effectively and efficiently as possible: through offering better value for money for their products and services (for example by cutting prices or improving quality or variety), and by developing new products and services in response to customer demand. [10] There may also be benefits from expansion by efficient firms and the entry into the market of new firms with innovative products, processes and business models, and the exit of less successful ones. The process of competition encourages innovation and this ensures a greater range of choice. Innovation can often be an important parameter of competition impacting the development and growth of markets over the longer-term.

2.3 Customers also have an important part to play in ensuring markets work well, stimulating rivalry between suppliers by making informed decisions which reward those firms that best satisfy their needs or preferences. Markets that work well should drive better outcomes for customers, and ultimately consumers,[11] as well as fostering economic growth, as firms respond to

---

[9] Section 25(3) of the ERRA 2013.

[10] In some instances firms compete for a market, rather than in a market, for example, by competing to be the first to claim a patent in a key area, the first to achieve scale in a new market, or to win a public procurement contract or franchise to supply a public service.

[11] Throughout this publication 'customers' refers to both consumers and firms purchasing intermediate products/services used as inputs in the supply chain for a final good or service. Market studies and market investigations, as well as market reviews, may focus on the supply of such inputs and, where markets for those inputs do not work well, it would generally be expected that end consumers would also be worse off than if those markets did work well. In such cases, the CMA may focus on the effect in the intermediate market without necessarily tracing the effect throughout the supply chain to the end consumer (though it may and often will do the latter too).

competitive pressure by striving for efficiency and directing their resources to customers' priorities.

2.4 In contrast, markets that are not working well can result in restricted choice for customers and consumers, higher prices (for example, where inefficient, high-cost firms are protected from new entrants) and blunted incentives to innovate and introduce new technologies, which can slow economic growth.

2.5 There are many reasons why markets may not work well. The CMA's functions and powers under the markets regime enable it to look at markets holistically. They are a flexible set of tools that enable the CMA to assess markets in different ways to see how they are operating and give the CMA a range of options for addressing any problems it finds.

2.6 The CMA's main focus will usually be whether competition is working well and, as a result, driving better outcomes for customers in markets and, ultimately, for consumers. In many cases, poor outcomes may result from a firm or firms holding market power.[12] Such market power may arise from a number of different factors, the most common of which are discussed further in paragraphs 2.50 to2.53 below and in sections 5 to 9 of this guidance.

2.7 Competition, and the way it works in a market, can also, however, be thought of more broadly. Markets work best when both the supply side (the firms) and the demand side (the customers) interact effectively. In addition to the decisions firms make in relation to the goods and services they offer, their quality and the prices they charge, competition is also affected by matters such as the way in which goods and services are sold to consumers, how consumers interact with the market, government policy and regulation. The CMA's examination of markets may therefore also examine how these other matters affect outcomes for consumers (as it often does in market studies).[13]

2.8 For example, the CMA may look at:

[12] There are gradations of market power. Often many firms have limited or transitory market power and only some have a significant degree of market power, which endures over time and gives them the ability to maintain prices above, or restrict output or quality below, the level which would be observed in a competitive market, without the consequent loss of sales becoming unprofitable. In general, the CMA is concerned with more significant or enduring market power, and this is what is referred to in these guidelines.

[13] See for example Housebuilding market study, Children's social care market study, Electric vehicle charging market study, and Care homes market study, among others.

(a) The information available to consumers,[14] how consumers make decisions about what they buy and whether there are other factors, such as a lack of expertise or vulnerability in particular circumstances, that hamper consumers' ability to make decisions. Where relevant, the CMA may also consider the scope and application of consumer protection laws and whether they operate effectively.

(b) The presence and effects of government policy and regulation. This can include, for example, how such policy contributes to the form or shape of the market. It can also include whether particular regulatory provisions (i) achieve their intended objectives; and (ii) may lead to unintended consequences, such as a reduction in output or barriers to entry, that affect the operation of the market. In those cases, the CMA may take account of public policy considerations that underpin regulation and identify the trade-offs for policy makers to consider, even if it is not for the CMA to resolve them.

2.9 Other factors which affect how well markets deliver for consumers, and which may also form part of the CMA's considerations in market studies and market investigations, include:

(a) The existence of costs or benefits which are not reflected in prices (known as externalities), which may lead to under- or over-provision of products or services compared to the level desired by society.[15]

(b) The need for costly upfront investments where the benefits may not fully accrue to a firm making them, or the pay-off may be uncertain, which may mean no firm is incentivised to undertake such investment.[16]

2.10 Competition problems and poor outcomes for customers and consumers, can also arise from what might be described as poor market design. As well as

---

[14] Including how goods and services are sold to them: see section 9 below on the possible impact of choice architecture.

[15]See for example Electric vehicle charging market study paragraphs 25 to 27, Housebuilding market study paragraph 4.120(b).

[16] See for example the discussion of the 'chicken and egg problem' of interrelated demand for EVs and charging infrastructure in the Electric vehicle charging market study, paragraphs 3.30 to 3.31.

issues connected with developments in regulation,[17] these can relate, for instance, to poorly designed or executed privatisation or Private Finance Initiative arrangements;[18] or where public sector provision is replaced by private operators without the adoption of a sufficient regulatory or demand side framework to protect consumers.[19]

2.11 The way new markets develop can also be relevant. Emerging markets are often shaped by rapid technological change. They may evolve in ways that distort competition and produce poor outcomes for customers and consumers. Where it appears that this may be happening, the CMA can examine whether there are ways to influence the market's development at an early stage in a direction which would allow and encourage better outcomes for customers and consumers.[20]

2.12 The CMA's markets functions and powers allow it to consider the relationships between consumer activity in a market, the behaviour of firms in that market, the market's structure and the effects of government policy and regulation. These help it to understand what may be driving poor outcomes for consumers. By looking at these relationships, the CMA can determine whether action that will encourage changes to consumer or business behaviour, the structure of a market or government policy and regulation (or a combination of such actions) will best address market problems and drive better consumer outcomes. The CMA can do this in market reviews,[21] market studies and market investigations, each of which we describe further below. This guidance is about how the CMA will apply those tools to improve outcomes for consumers.

---

[17] Such as uneven or problematic developments in regulatory systems where, for example, incremental regulation adds up to significant barriers and distortions (as in Housebuilding), or where market participants change their to behaviour in response to existing regulation and the regulatory framework is not effectively updated.

[18] See for example, Mobile radio network services.

[19] See, for example, the discussion of private estate management of amenities in Housebuilding.

[20] See, for example, Electric vehicle charging market study.

[21] And other work under section 5 of the EA02.

Market reviews

2.13 The CMA's general function under section 5 of the EA02 enables it to review markets,[22] often as an initial assessment of how the market may be operating and of whether there are issues affecting outcomes for consumers. Examples include the initial work the CMA undertook on Road Fuel,[23] Veterinary Services, the Groceries Market and AI Foundation Models.[24]

2.14 These kinds of reviews enable the CMA to develop its understanding of a market and any issues within it. As described in section 6 of the Markets Procedural Guidance, such reviews enable the CMA to decide whether further consideration of an issue or market is appropriate and so facilitate the efficient and effective use of its and others' resources. A market review may, but need not, be a pre-cursor to a market study or a market investigation, or may lead to a decision that no further action is required.

2.15 The range of work the CMA conducts in a market review may vary. It can include desktop research and engagement with, and informal information gathering from, market participants, consumers and consumer groups, governments, regulators and other interested parties.

2.16 In appropriate cases, the CMA may use some similar analytical approaches to those set out in this guidance in relation to market studies[25] and market investigations. For example, in considering whether there are problems in a market and poor consumer outcomes, the CMA is likely to consider what the market might be expected to look like if it is functioning well and producing good outcomes for consumers.[26]

2.17 A market review may lead the CMA to form the view that any concerns relating to consumers' interests can be addressed by using its other tools.

---

[22] As well as market reviews, the CMA can use its general review function in section 5 of the EA02 to undertake calls for evidence or input. More information on market reviews is set out in the Markets Procedural Guidance and Markets Remedies Guidance.
[23] Road fuel review (publishing.service.gov.uk)
[24] See Veterinary services for household pets, Competition, choice and rising prices in groceries, and AI Foundation Models Initial Report.
[25] The substantive approach to the assessment of the market in terms of the types of concerns considered and how evidence is analysed is often similar to the approach taken by the CMA in market studies.
[26] This may have some similarities to the well-functioning market concept discussed in paragraph [xx] below in relation to market investigations, but the analysis would generally be less detailed than in a market investigation.

That may include taking action to enforce consumer protection law, or issuing advice to businesses, consumers, or governments and regulators (and which advice may include recommendations to such governments and regulators).

2.18 Alternatively, the CMA may come to the view that there are concerns with the way the market operates that it needs to assess further using its formal powers to gather information and evidence. In those cases, the CMA may decide either to undertake:

(a) a market study (where, if required, recommendations are considered the most likely course of action); or

2.19 a market investigation (allowing for the making of recommendations, the taking of remedial action itself in the form of the acceptance of undertakings or the making of aa formal order, or both).

Market studies

2.20 Market studies are examinations into whether particular markets are working well, taking an overview of regulatory and other economic drivers and patterns of consumer and business behaviour.

2.21 As described in paragraph 3.2 of the Markets Procedural Guidance, market studies link the CMA's competition and consumer protection responsibilities. Through gathering intelligence from a range of sources, the CMA will seek to identify with respect to the market(s) under consideration whether there are effects adverse to the interests of consumers and the extent to which steps should be taken to address these effects.[27]

2.22 As well as taking a look at particular markets, market studies can relate to practices (such as sales or marketing techniques) across a range of goods and services. The term 'market studies' is therefore not limited to individual markets in the economic sense.

2.23 On opening a market study, the CMA makes no presumption that there are aspects of the market that harm the interests of consumers. The starting point will generally be to consider how the market might be expected to operate in

[27] Section 130A of the EA02.

the absence of competition issues and where it produces good consumer outcomes. This may have some similarities to the approach in market reviews (see paragraph 2.16 above) or to the concept of a well-functioning market in a market investigation, though may be less detailed than in that latter case. Some of the analytical approaches the CMA may employ as it moves through its market studies are described in the following sections of this document.

2.24 The CMA may conclude following a market study that the market(s) considered raise no material competition or consumer concerns (in that the initial concerns about consumer detriment are not substantiated by the information collected over the course of the study). Alternatively, the CMA may find that further action needs to be taken.

2.25 For example, the CMA may conclude that a market is affected by concerns that would require action by government or regulators and make recommendations to them about the action they should take. Where the CMA's concerns clearly relate to the operation of the market, and the CMA has identified an opportunity to improve outcomes within the market without significant trade-offs with other policy objectives that involve wider political choices outside the CMA's focus, the CMA is more likely to make firm recommendations to government or regulators to address its concerns. Where there are more complex interactions requiring trade-offs with wider policy aims which are not for the CMA to resolve, it may instead offer options for governments or regulators to consider.

2.26 In other cases, the CMA may decide that it should examine matters further through a market investigation or take action through the use of its other tools. Market investigations are described below.

2.27 Further details on the process for conducting market studies are set out in the Markets Procedural Guidance (Chapters 2 and 3).

Market investigations

2.28 When the findings of a market study give rise to reasonable grounds for suspecting that a feature or combination of features (see paragraphs [2.39] to

[2.43])[28] of a market or markets in the UK prevents, restricts or distorts competition, and a market investigation reference appears to be an appropriate and proportionate course of action, the CMA is able to make such a reference. However, a market study is not a prerequisite to a reference: references may also be made of matters which have not been the subject of a market study,[29] provided the statutory reference thresholds are satisfied and the CMA has consulted in accordance with section 169 of the EA02.[30]

2.29 A market investigation may examine any competition problem and identify the feature or features causing the problem. It aims to see if competition within the particular market under review is working well for customers or can be improved.

2.30 The CMA is required to decide, on the balance of probabilities, 'whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of goods or services in the United Kingdom or a part of the United Kingdom'.[31]

2.31 If that proves to be the case, this constitutes an adverse effect on competition (AEC) under the Act.[32] The CMA interprets the phrase 'prevents, restricts or distorts' in the Act broadly to cover any adverse effect on competition, whether actual or potential. It will therefore consider features that affect potential competition in a market (for example, by preventing entry and/or expansion) as well as those that affect the existing market situation. The CMA can consider both short-term and long-term effects on competition arising from features present in the market.

2.32 The overarching framework allows the investigation to consider, and where relevant tackle, AECs from any source. As well as being able to look into the conduct of firms, the CMA can probe for other causes of possible AECs, such

[28] Section 131(2) of the EA02 sets out what is to be construed as a feature for the purposes of Part 4 of the EA02.
[29] For example, following a super-complaint under section 11 of the EA02, the CMA may make a market investigation reference. For further information on super-complaints, see Super-complaints: guidance for designated consumer bodies (OFT514). Examples where the CMA has proceeded to an MIR without a market study have included Mobile radio network services and Veterinary services for household pets.
[30] For further information on the consultation process, see Markets Procedural Guidance.
[31] Section 134(1).
[32] Section 134(2).

as structural aspects of the market, the impact of regulation or the behaviour of customers.

2.33 Whatever the source of a potential AEC, the overall focus of a market investigation is on competition. There may be other problems in the market which are not driven by competition issues (for example, ‘externalities’, such as air or water pollution, the cost or benefit of which is not transmitted through prices, or distributional effects which raise concerns with how the market is performing for some customer groups)[33] which may also be considered as part of an investigation. These may, in appropriate cases, be identified as requiring intervention by other regulators or government, but they would not generally be the main focus of the market investigation.

2.34 Having established an AEC, and identified its causes, the CMA is able to impose a wide range of legally enforceable remedies that typically focus on making the market more competitive in the future and make recommendations for remedial action by other public bodies. Remedies in the context of a market investigation are considered in the Markets Remedies Guidance.

Well-functioning market

2.35 The Act does not specify a theoretical benchmark against which to assess an AEC. In its market investigation reports, the CMA has used the term ‘a well-functioning market’ – ie one that displays the beneficial aspects of competition which make markets work well for customers as set out in paragraphs 2.2 to 2.3 above and ultimately leads to the best outcome for consumers, but not an idealized, perfectly competitive market.[34]

2.36 The well-functioning market benchmark is not a statutory test, but rather an analytical tool used in answering the question of whether there is an AEC. What a well-functioning market benchmark looks like in practice may differ significantly from case to case, depending on the nature of competition and different underlying market features.

[33] These may also include the sorts of consumer and regulatory concerns that can be considered in market reviews and market studies (see paragraph 2.8 above).

[34] As noted in paragraph 2.16 above, the CMA may also consider what it would expect to see in a market without competition issues in its analysis for a market study.

2.37 Typically, however, the indicators that the CMA will consider when assessing whether the market it is considering is 'well-functioning' may include (but are not limited to) whether :

(a) Customers are able to make effective decisions between a range of alternatives and are able to switch between products or suppliers.

(b) Firms face low barriers to entry, expansion and exit and are able to be/are rewarded for operating efficiently, innovating and competing to supply the products that customers want.

(c) Profits earned by firms in the market reflect a 'reasonable' or 'normal'[35] rate of return based on the nature of competition (e.g. taking into account patents, etc.).

(d) Market shares reflect the relative strengths and weaknesses of different firms' product offering (e.g. all else being equal, firms that better meet customers' needs through a better price/quality offering are rewarded with a larger share).

(e) Firms flex parameters of competition in response to rivals and wider market developments (e.g. prices broadly track market wide costs, rivals react to each other's prices and quality changes/innovations/product developments).

2.38 When describing a well-functioning market, the CMA will not seek to set out in detail the competitive conditions that would prevail in such a market. Rather, in its assessment of whether there is an AEC, the CMA will focus on whether certain feature(s) prevent in some way the effective interaction of the demand and supply side of the market, compared to what the market may look like absent the feature(s) and/or absent the effect of the feature(s).[36] Where there are such features, the CMA will consider what effect the feature(s) have in shaping competition.

---

[35] The minimum level of profits required to keep the factors of production in their current use in the long run, ie the rate of return on capital employed for a particular business activity would be equal to the opportunity cost of capital for that activity. What constitutes a 'reasonable' or 'normal' rate of return will be specific to each case.
[36] Taking account of what might be expected in a well-functioning market as described in paragraph 2.36.

2.39 The focus of the CMA's analysis will depend on the specifics of the case and, in particular, the nature of the features identified. For example, certain features may be intrinsic to some extent (as in the case of a natural monopoly) such that the relevant market cannot realistically be envisioned without them or there are no interventions that could directly address the feature itself. In such situations the CMA may focus more on what the market may look like absent the effect of the feature rather than absent the feature itself.[37] In addition, where competition in a market is affected by an intrinsic feature, this is something that may influence the assessment of remedies, for example pointing towards remedies that mitigate the effect of the feature rather than addressing the cause (see Markets Remedies Guidance).

Features

2.40 The Act states that the following may be taken to be a 'feature' of a market:[38]

(a) the structure of the market concerned or any aspect of that structure;

(b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or

(c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

2.41 A market feature may therefore relate to the structure of the market or may arise from the conduct of any market participant. Specifically:

(a) Structural features may include high levels of market concentration, high entry barriers, common ownership of competing assets and, in certain limited instances, buyer power.[39] They may also include government policy and regulation.

[37] For example, in a market characterised by natural monopoly, the well-functioning market may be envisioned as one where the incumbent firm acted as if the market were contestable and so set prices, quality and other parameters of competition as if it were constrained by potential competition.
[38] Section 131(2).
[39] Buyer power is the ability of a firm to secure from its supplier(s) prices or other terms in its favour. While buyer power generally helps markets work well (as it represents the other side of the coin to suppliers' market power),

(b) 'Conduct' of a market participant (whether supplier, acquirer or customer and whether or not in the goods or services referred for investigation) may include sellers' strategies which foreclose rivals, co-ordinate behaviour to limit competition or impose unjustifiably high switching costs on customers. The behaviour of customers can also be a feature limiting competition between firms[40] and may involve customers being unable or unwilling to shop around or being unable to fully assess all competitive parameters of a good or service. Conduct features also include any failure to act, whether intentional or not, and any other unintentional conduct.[41]

2.42 The Act does not require the CMA to state whether particular features of a market are to be considered structural features or an aspect of conduct. Such categorization is not important. Since the concept of a feature is broad, the CMA has the flexibility to investigate a wide range of possible market features, each of which may have effects on different aspects of competition (see paragraphs 2.51 to 2.53 below).

2.43 Moreover, how directly any feature identified by the CMA results in harm to competition may vary (ie some may be directly causing harm and others may be doing so indirectly).

2.44 As discussed in paragraph 2.23 in relation to market studies, on opening a market investigation the CMA makes no presumption that there are market features that harm competition. A CMA market investigation may find that there are no such features giving rise to an AEC in the relevant market.[42]

---

there may be certain circumstances in which it raises concerns. For example, in the Groceries market investigation the CC found the exercise of buyer power by certain grocery retailers in relation to their suppliers of groceries, through the adoption of supply chain practices that transfer excessive risks and unexpected costs to those suppliers, was a feature of the markets for the supply of groceries by all grocery stores, which prevents, restricts or distorts competition in connection with the acquisition of groceries by large grocery retailers and some wholesalers and buying groups.

[40] Market investigations allow the CMA to look at customer behaviour and customer vulnerability in relation to their implications for competition, instead of just looking at them as consumer protection issues. See for example the Funerals market investigation.

[41] Section 131(2) and (3) of the EA02. For example, customers remaining with a default option rather than actively considering and selecting alternative options may weaken competitive pressure on the provider of the default option. Another example may be firms failing to provide information or infrastructure to allow competitors to integrate complementary products or services with their products such that other firms are prevented from offering effective alternative options.

[42] For example, see Movies on pay TV market investigation, 2 August 2012.

Theories of harm

2.45 To provide focus and structure to its assessment of the way a market is working, the CMA sets out one or more 'theories of harm'. A theory of harm is a hypothesis of how harmful effects might arise in a market and adversely affect customers and consumers. The use of the term does not imply any prejudgement of a competition problem in a given market.

2.46 Focusing the substantive assessment on testing theories of harm helps the CMA to understand the issues in the market and to evaluate evidence. This enables it to assess if there is a problem and, if so, the causes of the problem and ultimately decide the statutory questions when considering both a market investigation reference and whether the AEC test is met in a market investigation. The use of theories of harm also helps the parties by identifying the issues that will be investigated and indicating the information that will be gathered.

2.47 The CMA will generally take a forward-looking approach to the assessment of any theories of harm, considering competition both now and in the future.

Formulating and reviewing theories of harm

2.48 The starting point for formulating theories of harm depends on the situation:

(a) In a market review or market study the CMA's starting point will be intelligence gathered from a range of sources.[43] In particular, through gathering intelligence the CMA can identify markets which appear not to be working well and in doing so will identify the possible problems in a market and an explanation of their possible causes.

(b) In a market investigation the CMA's starting point will generally be the work already done by the CMA or external referring body, particularly any

[43] Sources may include: (i) complaints from businesses and trade associations; (ii) consumer complaints data from Citizens Advice; (iii) suggestions from organisations representing consumer interests; (iv) super-complaints from designated consumer bodies (see What are super-complaints? - GOV.UK (www.gov.uk)); (v) suggestions made by other Government departments, local authority Trading Standards Services (TSS) and regulatory Bodies; (vi) CMA concerns based on information acquired in the course of enforcement and advocacy work; (vii) intelligence gathering from publicly available sources, and (viii) CMA research.

outcome or decision documents[44] and the terms of reference (see Markets Procedural Guidance paragraphs 4.32 to 4.36). These will not only include observations on the structure of the market but they will also have described the products or services the relevant referring body considers are affected and the features it has grounds for suspecting may be the cause of harm to competition. At this stage, the CMA supplements the analysis carried out so far and may formulate theories of harm involving other possible aspects of the market on the basis of its own analysis.

2.49 Although the CMA aims to focus on those aspects of the market that appear most likely to influence how it is working, these are not always clear at the outset of a market study or a market investigation. This is particularly the case in market studies where the CMA generally starts from a lower base of knowledge. Therefore at the start of a study or investigation one or more theories may often be set out in broad, generic terms.[45]

2.50 As the CMA's investigation progresses, the theories of harm often become increasingly specific to the investigation, some theories of harm may be dropped and others put forward. The theories of harm investigated need not be mutually exclusive. In exploring theories of harm or deciding to drop them, the CMA will seek to prioritise its resources appropriately based on the information available.

Market power and potential sources of competitive harm

2.51 As noted in paragraphs 2.5 to 2.13, there are many reasons why markets may not work well. The functioning of a market and how well it ultimately delivers for consumers can be affected by any or all of the decisions firms make in relation to the goods and services they offer, how they sell those goods and services, how consumers interact with the market, the structure of the market

---

[44] But, as noted in Markets Procedural Guidance, the CMA proceeds wholly independently of the referring body. This includes through the use of an independent group when the referring body is the CMA itself (see paragraph 4.38 of the Markets Procedural Guidance).

[45] See discussion of market study notices and terms of reference for market investigations in paragraphs 3.4 to 3.6 and 4.32 to 4.36 respectively of the Markets Procedural Guidance for more on the information which is set out at the commencement of a market study or market investigation.

and the impact of government policies and regulation. A key area of the CMA's focus will be on the causes and effects of market power.

2.52 When one or more suppliers enjoy a significant degree of market power, they are able to influence market outcomes and other important aspects of competition to increase their profits to the detriment of customers. The features that give rise to suppliers having a significant degree of market power may cause an AEC to arise. Such market power can be exerted by a single firm, or by several firms acting independently of one another in a market (this is termed 'unilateral market power'). It can also arise as a result of several firms coordinating their conduct in the market. Such coordination can be tacit, making it difficult to distinguish it from non-coordinated oligopolies.[46]

2.53 The sources from which market power may arise are numerous and specific to different markets. However, many market studies and market investigations draw on a limited number of common potential sources through which competition may be harmed. These reflect the nature of the competitive process. Constraints helping to ensure that competition is effective mainly come: first, from other firms already in the market; secondly, from firms that could readily enter it; and, thirdly, from their customers. Conversely, in past cases competitive harm from market power has often been found arising from:

(a) Limited alternatives available for customers;

(b) barriers to entry and expansion;

(c) coordinated conduct;

(d) cross-market relationships; and

(e) weak customer response.

[46] Whilst market power can manifest itself through coordinated conduct, unilateral market power can be enjoyed by a number of firms even where they act independently, albeit aware of each other's presence—so-called 'non-coordinated oligopolies'. In such situations, each firm knows that it can affect market prices and hence its rivals' profits. This awareness conditions the way in which competition occurs, although the precise way it does so will depend on the specific characteristics of the market in question. In practice, it may on occasion be difficult to assess whether a particular market outcome has been driven by tacitly coordinated conduct or is the result of a non-coordinated oligopoly.

2.54 The list is not exhaustive. These (and other) sources are not mutually exclusive and some may have mutually reinforcing effects. For example, barriers to entry and expansion have been found to be features in combination with, and reinforcing, other features, in many market investigations.[47]

Factors which may counteract potential competitive harm

2.55 In assessing theories of harm, the CMA also considers factors that may, on the other hand, benefit competition and operate to the benefit of customers. While such factors are considered in both market studies and market investigations, in market investigations the CMA will assess whether the benefits to competition outweigh the harm as part of the AEC test.

2.56 Such factors include:

(a) Efficiencies which enhance rivalry between firms; and

(b) the prospect of entry and expansion which is timely, likely and sufficient enough to constrain firms' behaviour. In this context, the ability for customers to exercise buyer power by sponsoring entry or self-supplying may be relevant in some markets.

How the CMA assesses evidence

2.57 The CMA does not have a prescriptive list of evidence that it will take into account in its assessments. Instead, the CMA will in each case undertake reasonable evidence gathering, consider the relevant available evidence and decide the weight to place on that evidence in its decision-making. The evidence gathered and used will depend on factors such as the theories of

[47] For example, this was the case in relation to crematoria in the Funerals market investigation, where the CMA identified AECs as arising as a result of low levels of customer engagement, high barriers to entry and high levels of concentration. In the Energy market investigation, the CMA found an AEC in the prepayment meter segment as a result of technical constraints that limit the ability of all suppliers, and in particular new entrants, to compete to acquire prepayment customers as well as softened incentives on all suppliers, and in particular new entrants, to compete to acquire prepayment customers, due to higher costs to engage and acquire prepayment customers and a low prospect of successfully completing the switch of indebted customers.

harm being investigated, the nature of competition in the marketplace and what evidence is available.

2.58 The CMA must take reasonable steps to acquaint itself with the relevant information to reach a decision on the statutory questions.[48] Where the CMA has persuasive evidence of a particular proposition to answer a statutory question, there may be little additional value in gathering further evidence on the same proposition and evidence submitted on those points may need to be more persuasive to counter it. In considering challenges to CMA decisions, the CAT has said that it will not intervene merely because it considers that further inquiries would have been desirable or sensible, but will assess whether the CMA has a sufficient basis in light of the totality of the evidence available to it for making the assessments and in reaching the decisions it did.[49]

2.59 The CMA also has a wide margin of appreciation in its use of evidence.[50] Given the case-specific nature of market reviews, market studies and market investigations, the CMA may apply different analytical methodologies and approaches in different cases.[51] In assessing the evidence, the CMA is not required to make precise predictions about the future, such as whether any particular innovations will take place or whether certain firms will enter or exit the market.[52]

Range of analysis

2.60 The CMA only carries out analysis that it considers necessary to reach a view on the matters specified in the market study notice or market investigation reference and make a decision on the statutory questions, as relevant. As the

---

[48] *BAA Limited* v *Competition Commission* [2012] CAT 3, paragraph 20(3); Secretary of *State for Education and Science* v *Tameside Metropolitan Borough Council* [1977] AC 1014, at 1065B; *Barclays Bank plc* v *Competition Commission* [2009] CAT 27, at [24].
[49] BAA Limited v Competition Commission [2012] CAT 3, paragraph 20; *R* v *Royal Borough of Kensington and Chelsea, ex p. Bayani* (1990) 22 HLR 406, at 415.
[50] See *Société Coopérative de Production SeaFrance SA* v *CMA* [2015] UKSC 75 paragraph 44.
[51] *JD Sport Fashion plc* v *Competition and Markets Authority* [2020] CAT 24, paragraph 97.
[52] *BSkyB and Virgin Media* v *Competition Commission and BERR* [2010] EWCA. Civ 2, paragraph 69. See also *Intercontinental Exchange, Inc.* v *CMA and Nasdaq Stockholm AB* [2017] CAT 6, paragraph 246.

CMA scrutinizes evidence, it will prioritise the uses of its resources to undertake as wide and as deep analyses as appropriate.[53]

2.61 In addition, the CMA does not normally assess specific pieces of evidence in isolation when considering the statutory questions, although it is common for the CMA to weight pieces of evidence differently. In attaching weight to different pieces of evidence, there is no set hierarchy between quantitative evidence, such as consumer surveys or statistical or econometric analysis, and qualitative evidence, such as internal documents or the statements or conduct of market participants. The CMA may attach greater weight to one or the other as appropriate in the circumstances, depending on the relative quality of such evidence.[54]

2.62 The CMA's analysis covers all relevant aspects of competition, and may cover other matters that affect outcomes for consumers (see paragraphs 2.5 to 2.12 above). It often assesses the ability or incentives firms have to offer better prices or terms to customers and to strive for efficiency, better ways of operating and improved products.

2.63 Whatever form competition takes, the CMA considers its effects and expected development over time. Although there may be circumstances in which analysis can be conducted only on the basis of the current state of the market, the CMA also considers how a market may evolve. In doing this, some aspects of the CMA's assessment may be subject to a large degree of uncertainty. Whilst the degree of uncertainty will be appropriately weighted in the CMA's assessment of whether the relevant standard of proof is met, the presence of some uncertainty will not in itself preclude the CMA from concluding on any of its statutory questions on the basis of all the available evidence.

2.64 In the context of sectors that are characterised by fast-moving technological and commercial developments or markets where market conditions evolve rapidly, the types of evidence that are available to the CMA may be more

---

[53] The need for the CMA to focus on the bigger issues in reaching a decision on the statutory questions has been underlined in Competition Appeal Tribunal (CAT) judgments: in *Barclays Bank plc* v *Competition Commission* (2009), CAT 27 (paragraph 21); citing *Tesco* v *Competition Commission* (2009), CAT 6 (paragraph 139), the CAT said: 'the depth and sophistication called for in relation to any particular relevant aspect of the inquiry needs to be tailored to the importance or gravity of the issue within the general context of the Commission's task.'

[54] *Aberdeen Journals* v i [2003] CAT 11, paragraphs 126-127.

restricted (for example, in many instances recent evidence of market conditions will be a good indicator of future market conditions, but this may not be the case in nascent markets with dynamic effects). In such cases, the CMA may place particular weight on evidence such as internal documents, similarities between the characteristics of the products or services that are under development, and the views and expansion plans of market participants. As with uncertainty, the absence of certain types of evidence such as historical data will not in itself preclude the CMA from concluding on its statutory questions on the basis of all the available evidence assessed in the round.

Qualitative and quantitative analysis

2.65 The CMA will seek data and information about a range of factors and apply a range of analytical techniques, both qualitative and quantitative, so as to understand the nature of competition in the market under consideration and assess the theories of harm.

2.66 In doing this the CMA will maintain an open mind regarding the assessment of evidence in each case. By way of example, the CMA regularly requests internal documents and its interpretation of that evidence will be affected by the context in which it was generated. For example:

(a) Where internal documents support claims being made by market participants or third parties that have an interest in the outcome of the CMA's investigation, the CMA may be likely to attach more evidentiary weight to such documents if they were generated prior to the opening of any market study or market investigation, or if they are consistent with other evidence.

(b) An absence of internal documents pointing to, for example, competitive interactions between certain market participants may not be probative if the market participants do not normally generate documents in the ordinary course of business.

2.67 The CMA may also consider the purpose and effect of any internal document (for example, whether it was a document for the board or executive decision-making). When considering the weight to place on internal document evidence the CMA will consider that evidence alongside all of the evidence that it has.

2.68 The CMA often commissions surveys,[55] normally on customer behaviour and attitudes, particularly in market investigations, but also on occasion in market studies.[56] It will use various other means of collecting evidence, including questionnaires to parties, requests for internal company documents (including management information), and discussions with customers, investors and other market participants. (See Markets Procedural Guidance on the procedures for information-gathering).

2.69 Parties may also choose to provide the CMA with information they consider relevant to the investigation. When making submissions involving technical economic analysis, parties should adhere to the principles set out in the CC's publication *Suggested best practice for submissions of technical economic analysis from parties to the Competition Commission*.[57] In addition, the CMA's *Good practice in the design and presentation of customer survey evidence in merger cases* is also relevant in market studies and market investigations.[58]

2.70 The CMA is not required to quantify any of its findings, but may choose to do so on in particular cases. Whether and the extent to which the CMA will seek to quantify particular effects (eg on the adverse effects on competition in a market investigation), and the degree of precision with which this is attempted, is likely to vary from case to case.[59] Relevant considerations in determining the extent and nature of quantification that the CMA will carry out in a particular case may include:

(a) The scale of any particular effect: if it is clear from an initial assessment that a particular effect is unlikely to be material, it may not be necessary to quantify its magnitude with great precision to reach a view about the scale of any harm to competition. Similarly, when it considers that the harm is

---

[55] As part of its evidence gathering the CMA may also commission other customer research (eg qualitative research based on focus groups or interviews) and field and online experiments (see Experiments at the CMA: How and when the CMA uses field and online experiments - GOV.UK (www.gov.uk)).

[56] Market studies where the CMA has undertaken a survey include the Mobile ecosystems market study and the Digital comparison tools market study.

[57] Suggested best practice for submissions of technical economic analysis from parties to the Competition Commission (publishing.service.gov.uk).

[58] Good practice in the design and presentation of customer survey evidence in merger cases.

[59] This includes depending on whether the case is a market study or market investigation. In general, the extent to which the CMA will seek to quantify particular effects is less in market studies than market investigations.

material, the CMA may decide that quantification would not add value to its assessment.

(b) The practicality of conducting quantitative analysis: whether reliable data is available and the extent to which it is possible to quantify a particular effect with any degree of accuracy.[60]

(c) The resource implications: the costs in terms of time and resources to acquire and process the data, to apply a suitable methodology and to test the robustness of the results would not be justified if the outcome would not significantly help the CMA to reach a decision on the statutory questions.

The CMA's assessment

2.71 While every market study and investigation differs, the CMA's assessment will generally include:

(a) An assessment of the nature of competition. Understanding how competition operates in practice in a market is important as it allows the CMA to apply the appropriate framework to its analysis and collect the relevant evidence.

(b) An assessment of market outcomes. Understanding the outcomes being produced in a market (such as levels of prices, profit and quality) can help the CMA to understand whether or not the market is functioning well.

(c) An assessment of its theories of harm (see paragraphs 2.44 to 2.53 above). This involves understanding the potential sources of competitive harm the CMA observes.

(d) As part of its assessment of the theories of harm and/or of the market outcomes, the CMA will consider any factors which may remove or mitigate the competitive harm (see paragraphs 2.54 and 2.55).

2.72 The CMA's assessment will also consider the relevant goods and services which should be included within its analysis, although the CMA does not have

[60] In general, it is likely to be more straightforward to estimate the effects on prices in the shorter term than to quantify the longer-term effects on dynamic and non-price competition.

to provide a precise definition of the relevant market or markets it is considering.

2.73 In the sections below we deal with each of these in turn. In particular:

(a) Section 3 sets out the factors that the CMA typically considers when assessing the nature of competition.

(b) Section 4 sets out the factors that the CMA considers when assessing market outcomes.

(c) Sections 5 to 9 cover the five sources of competitive harm identified at paragraph 2.52.

(d) Section 10 covers factors which may mitigate or prevent competitive harm arising.

(e) Section 11 covers market definition.

3. Nature of competition

3.1 To develop robust findings in either a market study or market investigation, the CMA collects and analyses information to understand how a market operates and how competition takes place (ie the nature of competition).[61] The CMA's analysis of these factors continues throughout market studies and market investigations and informs the theories of harm being investigated and how they are analysed. In doing this, the CMA may consider both how the market currently operates and the likely development of the market in the future.

3.2 Understanding how competition takes place in practice in a market is important as it allows the CMA to apply the appropriate framework to its analysis and gather the relevant evidence to carry out its assessment.

3.3 Every market is different and therefore the specific factors relevant to understand the nature of competition will vary. While it is not possible to provide a comprehensive list of all factors the CMA may consider, examples of such factors include:

(a) how products are purchased: negotiations, tenders, list prices, framework agreements;

(b) what the main parameters of competition are: price, quantity, quality, brand and reputation, convenience, innovation;

(c) how these parameters are flexed: per individual customer, customer category, channel, nationally, globally;

(d) how pricing works at a high level: per unit, fixed fees, subscriptions;

(e) firms' business models: how products are supplied, links to the firms' broader activities (eg complements, ecosystems, two-sided platforms, secondary products) and monetisation strategies;

(f) customer behaviour and decision-making processes: what customers want, what they know about the products available, their purchasing

[61] The CMA will also usually do something similar in a market review, as part of the development of its understanding of the market and any issues within that market.

journey, whether they demonstrate certain behaviours such as inertia, lock-in, multi-homing, preference for bundles, etc;

(g) key market features: eg network effects and the rate of technological change;

(h) regulation and government policy: how regulation shapes the nature and type of products or services which can be provided, what requirements are placed on firms seeking to operate in the market, whether and how different branches of government get involved in supply or procurement of products or services, etc;

(i) the appropriate time horizon: frequency of purchases and switching, length of contracts and procurement, foreseeability of the future; and

(j) the history of the market and any significant changes that are anticipated in the market in the foreseeable future.

3.4 Different aspects of how competition works will be important in different cases. Below we set out examples of the types of issues which have come up across a number of different cases:

(a) two-sided platforms; and

(b) local markets.

Two-sided platforms

3.5 Some firms operate two-sided platforms which supply services to two distinct but related customer groups. Examples include media publishers or social media platforms, which serve consumers on one side and advertisers on the other; shopping centres, which serve both retail tenants and shoppers; and online food delivery platforms, which serve both restaurants and consumers.[62]

3.6 Two-sided platforms are often characterised by network effects.

[62] The CMA has considered two-sided platforms in a number of cases including Digital comparison tools market study, Online platforms and digital advertising market study, and Mobile ecosystems market study.

(a) Direct networks effects arise where the value of the product for customers on one side of the platform depends on the volume of users on the same side of the platform. For example, the value of a social network to a user will depend on the number of other users they know using that social network.

(b) Indirect network effects arise where the value of the product for customers on one side of the platform depends on the volume of users on the other side of the platform. For example, the value of a mobile operating system to a user depends on the volume and quality of native apps they can access on that operating system. Indirect network effects may operate in one direction (eg a social network will be more attractive to advertisers if it has more users, but not vice versa) or both directions (eg a food delivery platform will be more attractive to users if it has more restaurants and vice versa).[63]

3.7 Where network effects are strong, the growth of a two-sided platform may be self-reinforcing: growth in customer numbers increases network effects; increased network effects attract more customers; more customers lead to greater network effects, and so on. In some circumstances, this may lead to a 'tipping' effect, where one platform gains a position of significant market power and smaller platforms exert only a weak constraint and find it difficult to expand.

3.8 Network effects and the risk of tipping may influence the CMA's competitive assessment of two-sided platforms. For example:

(a) Where network effects are important larger platforms are more likely to have market power as they will be a more attractive option for users when compared to smaller platforms with less significant network effects. For example, search engines are subject to direct network effects, in the sense that users benefit from increased quality as the search engine acquires a greater number of users. This is because search engines can use data showing how users responded to past searches in order to improve their ranking algorithms, and return more relevant results to users. In the Online platforms and digital advertising market study the

[63] Two-sided platforms sometimes also involve users on one side of the platform being offered a product or service at a zero price.

CMA found that this was one of the factors that insulated Google's search engine from competition.

(b) Barriers to entry are likely to be high. Barriers to entry may also be increasing for each successive entrant: as the pool of available users shrinks, the cost of building sufficient network efficiencies to compete may rise.

(c) The effect of these network effects may be amplified if there are barriers to switching platform or using multiple platforms. Such barriers can arise naturally in a market or be due to the actions of firms (eg restrictions on interoperability).

3.9 When assessing theories of harm in markets involving two-sided platforms, the CMA may consider each side of the platforms separately, or it may consider the overall competition between platforms (incorporating both sides in one assessment). The CMA's approach will depend on:

(a) **How competition works**. Where competition primarily involves platform operators improving aspects of their offer that affect one side of the platform (for example, charges applied or service levels offered to users on one side), the CMA may assess each side separately.[64] Where competition is focused on aspects of the platform that affect both sides (for example, improvements to technology that benefit the overall efficiency of the platform), the CMA may assess both sides together.[65]

(b) **Competitive conditions**. Where competitive conditions (such as the number and strength of available alternatives) are different on the two sides of the platform, a platform operator may have different incentives as regards what it offers to users on either side, and the CMA may therefore assess each side separately.[66]

---

[64] For example, the CMA assessed competition in consumer services and competition in digital advertising separately in the Online platforms and digital advertising market study.
[65] For example, the CMA considered both sides of the market in its assessment of operating systems competition in the Mobile ecosystems market study.
[66] For example, in the Digital comparison tools market study the CMA assessed how Digital Comparison Tools (DCTs) competed for consumers separately to assessing the balance of negotiating power between DCTs and suppliers.

(c) **Indirect network effects**. Where indirect network effects are strong, the platform operator's incentive to compete for users on each side of the platform are more likely to be influenced by competitive conditions on the other side of the platform. When they are strong in both directions, the assessment of the two sides may be sufficiently closely linked that a single assessment would be appropriate.

3.10 Firms can also operate multi-sided platforms that intermediate between more than two customer groups. This is a common business model for digital platforms. The guidance set out in this section relating to two-sided markets can be extended to multi-sided platforms. Indeed, the effects discussed in this section are likely to be exacerbated the more sides there are to a platform. For example, it is likely to be harder for a new entrant or a smaller competitor to attract customers away from a larger platform in the presence of indirect network effects between multiple sets of customers than it is, all else equal, when there are two sets of customers. [67]

Local markets

3.11 In some industries customers purchase products locally. Firms that compete in many different local areas can set their competitive offering uniformly across all local areas, or flex their offering in each local area depending on the specific competitive conditions, or take a mixed approach where certain aspects of competition are set uniformly at a national level, while others are set at a local level. The CMA will consider how competition takes place in the market or markets and how the local and national levels interact in order to ensure that it then applies the appropriate framework to the analysis of any theories of harm.

3.12 The CMA will conduct its competitive assessment at the aggregate level where firms mainly compete by improving aspects of their offer in a uniform way at the national level, or where the local variation in the competitive offering is not driven by differences in competitive conditions (but rather, for

[67] Some firms build large 'ecosystems' of complementary products and services around their core service. While this type of integration can deliver efficiency savings and improve the consumer experience overall, it can also increase barriers to entry/expansion, insulating these core services from competition. Indeed, new entrants or smaller competitors will find it harder to compete as they may have to enter across a range of products/services to effectively compete in relation to the core services.

example, by differences in local demand), or where the competition concerns under investigation apply across local markets.[68]

3.13 Where firms mainly compete by flexing aspects of their competitive offering that are tailored for the specific competitive conditions within each local area, the CMA's assessment may focus on competition at this narrower level. The CMA will typically only carry out an assessment at both the local and the aggregate national level where important aspects of competition take place at each level.

3.14 The broad principles set out in this sub-section may also apply to cases where firms are active across multiple markets or segments of other types, such as product segments, customer groups, distribution channels, temporal markets (such as 'peak' and 'off peak' ticket sales), or across the supply of standalone and bundled services.

---

[68] In some cases or in relation to certain theories of harm, while there may be aspects of local competition, it may not be necessary to engage in a detailed assessment of local competition where the competition concerns under consideration apply across those local markets. This was the case in the Funerals market investigation where the CMA stated that 'Our analysis of potential distortions in competition is not focused on individual local markets, but rather on market structure or behaviour that potentially distorts competition between funeral directors across many, or all, local markets.' See paragraph 8.13 of the Funerals market investigation final report

4. Market outcomes

4.1 Outcomes in a market can provide evidence about how that market is functioning. Evaluating these outcomes helps the CMA assess the theories of harm it is considering and the extent to which those theories of harm may be leading to customers being harmed, ie the degree and nature of 'customer detriment'.

4.2 Outcomes that the CMA may consider include prices and profitability, and non-price indicators such as levels of innovation, product range and quality. In some cases, the CMA may also consider market shares and concentration as an outcome, for example in considering the level of choice available to customers. Measures of market concentration are discussed further in paragraphs 5.6 to 5.10 below.

4.3 Market shares, concentration, prices and profits are among the more observable and measurable outcomes. An analysis of these may be useful in assessing customer detriment. However, even if other outcomes, such as quality and innovation, are less quantifiable they may be no less important to customers. In addition, there may be linkages between outcomes[69] and therefore the CMA will not normally consider them in isolation.

4.4 The rest of this section deals in turn with: (i) prices and profitability; and (ii) non-price indicators.

Prices and profitability

4.5 The types of analysis the CMA may undertake on prices and profitability depend on the data available, the nature of competition and the theories of harm under consideration.

Prices

4.6 In markets subject to effective competition, prices are likely to respond to changing supply and demand conditions and firms will seek to win business

---

[69] The extent to which prices respond to changes in costs and the question of whether those costs are at an efficient level, for example, may have implications for a firm's profitability, and the level of investment may have implications for efficiency and product or service quality.

by improving their prices and other aspects of their offer. Given this, the CMA will generally seek to gather information on pricing strategies, current prices and how prices have evolved over time. This may include seeking to understand whether there are price differences across different dimensions (between suppliers, customer groups, geographical areas, time periods, etc.).

4.7 The CMA may analyse the pricing data in different ways, ranging from simple comparisons[70] to more sophisticated methods involving econometric analysis.[71] The pricing analysis the CMA conducts in each case can help it evaluate the theories of harm it is assessing. For example, increasing prices over time may indicate a lack of competition, or short-term discounts followed by price increases might indicate high switching costs or customer inertia (see section 9 on weak customer response).

4.8 However, there may be several factors affecting prices and the CMA will take this into account when considering what inferences can be made from its analysis of prices. In particular, the CMA will consider any pricing analysis alongside other evidence as appropriate. For example, when observing a trend of increasing prices the CMA will seek to understand the extent to which costs have increased at the same time. This may be done by considering price-cost margins[72] (although the CMA will need to consider how appropriate price-cost margins are in any given case and a fuller analysis of profitability may be required to establish whether prices are on average above the competitive level,[73] as described below).

Profitability

4.9 One approach to the question of whether prices are above competitive levels is to consider the profitability of the business activity being investigated. In many cases, the CMA's focus will be on the largest incumbent firms in the market or sector. However, in some cases the CMA may also consider the

---

[70] For example, the CMA assessed trends in prices and average revenues and differences in prices within local areas in assessing outcomes in funeral director services in the Funerals market investigation.
[71] For example, in the Road fuels market study the CMA assessed drivers of geographic variation in prices using econometric modelling.
[72] Typically a price-cost margin is calculated by subtracting some measure of marginal cost from revenue and expressing the difference as a percentage of revenue. Generally, this analysis is feasible only if it is possible accurately to measure price and some version of marginal cost, usually average incremental cost.
[73] i.e. the level which would be observed in a well-functioning market.

profitability of less well-established firms with smaller market shares, eg for comparative purposes, or to ensure it gathers a sufficient coverage of data where markets are more fragmented. Where the business activity being investigated is only one part of the firms' activities, it will be necessary to take this into account.

4.10 In its analysis, the CMA is concerned with economic profits, and these can differ in important respects from accounting profits. The CMA will generally derive the profitability of the relevant business activity by identifying the relevant revenues and costs for that business activity, including appropriate treatment of assets and liabilities in determining the capital employed and an allowance for the cost of capital. More information about the CMA's approach to the calculation of profitability is in Annex A (the measurement of profitability).

4.11 In principle, firms in a competitive market would not generally earn more than a 'normal' rate of profit – ie the minimum level of profits required to keep the factors of production in their current use in the long run.[74] The profitability of firms in the market can therefore be a useful indicator of competitive conditions in a market (see paragraphs 4.13 and 4.14).

4.12 In practice, a competitive market would be expected to generate significant variations in profit levels between firms and over time as supply and demand conditions change, but with an overall tendency towards levels commensurate with the cost of capital of the firms involved. At points in time the profitability of some firms may exceed what might be termed the 'normal' level. There could be several reasons, including cyclical factors, transitory price or other marketing initiatives, and some firms earning higher profits as a result of past innovation or superior efficiency.

4.13 However, a situation where profitability of firms in the market has exceeded the cost of capital over a sustained period could be an indication of limits in the competitive process.

4.14 For example, the ability of firms to earn profits persistently above the competitive level could indicate the presence of entry barriers (see paragraph

[74] The rate of return on capital employed for a particular business activity would be equal to the opportunity cost of capital for that activity.

6.9). A situation where a firm (or few firms) with a larger market share has earned profits that have been persistently above the competitive level may indicate significant market power, which in turn may arise from various sources (see paragraph 2.52). A situation where levels of profitability have remained persistently high and stable over time across several incumbent firms may indicate coordinated conduct.

4.15 The extent to which the results of profitability analysis indicate limitations in the competitive process may depend on both the size of the gap between the level of profitability and the cost of capital, and the length of the period over which the gap persists.

4.16 The appropriate time-period over which to examine the persistence of the gap between profitability and the cost of capital may vary according to the specific market. The pattern of investment and the nature of sources of competitive advantage (eg advertising, research and development (R&D), more efficient production) may affect the CMA's view of the relevant timescales over which it would expect to see competition playing out in the market. Where large and risky investments have been made, the CMA would expect to see a normal level of profitability restored over a relatively long timescale.

4.17 The CMA will consider the analysis of profitability in conjunction with other information about the operation and nature of the market concerned. This may be particularly important, for example, in cases where a persistent gap is not unequivocally substantial. Moreover, as with other forms of analysis, the CMA's interpretation of profitability analysis may be affected by the quality of the data available (See section on the gathering and analysis of evidence, paragraphs 2.56 to 2.69).

4.18 The variation in profits over time will be an important consideration and the CMA will seek to understand the reasons for the observed trend. Where the size of the gap between the level of profitability and the cost of capital has grown over a period, the competitive conditions may have worsened. Where that gap has fluctuated, the CMA may consider whether, taking the time-period as a whole, profits have exceeded the cost of capital for firms in the market.

4.19 A CMA finding of low profitability would not necessarily signify that competition in the market is working well. Low profitability may be concealing ineffective competition. Reasons for this may include:

(a) A period of low profitability may occur during the course of a downturn in trading conditions, regardless of the state of competition in the affected market.

(b) Inefficiency of firms may result in firms charging high prices but earning low profits. This is likely to arise from one of two scenarios, ie competition is weak because: (i) customers are not responding effectively; or (ii) barriers to entry are high.

4.20 Weak competition as a result of customers not responding effectively to competing offers may sometimes result in an inefficient market structure in which firms are able to set higher prices to cover their higher costs without risking losing more customers than would be the case in a competitive market[75] (see section 9 on weak customer response).

4.21 Barriers to entry may lead to incumbent firms being inefficient and operating with higher costs than would be sustainable with stronger competition in the market (see section 6 on barriers to entry). Firms may be competing (and incurring associated costs) on factors that do not have a discernible benefit to consumers. Examples could include high levels of spending on advertising/ building brand awareness (which in some markets could act to re-enforce barriers to entry and expansion); and spending on research to develop tools to increase the conversion rate of customers onto subscriptions that are not in customers' interests.

4.22 In some cases, the CMA may consider whether actual costs have been efficiently incurred when looking at the level of profitability achieved by firms, but this may not always be practical. To assess whether actual costs are efficient, the CMA may consider if there are suitable benchmarks available to inform this assessment. For example, the CMA may compare costs over time and across different companies within the market, or the CMA may consider if there are suitable benchmarks outside of the market.

---

[75] Hotels near airports, for example, may exhibit a form of monopolistic competition characterised by low entry barriers, in which customers do not compare offers effectively, and hence there are more operators, with excess capacity, charging higher prices than would otherwise be the case. Individual operators may be observed to have normal profitability in this example. Weak customer response may also result in high profits, as well as inefficient entry.

Indicators not features

4.23 In summary, the CMA will consider prices and profitability in the context of its overall assessment of the market. While useful, however, findings that price-cost margins or profitability are high in a market do not on their own provide conclusive evidence that the market could be more competitive. It may also not always be feasible for the CMA to come to a view on what a specific appropriate level of profitability in a sector is. Further, in the context of a market investigation reference or a market investigation it is necessary to identify the features of the market as part of the reference/AEC test alongside considering market outcomes. Put another way, outcomes in terms of prices and profitability may indicate that a market is not working well, but they are not features of the market giving rise to any AEC.

Non-price outcomes

4.24 The CMA will also consider non-price outcomes in its assessment. Lack of innovation, poor quality or limited product ranges can be other indicators of competition in a market not being effective.

4.25 One particularly concerning outcome of ineffective competition can be to stifle incentives on firms to innovate or invest in product development and thereby prevent the gains in productive efficiency and customer benefits that innovation or new products bring over time. When firms face competition (either from existing competitors or the threat of entry by new competitors), the possibility of generating high profits or protecting existing profits encourages them to discover new products and processes. In contrast, firms that do not face competitive pressures may choose not to invest significantly in R&D.[76]

4.26 However, the relationship between market power and innovation is not always clear cut. Large incumbent firms, who may be more likely to have market power, may benefit from significant economies of scale in the innovative

[76] On the other hand, in some cases R&D may be used on developments which do not actually benefit customers, such as additions to products aimed at distinguishing it from rivals but without actually adding value (see also discussion at paragraph 4.19c).

process.[77] On the other hand, an incumbent firm with market power may have a lower incentive to innovate than a smaller competitor or new entrant because it has less to gain.[78]

4.27 In high-technology industries, the CMA will pay particular attention to the number of products and/or technologies that are being developed. Another useful indicator in high-technology industries is R&D spending relative to sales. High R&D spending to sales ratios provide a clear indication that competition takes place through innovation. Where R&D investment is high, market power may be vulnerable to future innovations by rivals or new entrants.

4.28 The CMA may also take into account evidence on the experience of customers, including levels of, and changes in, customer satisfaction. However, high levels of satisfaction are not always a good indicator that a market is functioning well. This may be the case where, for example, general levels of satisfaction hide particular concerns for some customer groups or in relation to particular aspects of a service.[79]

4.29 Evidence relating to non-price outcomes tends to be qualitative, often from surveys, questionnaires or discussions with customers, investors, or other market observers. In several past market investigations and studies, such analysis has spotlighted various negative non-price factors as important indicators of weak competition.[80]

---

[77] Large-scale firms that undertake large amounts of R&D may be able to employ more specialized resources; they will face smaller average total costs because they can average the fixed costs of their innovative effort over a greater level of output; and they may be able to support a larger portfolio of R&D efforts, increasing the likelihood that this will develop an improved product or process likely to be applicable to at least one of its businesses.

[78] A strong incumbent might be deterred from investing because it could not be confident that it would increase its sales or its already large share of the market. In contrast, a new entrant or small incumbent supplier might have a strong incentive to invest because, having only a small or no presence in the market, its investment would have greater potential to gain business.

[79] Examples of markets where the CMA has identified concerns with certain aspects of how a market functions despite customers generally reporting being satisfied with their purchase decisions include the Funerals market investigation and the Housebuilding market study.

[80] See for example discussion of back of house quality in funeral directors in the Funerals market investigation, and discussion of audit quality and the relationship between audit quality and competition in the Statutory audit market study.

4.30 The specific non-price outcomes considered will depend on the case. For example, the CMA has increasingly considered evidence relating to quality dimensions such as privacy and security in the context of digital markets.[81]

[81] See for example discussion of privacy and data collection in the Online platforms and digital advertising market study and discussion of privacy, security and online safety in Mobile ecosystems market study.

5. Limited alternatives available for customers

5.1 In many instances, the degree of market power a firm has depends on the number of alternatives to the firm's products or services available to customers and the extent to which they are substitutable. The market power of a firm will be strong if customers have few alternatives and/or those alternatives are not close substitutes. Alternatives may include products or services available in the present (through current competition between firms active in the market) and products and services that could be available in the future through firms' entry and expansion (potential competition).[82]

5.2 This section focuses on market structure and alternatives available to customers through current competition between firms and short-term possibilities of entry and expansion via supply side-substitution. Section 6 which follows considers the factors that determine longer term possibilities of entry and expansion.

5.3 Generally, the most common reasons why customers may have few alternatives to choose from and, as a result, one or more firms in the market have market power are:

(a) high market concentration (see paragraphs 5.5 to 5.10);

(b) capacity constraints (see paragraphs 5.11 to 5.12);

(c) lack of close substitutes (see paragraphs 5.13 to 5.15); and

(d) absence of supply-side constraints (see paragraphs 5.16 to 5.17).

5.4 In the following sub-sections we discuss each of these in turn.

High market concentration

5.5 Market power by one or more firms may arise because there are few firms in the market (ie, market concentration is high) and, as such, competitive

[82] Potential competition includes both future competition, which is the competition that happens among firms after entry or expansion has occurred, and dynamic competition, which is the ongoing competition that happens before entry or expansion among firms which are making efforts or investments in the present for future entry or expansion, or to protect future sales from potential competitors.

constraints among them are weak.[83] In these circumstances the CMA may find that high concentration is a feature causing market power and harming competition. The CMA would generally expect to find this in conjunction with other features, such as barriers to entry and expansion (see section 6).

5.6 One way in which the CMA may assess whether firms enjoy market power and competitive constraints are weak is therefore through a consideration of measures of concentration.

5.7 The CMA will generally consider market concentration, if possible over several years, among the suppliers of the products or services under consideration. Concentration can be measured in different ways, and the relevance of different measures to a given assessment will depend on the specific circumstances of a case. Measures of concentration might include, for example: shares of supply (by volume, by value, of capacity, or other measures), counts of the number of competitors, or the Herfindahl-Hirschman Index (HHI).[84]

5.8 The CMA will determine the appropriate weight that it can place on concentration measures in each case. For example:

(a) Measures of concentration can be particularly useful when there is persuasive evidence on demand- and supply-side substitution between products or services such that it is clear which products or services should be included or excluded from the market, and when the degree of differentiation between firms is relatively limited. In such circumstances, concentration measures are more likely to be a useful indicator of the extent of market power.

(b) Where the boundaries of a market are less clear the CMA may calculate concentration measures on multiple bases, including and excluding different firms. In such situations the CMA may attach greater weight to

[83] As noted above, market concentration and the exercise of market power are not necessarily linked to the position of a single firm. In this section we consider concentration and market power exerted by firms unilaterally. Market structure and concentration may also be relevant to other theories of harm, for example through influencing the stability of co-ordination. The role concentration measures can play in the assessment of different sources of competitive harm is discussed in the separate sections below.
[84] The HHI is a measure of market concentration that takes account of the differences in the sizes of market participants, as well as their number. The HHI is calculated by adding together the squared values of the percentage market shares of all firms in the market.

concentration measures that include firms whose products are more substitutable, and vice versa.

(c) In other cases, not just where the boundaries of the market are not as clear but also, for example, where reliable estimates of shares of supply are not readily available, or where there is a high degree of differentiation between firms, the CMA may rely to a greater extent on other sources of evidence.

5.9 In interpreting evidence on concentration measures, the CMA will consider concentration in the context of the nature of competition in the market and alongside other evidence, including on closeness of competition between suppliers:

(a) Observed changes in shares of supply over time may help interpret the implication of high concentration in a market. For example, when shares of supply have been stable over time, especially in the face of historical changes in prices or costs, high concentration may indicate that competition within the market is weak. However, a highly concentrated market may be competitive if market shares fluctuate over short periods in response to changes in competitive offers; such volatility may indicate the existence of effective competitive constraints, such as successful entry and innovative developments.

(b) It is important to consider the nature of competition. For example, in markets characterized by bidding and tendering processes, shares of supply may fluctuate only when tenders occur and a firm may have a high share of supply at any given point as a result of winning several recent tenders, without necessarily possessing significant market power. In such markets, it may be more relevant to consider shares over a longer period of time.

(c) Even if a firm, or firms, has a large share of supply it may simply indicate that the firm possessing it is relatively efficient, having low costs, an attractive product, or both. Conversely, since a firm’s level of market power will be related to the alternatives available to customers and the extent to which they are substitutable (see paragraphs 5.13 to 5.15), even a firm with a low share of supply may have significant market power if the alternatives available to its customers are not good substitutes for its products or services.

(d) In some cases, recent or ongoing changes in market conditions may indicate that the current share of supply of a particular firm either understates or overstates the firm's expected competitive significance in the near future. Predictable effects of such changes—for example, the spreading of new technologies, the longevity of patents and the prospective development of new products—may be taken into account when interpreting market share data.

Capacity constraints

5.10 In markets involving relatively undifferentiated products, one or more suppliers may exercise market power by unilaterally reducing output and increasing the market price (eg by leaving capacity idle or diverting production to another market). Such a strategy is more likely to be profitable when rivals' ability to respond (eg by increasing their output) is limited by capacity constraints or the demand for rivals' products is not very responsive to changes in price. In these markets, shares of capacity may be more informative of the extent of market power than shares of supply.

5.11 In assessing the ability and incentive of a firm, or firms, to suppress output unilaterally in this way the CMA focuses on the degree of spare capacity other firms in the market may possess, the ease with which these firms could expand existing capacity, and their commercial incentive to counteract any overall output shortfall.

Lack of close substitutes

5.12 In differentiated product markets, while some products can be close substitutes and compete strongly with each other, others are more distant and compete less strongly.[85] In these markets, a firm may enjoy market power because its customers have limited close alternatives they could switch to.

---

[85] For example, one high-end product may compete more directly with another high-end product than with a low-end product. Similarly, to the extent there is a geographical dimension to competition, then two suppliers may compete more intensely the closer they are located to each other.

5.13 Closeness of competition[86] is not limited to products or services that have similar characteristics. A firm may be a close competitor if it represents a significant competitive force or exerts a strong constraint on other firms. For example, a firm that has a particular reputation or incentive to compete aggressively or otherwise behave as a 'maverick', or that is actively disrupting the status quo using a new technology or business model, may represent a close competitor to other firms, even if their respective offerings are quite different.

5.14 The types of evidence the CMA may rely on to assess closeness of competition are diverse and will vary from case to case. Examples include evidence on products' characteristics or their intended use, which might be indicative of their substitutability. The CMA often gathers the views of customers and the firms active in the supply of relevant products. The CMA may review firms' internal documents, which can describe their perceptions of the competitive importance of rivals or reflect which competitors they monitor or respond to. The CMA might gather evidence on customer switching or diversion, for example from the data held by firms or from customer surveys.[87] Past competitive interactions, for example in tenders or negotiations, or reactions to each other's innovations, or through other responses to each other's competitive offering generally, may also be informative. Evidence of an impact on competitive outcomes following previous entry or exit may also provide relevant evidence. The CMA will normally not gather evidence from every possible source and will decide which sources to prioritise, and it may also consider evidence not described here. The CMA's general approach to assessing evidence is described in paragraphs 2.56 to 2.69 above.

Weak supply-side constraints

5.15 Firms supplying products or services in a market may be constrained by supply-side substitutes where firms can and do readily shift their existing

---

[86] Closeness of competition is discussed in more detail in paragraphs 4.8 to 4.11 of the Merger Assessment Guidelines.

[87] A diversion ratio between Product A and Product B represents the proportion of sales that would divert to Product B (as opposed to Products C, D, E etc) as customers' second choice in the event of a price increase for Product A. The cross-price elasticity of demand of Product A to Product B is a measure of the percentage change in the quantity of Product A sold when the price of Product B rises by 1 per cent. Higher diversion ratios are associated with closer competition between two firms.

capacity from another market into the market under consideration to start producing substitute products. Under certain conditions, supply-side constraints may be considered as constraints within the market. These conditions are set out in paragraphs 11.10 to 11.11 in the context of market definition. In cases where firms do not currently shift their capacity across different products as a matter of routine, it may be more appropriate for the CMA to consider the prospect that they may start doing so (which the CMA may do using its framework for assessing entry by rivals (see paragraphs 9.35 to 9.40)).

5.16 To assess the extent to which supply-side substitutes exert a constraint on firms in a market, the CMA may consider:

(a) Whether the existence of supply-side substitutes influences the market behaviour of incumbent firms which otherwise would enjoy significant market power (seeking evidence, for example from internal documents, past examples of where firms have shifted capacity between the different products, and from customers about the credibility of rapid entrants[88]).

(b) The timing of the likely supply response, possible legal restrictions (eg if contractual provisions restrict the extent to which production assets can be shifted), access to distribution channels, and commercial risks and incentives on account of factors such as customer loyalty, brand reputation or managerial expertise.

---

[88] Situations in which firms compete with products that are currently available may be distinguished from situations where firms compete by producing to order or on the basis of blueprints or where firms define their businesses in terms of the skills of their employees. In the latter situations the extent to which supply-side substitution exists is likely to be particularly important.

6. Barriers to entry and expansion

6.1 Entry or expansion by firms will often stimulate competition and the prospect of entry and expansion within a short time can sometimes prevent competition problems from arising, as discussed in section 9 below. In particular, entry or expansion, or the threat of it, can:

(a) lead to more competitive prices as well as greater choice and quality, to the benefit of customers;

(b) stimulate investment and innovation, and lead to the introduction of new or better technology or products, and fresh approaches to product design, marketing and delivery;

(c) promote efficient firms at the expense of inefficient ones; and

(d) upset established patterns of market conduct, particularly by making it difficult for an incumbent firm to continue wielding significant market power.

6.2 However, potential or actual competitors may encounter barriers which reduce or even severely hamper their ability to enter or expand in the market. Barriers to entry and expansion are specific features of the market that give incumbent firms advantages over potential competitors. They hinder the ability of potential entrants, or firms looking to expand, to constrain the exercise of market power by incumbents. Evidence of persistent high profits within an industry or among large incumbents could suggest there may be entry barriers in the market.

6.3 A major source of competitive discipline is therefore eliminated or reduced if there are high barriers to market entry and expansion. As such they may constitute a feature, often in combination with other features, that results in market power and harms competition.

Types of barriers to entry or expansion

6.4 Often barriers to entry or expansion are related to the nature of competition. While it is not possible to provide a comprehensive list of barriers to entry and expansion (as they are liable to vary between different sectors and over time), common barriers include:

(a) Initial set-up costs and costs associated with investment in specific assets are more likely to deter entry or expansion where a significant proportion of them are sunk.[89]

(b) Customers may place a high value on the reputation and track record of suppliers. This might be especially true where the product or service being provided is important for the customer, and where the quality of the product is difficult to ascertain in advance. This may also arise where customers are likely to be particularly risk averse about making a poor choice, or are making decisions in circumstances that make them vulnerable, and as a result become less likely to switch suppliers.[90]

(c) Customers/consumers may demonstrate a high level of brand loyalty, may be subject to inertia or other factors which make it difficult to engage (as discussed further in section 9), be tied into long term contracts or exclusivity agreements, or face other significant switching costs, which may make entry or expansion more difficult and require investment to overcome these costs. For example, in some digital markets switching might involve giving up access to an ecosystem of products and services such that at least some customers are unlikely to switch away from the incumbent products.

(d) Economies of scale[91] may be present in many markets.[92] These may prevent small-scale entry from acting as an effective competitive constraint in the market. Further, in the presence of economies of scale, large-scale entry or expansion will generally be successful only if it expands the total market significantly, or substantially replaces one or more existing firm; and if the entrant can afford the risk that such investment will involve.[93]

[89] ie the costs cannot be recovered when exiting from the market.
[90] For example, for products or services where customers are making choices that affect the health or well-being of others', they may be concerned about making a poor choice if they switch supplier.
[91] These arise where average costs fall as the level of output rises over a range of output volume.
[92] For example, many digital and software markets as well as other markets such as pharmaceutical markets.
[93] Incumbents may also have an advantage relative to new entrant firms where production costs decrease as the cumulative quantity produced increases (ie through 'learning by doing').

(e) Economies of scope may be present.[94] Where economies of scope are significant, for an entrant to be successful, it might have to produce a range of products from the outset, adding to the costs of entry.

(f) When network effects[95] are present, the need to attract many customers to one or both sides of a platform in order to be an effective constraint on the incumbent platform may make entry and expansion both costly and risky, particularly in the presence of large incumbents. Many markets are characterised by considerable network effects, particularly digital markets.[96]

(g) The technology and production methods used in the market may themselves represent barriers to an entrant. For example, intellectual property rights and interoperability requirements with the incumbent products may need to be taken into account by entrants.

(h) Incumbents may have early mover advantages as a result of branding or switching costs. The data held by many digital market firms allow them to hone, improve and personalise their products and services, and this may be difficult for an entrant to replicate in a timely manner.[97]

(i) Regulations[98] may also represent considerable barriers to entry. For example, regulation may mean firms need to meet specific requirements to be able to operate in the market, which limit how many or the type of

---

[94] These arise where producing two (or more) products is less costly for a single firm than for two (or more) firms each producing the products separately. Economies of scope can arise in many ways, for example, a firm may use data collected in one market to lower the costs or improve the quality of a product it offers in another market.
[95] See paragraphs 3.5 to 3.10 for further discussion of network effects.
[96] Examples of non-digital markets where network effects are present include card payment systems.
[97] Early mover advantages are also present in non-digital markets.
[98] Regulations may be beneficial for a variety of reasons ranging from ensuring the stability of the financial system to protecting the environment, but they may inhibit the extent to which competition can flourish in certain circumstances. With regard to their effect on competition, a distinction can be drawn between regulations that impose costs proportionately on all firms and those that hit new entrants harder than incumbent firms. For example, regulation that raises fixed costs can more easily be absorbed by an incumbent firm than by an entrant (because of the former's larger sales in the market); however, regulation that raise variable costs would fall more evenly on both firms.

firms which can enter,[99] or the choices they can offer.[100] Other forms of regulation which can create considerable barriers to entry include licensing arrangements, intellectual property rights and trade barriers.

6.5 Barriers to entry and expansion might be particularly high if multiple factors are present. For example, an incumbent might have a large cost advantage from its scale and/or data, while also benefitting from network effects. In addition, in some cases barriers to entry and expansion may be intrinsic such that the relevant market cannot realistically be envisioned without them as set out in paragraph 2.38.

6.6 In its assessment of barriers to entry and expansion, the CMA will also consider the strategic behaviour of incumbents as this may create or strengthen a barrier to entry or limit the ability of a new entrant to gain a foothold in a market. A non-exhaustive list of examples includes:

(a) Investments by incumbents which increase sunk costs.[101]

(b) Long term contracts or exclusive dealing arrangements which could make it difficult for an entrant to gain sufficient distribution outlets or access to vital components.

(c) Increasing switching costs including through fidelity rebates, restricting interoperability or data portability, etc.

(d) Tying or bundling products which could raise the costs for an entrant that produces only one of the complementary goods.

(e) Incumbent firms signalling that they would respond aggressively to entry, including by over-investing in spare capacity, or seeking to compete

[99] Such requirements can specifically require providers to meet certain criteria, such as having particular professional qualifications. It can also be the case that the nature or number of regulatory requirements are such that certain types of firms have an advantage in competing (for example, established firms with experience of understanding and navigating the rules, or firms over a certain size being able to absorb regulatory costs more easily).

[100] See for example discussion of the effect of Ofgem's requirement to limit the number of tariffs offered by energy suppliers in the Energy Market Investigation.

[101] For example, by investing in brand and product proliferation an incumbent can alter demand conditions in their favour.

strongly with entrants specifically to discourage them from entering the market.

Assessing the impact of entry barriers

6.7 To test a theory of harm based on the effects on competition of barriers to entry, the CMA has to assess the impact that the entry barriers identified have had, are having, or may have in the future.

Cost and timescale of entry or expansion

6.8 In assessing the factors influencing entry decisions, the CMA may consider:

(a) the costs involved in entry and in operating at the minimum efficient scale necessary to achieve a reasonably competitive level of costs;

(b) the likelihood of entry within a timescale that would bear on the incentives and decisions of the existing firms in the market;

(c) the cost of exiting the market; and

(d) the likely response to entry by incumbent firms.

Past and prospective entry or expansion

6.9 Evidence of persistent profits above the competitive level within the industry or among large incumbents could suggest there may be entry barriers in the market. However, such evidence is neither necessary nor sufficient. Conversely, data showing that incumbents consistently fail to earn high profits may be consistent with low entry barriers, but it does not prove that barriers are low and that competition is working dynamically (see paragraphs 4.19 to 4.21 above).

6.10 The CMA will examine the history of entry or expansion, and evidence of planned entry or expansion. This assessment will consider the extent to which past entrants and smaller firms have successfully gained market share (see paragraphs 5.5 to 5.10 for further discussion of market concentration analysis) and, more generally, the cost of gaining a significant share of the market.

6.11 In considering historical evidence, the CMA may consider the effects that entry or expansion had on competition in the market, in particular whether past entry or expansion modified the pattern of behaviour by incumbents and increased competition; and if so, whether this would be relevant for the present analysis. This could, for example, include considering any price effects or effect on other parameters of competition.

6.12 Although evidence of past entry (or the lack of it) can be helpful in assessing the significance of entry barriers in a market, previous episodes of entry do not necessarily prove that entry was easy, that it was competitively significant, that it is likely to take place again, or that the possibility of entry is imposing a competitive constraint (see also paragraphs 9.34 to 9.40). Moreover, current potential entrants may not face the same market conditions that previous entrants faced.

The positive effects of a barrier

6.13 In some circumstances barriers to entry may have a positive impact:

(a) Some behaviours which may act as a barrier to entry or expansion may also provide benefits to customers. For example, safety regulation may be important in protecting customers from faulty or dangerous products, even though they raise the costs of production for firms.

(b) Some regulations which restrict entry may achieve important social goals which are not the focus of competition policy (see paragraphs 2.7 to 2.8 above).[102]

6.14 Such positive impacts could be taken into account at different stages of an investigation. First, they may be considered as part of the competitive assessment, for example, a restriction on short-run competition might be tolerated to preserve incentives to compete in longer-term ways (see section 10 below). Secondly, they may be considered during the remedies process as

---

[102] For example, in the Housebuilding market study the CMA recognised that planning systems, by their nature, aim to control the type of development that may take place, trading off the need to deliver appropriate levels and types of building against other desirable outcomes. As a result, the CMA acknowledged that its analysis of how the planning system facilitates meeting housing need was necessarily partial and that policymakers taking decisions on the overall design of the planning system would need to consider a wider range of policy objectives.

relevant customer benefits (RCBs) (see paragraphs 3.45 to 3.61 of the Markets Remedies Guidance).

7. Coordinated market outcomes

7.1 Rivalry between firms operating in the same market may be restricted due to the presence of coordination in that market.

7.2 Coordination may take different forms and can affect any aspect of competition. For example, firms may coordinate by fixing prices, by dividing up the market between them, such as by geographic area or customer characteristics, or by allocating contracts among themselves in bidding competitions. In other cases, coordination may involve limiting production or innovation. Firms which operate across a number of related markets may coordinate on avoiding launching competing products. Joint action may be taken to foreclose access to markets, inputs or customers. Coordination may also involve firms reaching an understanding, either explicitly or tacitly, that they will avoid taking an overly aggressive stance in terms of their competitive offering.

7.3 Firms can use algorithms to implement, monitor or enforce anticompetitive coordination. Even without explicit coordination, where firms use algorithms that inform or set prices, a coordinated outcome may grow out of repeated interaction between algorithms.

7.4 Regardless of the mechanism used, coordination will often result in firms in the coordinating group collectively enjoying market power and thus worsening the terms on which products are offered to customers, reducing customer choice and holding back efficiency and innovation. In many instances, prices will be higher than they would otherwise have been if the firms had competed effectively.

7.5 Evidence of some competition between some or all firms in a market may be consistent with also finding evidence of coordination. For example, coordination may not cover all competitive parameters or all regions, may not include all firms in the market and may be characterised by periods during which the coordinating group reverts to fully competing.

7.6 While coordination between firms can be explicit, it can also be tacit. Tacit coordination is achieved through an implicit understanding between the firms, but without any explicit arrangement or contact between the firms.

7.7 Where the CMA is conducting a market study or investigation, it can investigate whether and why a coordinated outcome is present without needing to establish whether the firms involved have reached a common understanding or whether that understanding is tacit or explicit.[103] This may be particularly pertinent where algorithms are being used to set prices.

7.8 Not all forms of cooperation between firms will be harmful to competition. Cooperation may sometimes also bring about pro-competitive effects, which benefit customers. For example, in some financial markets, credit providers and insurers routinely share certain data (eg about customers' repayment or claim history) that facilitates the efficient operation of those markets.[104][105] Furthermore, given that firms can independently use algorithms to monitor the prices of competitors and to inform their own price setting, this may lead to more intense competition, reduced costs and/or reduced barriers to entry.[106]

Conditions conducive to coordination

7.9 In assessing the prospect of coordinated conduct, the CMA considers whether market conditions are conducive to coordination, seeks to understand the way in which the firms in the market operate and comes to a view on whether the observed outcomes are best explained by coordinated behaviour among firms.

7.10 In particular, the CMA will analyse the extent to which the following three conditions are met:

(a) Firms are able to reach a coordinated outcome. Where there is no explicit agreement, firms need to have sufficient awareness of each other's actions and be able to anticipate each other's reactions so as to identify a

---

[103] By contrast, the CMA can only take enforcement action in respect of coordinated conduct under the Competition Act 1998 where that conduct amounts to an agreement or concerted practice within the meaning of Chapter 1 of the Competition Act 1998.
[104] The CC found that the absence of such data sharing was a feature harming competition in the market for home credit and required lenders above a certain size to provide credit reference agencies with full data on the payment records of customers.
[105] Some forms of cooperation may bring about other benefits to consumers – for example, see green agreements guidance on how competition law applies to environmental sustainability agreements.
[106] See further discussion of how algorithms can affect horizontal cooperation in Guidance on horizontal agreements, for example paragraphs 8.24 to 8.27.

mutually beneficial outcome. The repeated interaction between algorithms used by firms in a given market to inform or set prices may result in a coordinated outcome in certain circumstances.

(b) Coordination is internally sustainable among the coordinating group, ie firms find it in their individual interests to adhere to the coordinated outcome.

(c) Coordination is externally sustainable, ie it is unlikely that coordination will be undermined by competition from outside the coordinating group.

7.11 The CMA will assess the extent to which these conditions are met in relation to the form (or forms) of coordination that it considers to be most likely in the particular market on the basis of the available evidence.

Ability to reach the terms of coordination

7.12 Coordination can emerge where the firms involved are able to reach an understanding, which may be tacit, about their objectives (for example, a price below which they would not sell or customers they will not target). This includes firms recognising their interdependence and avoiding competitive actions. Such an understanding need not involve a precise outcome but needs to be sufficiently clear to enable their behaviour to be aligned. Coordination need not involve explicit communication; for example, the terms of coordination might emerge over time through repeated competitive interaction or through widespread use of automated tools such as algorithms to inform or set prices.

7.13 Factors that may be relevant to assessing whether a market is conducive to coordination may include:

(a) **Number of coordinating firms**. The fewer firms in the coordinating group, the lower the complexity and the easier it will be to reach a coordinated outcome. This is also the case when there is a more stable economic environment.

(b) **Suitable focal point or means for coordination.** This may be more challenging in a complex environment, for example where products are differentiated, firms sell a large number of products, or differ in their capabilities, product portfolios, customer mix and strategies. However, even in these circumstances, firms may be able to reach a coordinated outcome through simplifying the parameters of competition or focusing on a subset of parameters such as coordinating on known pricing points. Market division may be an easier means of coordinating than fixing prices. For example, firms may be able to reach an understanding to avoid targeting each other's customers, areas of geographic strength or areas of product development. Information availability about rivals' conduct and beliefs may assist in generating mutually consistent expectations among rival firms, making it easier for them to reach an understanding on the terms of coordination. Algorithms may also make it easier for firms to find a focal pricing point. [107]

(c) **Symmetry**. Firms may find it easier to reach a common understanding if they are relatively symmetric, for example in terms of cost structures, market shares, capacity levels and extent of vertical integration.

(d) **Structural links**. The existence of significant structural links between firms in the market (such as being each other's customers or suppliers, holding cross-shareholdings or belonging to trade associations) may also assist in reaching a common understanding on the terms of coordination. Where competitors use a common pricing tool or algorithm, this may also increase the likelihood of a coordinated outcome.

Internal sustainability

7.14 Coordination will be sustainable where the incentive for each coordinating firm to coordinate is higher than the incentive to deviate.[108] Typically, deviating firms will make a short-term gain from having a more competitive offer than the coordinating firms so for coordination to be internally sustainable, the gain to firms from deviation must be outweighed by the costs of future reduced profits.

---

[107] See further discussion of how algorithms can affect horizontal cooperation in Guidance on horizontal agreements, for example paragraphs 8.24 to 8.27.

[108] Deviating may include, for example, offering discounts to the coordinated price, targeting another firm's customers or failing to match a price rise.

7.15 The size of the gain from deviation will depend on the characteristics of the industry. Factors which may influence gains from deviation include:

(a) **Customer behaviour.** Gains from deviation may be relatively low where there is strong customer loyalty or where many customers are already committed to long-term contracts.

(b) **Number of firms.** There will be a greater incentive to deviate where there are more coordinating firms since the profits from coordination are shared between a greater number of participants, lowering the relative payoff from coordination compared to the profit from deviating.[109]

(c) **Characteristics of firms.** The gain from deviation may be higher for some than others where firms have very different incentives; for example, if a firm particularly values having a reputation for offering the lowest price in the market.[110] As another example, if price discrimination is not possible, then a large firm may have a lower incentive to deviate than smaller firms if it will have to offer lower prices to its whole customer base.

7.16 Where there is an incentive to deviate, firms must be able to detect and respond to deviation in a timely manner in order to sustain coordination. In assessing whether this is likely, the CMA will consider evidence on the ease with which firms can detect the choices of their rivals. Factors which may enhance the ability to detect rivals' choices are:

(a) **Observability of rivals' behaviour**.[111] Transparency around firms' strategic choices and market outcomes will typically assist coordination, particularly where it enables timely detection of deviations. Online markets may be particularly transparent. Publicly available information on firms' pricing, product portfolio or investment decisions may enable the detection of deviation. In addition, algorithms can potentially be used to observe and respond to rivals' behaviour.[112] The CMA may also consider

---

[109] Although this assumes that a deviating firm has correspondingly greater spare capacity relative to its current sales.

[110] Such a firm is sometimes termed a 'maverick'. Having a reputation for offering the lowest price is just one example of the behaviour that a 'maverick' may engage in.

[111] Practices which may enhance transparency of rival's behaviour are discussed in paragraphs 7.20 to 7.25.

[112] See further discussion of how algorithms can affect horizontal cooperation in Guidance on horizontal agreements, for example paragraphs 8.24 to 8.27.

whether firms can infer their rivals' actions from market outcomes even if they cannot observe them directly.[113] Where there are firms outside the coordinating group, it may also be important to be able to observe whether any changes to market outcomes are a result of competition from these firms.

(b) **Market stability**. Where demand is predictable, it is easier for firms to detect deviation from coordination.

7.17 In assessing whether other firms' responses may be sufficient to disincentivise deviation and thus sustain coordination, the CMA may consider, for example:

(a) **Swiftness of response**. How swiftly any response would follow on from deviation. For example, in a market where prices are set using algorithms, the response to deviation may be automatic and almost immediate. Customer behaviour may encourage deviation through long-term contracts[114] (which may prevent an immediate response by fixing the terms of firms' competitive offers during the period of the contract). Conversely, parity obligations (see paragraph 8.5(c)) may raise the expected cost of deviation by guaranteeing a competitive response.

(b) **Effectiveness of response**. A more severe response may be more likely to discourage deviation but may also be less credible, as it is more costly to the responding firms. Often the response will take the form of a return to more intense competition by the other firms rather than a deliberate punitive strategy, particularly where coordination is tacit.[115]

---

[113] For example, a firm's knowledge of its own or competitors' sales volumes and capacities might, in some contexts, provide enough information to determine whether or not deviation from coordination is taking place.
[114] The customer does not have to be aware of any collusion for it to encourage deviation. For example, it may offer long term contracts for other reasons.
[115] A response to a perceived deviation from a coordinated outcome need not necessarily take place in the same market as the deviation; if coordinating firms have commercial interactions in several markets, these may offer various ways of responding to deviations, such as cancellation of joint ventures or selling shares in jointly- owned companies.

External sustainability

7.18 It is not necessary for all firms in the market to be involved in coordination but those firms that are involved need to be able collectively to exercise a degree of market power for coordination to be externally sustainable.

7.19 In assessing whether coordination may be externally sustainable, the CMA may consider:

(a) **Existing competition**. Coordination will be less sustainable where existing competitors outside the coordinating group (the competitive 'fringe') make up a significant proportion of the market or are able to impose a strong competitive constraint.

(b) **Potential competition**. External sustainability will typically be easier where new entry or expansion of any existing competitive fringe is unlikely. It will be more difficult if there is a firm with the capacity to take significant share from any group of firms that tried to coordinate without its participation (especially if that firms is a 'maverick').

Practices of firms operating in the market

7.20 The CMA will also look at whether would-be competitors have taken any actions[116] to reach, sustain or enhance coordination. Such actions may involve exchanges of information or specific types of arrangements.

Availability of information

7.21 The ease with which firms can obtain information about their competitors tends to facilitate coordination. As discussed above, readily available information or exchanges of information can increase transparency between firms. The use of algorithms can also increase firms' ability to collect and interrogate information, monitor market developments and help firms interpret the choices their competitors have made.[117]

---

[116] Equivalent, in economic parlance, to 'facilitating practices'.

[117] The aspects of firms' commercial strategies where transparency is required will depend on the form of coordination. For example, it may be easier to observe shifts in customer demand such that an understanding in

7.22 The means by which companies may obtain or exchange information, other than by the many forms of direct communication, include parity obligations (see paragraphs 8.5(c)), voluntary publication of information, price announcements, or information shared—even anonymously—through trade associations. Cross-directorships, joint ventures, supplier/buyer relationships and similar arrangements, as well as the use of algorithms, may also make monitoring and retaliation easier.

7.23 Less obvious means and practices may also increase the transparency or predictability of the environment in which firms operate. These may include the adoption of rules of conduct, ethics codes, product standardization, regulatory disclosures, joint marketing or buying agreements, price computation manuals and R&D joint ventures.[118] Such practices may sometimes be justifiable on efficiency or customer-benefit grounds, but they could also create market conditions favourable for coordination.

7.24 This Guidance cannot be prescriptive about the type of information that may be associated with coordinated conduct. The likely effects of the availability of particular information on competition are analysed by the CMA on a case-by-case basis.

Specific arrangements made by firms

7.25 Although sometimes benign from a competition viewpoint, specific arrangements firms make, which can sometimes facilitate coordination, include:

(a) Best price policies (or low-price guarantee):[119] they can increase transparency, facilitating consensus and the detection and punishment of deviation as well as deterring competitive price cutting.

---

relation to the allocation of customers may be feasible even if the firms in the market cannot observe each other's prices.

118 Such practices could also be beneficial in some circumstances, as set out in paragraph 9.14. Their likely impact will be assessed based on the facts of the case.

119 Best price policy is a commitment made by a firm (frequently a retailer) either to match or beat the lower price charged by other firms—a price-matching guarantee (PMG) and price-beating guarantee (PBG)—or by the same firm to other current or future customers— a parity obligation. Such policies may be adopted unilaterally or through agreement or they may simply become accepted practice.

(b) Parity obligations (see paragraph 8.5(c)): these provisions can in some circumstances deter competitive price cutting, reduce the incentive to deviate from established terms of coordination, and deter a firm from offering discounts to its smaller customers.

(c) Resale price maintenance (RPM, see paragraph 8.5(b) can be used to facilitate coordination between suppliers and retailers, making it easier to detect whether a retailer deviates from a coordinated price; strong or well-organized distributors may be able to use RPM to influence one or more suppliers to fix their resale price above the competitive price.

8. Cross-market relationships

8.1 Poor market outcomes may sometimes be the result of relationships which take place across different products or services (cross-market relationships). Cross-market relationships may involve one or more firms where there is either:

(a) a vertical link: where a firm, or group of firms, is active at different levels of a supply chain;[120] or

(b) an adjacent market link: where a firm, or group of firms, is active in separate markets that are not part of the same supply chain, but are related, eg markets where products are complements, purchased together or part of the same digital ecosystem.

8.2 Cross-market relationships can involve one or more firms. In particular, the relationship can involve:

(a) One firm being active in both markets. For example, a firm may be vertically integrated which means that it is active at upstream and downstream levels of the supply chain. Similarly, a firm may be active in two adjacent markets where the products are complements or may provide a range of products within a digital ecosystem.

(b) Agreements between two or more firms active in different markets. For example, a vertical arrangement may involve agreed pricing schemes or other contractual provisions between firms at different levels of the supply chain.

Practices arising from cross-market relationships

8.3 Cross-market relationships can give rise to a number of different firms' practices that the CMA may consider as potentially leading to competitive harm in the context of a market study or market investigation. Several of these

[120] This captures relationships where one market is linked to another because it provides an input to the other. These links take a variety of forms and those links may be more obvious (eg where iron ore is used as input to the production of iron) or less obvious (eg where data collected in one market is used to improve products in another market).

practices may appear in combination within the scope of one cross-market relationship.[121]

8.4 While it is not possible to provide a comprehensive list of the practices arising from cross-market relationships, examples of practices that involve one firm include:[122]

(a) Firms linking sales of two products in adjacent markets. For example, a firm could only offer the products as a bundle, integrate them within a digital ecosystem, or offer customers of one product a discount if they also purchase the other product. These practices can go beyond the mere linking of products – for example, in the Mobile ecosystems market study the CMA considered agreements that not only linked certain products, but also involved the exact placement of certain products on mobile devices and default settings on those mobile devices.[123] More generally, the CMA will consider the potential for a wide range of practices that may link products or otherwise cause customers to favour the package of products. For example, the CMA may consider unequal access to compatibility/interoperability information if it means that first party products work better together than when first- and third-party products are used together.[124] In digital environments the CMA may consider practices such as where default settings automatically favour first party products and making those defaults difficult to change.

(b) Self-preferencing. Firms providing products in adjacent markets may make it easier for customers to buy both products from them rather than seeking an alternative supplier for one of them through the way choices are offered. For example, in a context where customers use a platform to access or purchase products from a range of third parties as well as the platform owner, the platform owner may give its own products a competitive advantage over those of third parties. Platform owners may

---

[121] For the avoidance of doubt, some of these practices are not always anti-competitive or produce anti-competitive effects. However, in some circumstances they can dampen or restrict competition such that the CMA may be concerned about their effect on how the market(s) work(s).

[122] For a more detailed list and discussion of vertical agreements see the Vertical agreements block exemption order guidance which explains how the CMA applies the Chapter I prohibition in the Competition Act 1998 (CA98) to vertical agreements.

[123] Mobile ecosystems market study.

[124] In the extreme, third-party products may not work with first party products at all.

be able to self-preference their own products in several ways including the use of choice architecture[125] to make their products more prominent to customers.

(c) Refusal to supply. This is the unconditional refusal to supply another firm. For example, a firm may refuse to sell an input or license intellectual property to an actual or potential rival in a downstream market. A refusal to supply may not be explicit: a constructive refusal to supply can arise where a firm only offers to supply another firm on unreasonable terms.[126]

8.5 Examples of practices that involve two or more firms include:[127]

(a) Exclusivity agreements between firms at different levels of the supply chain which may take the form of either exclusive distribution or exclusive supply. Exclusive distribution is where the supplier allocates a geographical area or customer group exclusively to itself or to one or a limited number of firms it supplies in the downstream market, while restricting other firms from actively selling into the exclusive geographical area or to the exclusive customer group. Exclusive supply refers to arrangements that oblige or induce the supplier to sell the contract products only or mainly to one firm in the downstream market, in general or for a particular use. Such restrictions may take the form of an exclusive supply obligation, restricting the supplier to sell to only one firm in the downstream market for the purposes of resale or a particular use.

(b) Pricing restraints such as resale price maintenance (RPM), a practice whereby a manufacturer and its distributors agree that the latter will sell the former’s product at certain prices.

(c) Parity obligations, also known as Most Favoured Nation (MFN) clauses. These are restrictions that require one party to an agreement to offer the

[125] See paragraph 9.2 for further discussion of choice architecture.
[126] Such terms could include extremely high prices, degraded service or reduced technical interoperability. For a discussion of the refusal to supply see the International Competition Network’s Report on the Analysis of Refusal to Deal with a Rival Under Unilateral Conduct Laws.
[127] For a more detailed list and discussion of vertical agreements see the Vertical agreements block exemption order guidance which explains how the CMA applies the Chapter I prohibition in the Competition Act 1998 (CA98) to vertical agreements.

other party goods or services on terms[128] that are no worse than those offered to its own customers or to third parties.

Impacts of cross-market relationships

8.6 Practices arising from cross-market relationships can have beneficial effects for customers. For example:

(a) They can improve the coordination of activities at different stages of the supply chain or in adjacent markets and deliver savings in transaction and inventory costs.[129] This may arise from a firm bringing 'in-house' activities which would otherwise be carried out in separately-owned businesses,[130] or from a closer alignment of the incentives of firms towards the achievement of complementary objectives.[131]

(b) They can assist suppliers to open up or enter new markets, for example where some sunk investment is required to begin supplying a new geographic area, a distributor may need some assurance it will be able to recoup these investments. This may justify a supplier entering into an exclusive agreement with one distributor for that area.

(c) Integrated digital ecosystems can bring about benefits through well-integrated products and services which can lead to a simple and convenient user experience and additional or better functionality.

---

[128] These obligations can refer to both price and non-price terms. In addition, parity obligations can be in place at different levels of a supply chain. Parity obligations may typically be categorised as either 'wide' or 'narrow' in scope – for example, in a retail context a narrow parity obligation would apply to a supplier's direct sales channel (eg its own website) whereas a wide parity obligation would also apply to a supplier's indirect sales channels (eg intermediaries). For illustration, see the discussion of parity obligations in the CMA's Vertical agreement block exemption order guidance.

[129] For example, by helping guarantee stability of supplies, improve coordination on product design, production process and the way in which the products are sold.

[130] For example, in the absence of vertical coordination, if both producers and distributors add mark-ups over their costs, the resulting 'double' mark-up—or 'double marginalization'—may lead to inefficiently high prices. This is because each partner, when setting its price (the wholesale price for the producer and the retail price for the distributor) takes no account of the effect of this price on the other's profit. By aligning incentives, vertical relationships may lead to a coordinated reduction of the mark-ups at different levels in the supply chain, both increasing firms' profits and benefiting customers.

[131] The CMA sets out the positive effects on competition that vertical agreements may produce in the Vertical agreements block exemption order guidance, paragraphs 10.6 to 10.12.

8.7 However, practices arising from cross-market relationships can have negative effects on competition. Examples of possible negative effects include:

(a) Anti-competitive foreclosure of other existing firms or potential entrants in the downstream, upstream or adjacent market (depending on the circumstances and conduct) by making it more difficult for them to compete effectively and/or by raising barriers to entry or expansion. Foreclosure can be total (eg a supplier refuses to supply an input to a rival) or partial (eg where a supplier increases the price or worsens the quality of an input supplied to a rival).

(b) The softening of competition between a supplier and its competitors or the facilitation of (explicit or tacit) collusion between suppliers. This softening can occur in either the upstream, downstream[132] or adjacent market.

(c) The creation of limitations on customer choice or ability to purchase products in any part of the UK.

8.8 Foreclosure, softening of competition and collusion may lead to firms exercising market power and may harm customers by increasing the prices or lowering the quality of products. They may also harm customers by limiting the choice of products or reducing the level of innovation.

Assessing cross-market relationships

8.9 In assessing whether a particular practice arising from a cross-market relationship has an adverse effect on competition, the CMA will evaluate its overall impact on competition, taking into account efficiencies (see paragraphs 10.2 to 10.8), as well as adverse effects. This will normally require an assessment of the impact of the cross-market relationship on rivalry in each market.

8.10 For practices arising from cross-market relationships to have negative effects on competition the firms involved must have a significant degree of market

---

[132] Where the softening occurs in the downstream market it is important to consider the extent to which there is a reduction in intra-brand competition (ie competition between downstream firms that distribute the products of the same upstream firm) or a reduction in inter-brand competition (ie competition between downstream firms that distribute the goods or services of different upstream firms). If inter-brand competition is strong, it is unlikely that a reduction of intra-brand competition alone will have negative effects for customers.

power in one or more of the markets (ie in one of the markets in the supply chain or one of the adjacent markets). Therefore, an assessment of market power will be an important part of considering the overall impact of cross-market relationships.

8.11 The exact factors assessed in relation to practices arising from cross-market relationships are determined on a case-by-case basis. The CMA may take into account the following when considering if a practice arising from a cross-market relationship has an adverse effect on competition:

(a) The nature of the practice or practices (eg what it is, duration, exceptions, coverage, implementation). For example, vertical agreements can take many shapes and forms. It is therefore important to analyse the nature of the agreement in terms of the restraints that it contains, the duration of those restraints and the share of total sales on the market affected by those restraints.[133]

(b) The coverage of any agreement or conduct in terms of suppliers, buyers, customers etc., including whether there is a network of agreements. For example, the CMA may be more concerned about cross-market relationships where they relate to a larger proportion of activity in a market as any negative effects are likely to be more widespread.

(c) The behaviour of customers in the markets. For example, a firm may make purchasing products together the default option.[134] The extent to which this creates competition problems will depend on how many customers opt out of this default and decide either not to purchase the additional product or to purchase it from a different supplier.

(d) The rationale for the cross-market relationships. This will likely involve seeking evidence to understand the rationale for cross-market relationships and will include considering the pro-competitive benefits they may result in (see section 9 which sets out framework for considering

[133] In some cases it may be necessary to go beyond the express terms of the agreement. The existence of implicit restraints may be deduced from the way in which the agreement is implemented by the parties to the agreement and the incentives that they face.
[134] That is, the firm may bundle the purchase of one product with the purchase of another related product from the same supplier (for example, adding an extended warranty to the purchase of a durable good unless the customer actively decides not to take the warranty).

efficiencies). This will also include considering context around any agreements or conduct such as the timing of them relative to other developments in the markets.

(e) The extent to which there are barriers to entry and expansion. The presence of barriers to entry and expansion will reinforce the market power of incumbents. Thus cross-market relationships in markets with barriers to entry and expansion are more likely to be of concern. For example, the risk of foreclosure is likely to be stronger if there are significant scale economies such that rivals can only effectively compete if they are able to achieve significant volumes. In addition, cross-market relationships may also work as a barrier to entry and expansion and are more likely to be a cause for concern where these relationships reinforce other such barriers.

(f) The extent to which competitors have effective and timely counterstrategies. Competitors may have counterstrategies at their disposal allowing them to protect themselves against any cross-market relationships and to prevent any harm to competition. For example, the CMA may consider if competitors can replicate any cross-market relationships and if this mitigates any negative effects.

9. Weak customer response

9.1 Competition may be threatened if customers respond weakly to competitive offers. This may be variously caused by actions by suppliers, a structural feature of the market (for example, affecting the availability of information), or customers' behaviour. The CMA's markets regime is well placed among competition policy instruments to analyse and remedy undesirable patterns of customer responses which result in weak competition to the detriment of customers.[135]

9.2 An important factor in considering how customers' responses may be weakened is choice architecture. Choice architecture describes how the decisions customers make are affected by factors controlled by firms, such as the layout or ordering of choices that are available.[136] This can be used to affect how easily customers are able to seek information, compare different offers, negotiate prices and switch between suppliers. Furthermore, firms can use such practices to compete against other businesses (for example, through claims of scarcity, or use of reference prices), leading to a 'race to the bottom'. Conversely, firms with a significant degree of market power may enter into agreements to control or restrict the use of choice architecture across the market (for example, through default agreements[137]).

Impacts and assessment of weak customer response

9.3 In order to understand the drivers for weak customer responses in a market, it is important to consider the broader context in which the customer is making purchase decisions. Factors the CMA may consider to understand the broader context include:

(a) **When and why the customer is purchasing the good or service** e.g. whether customers face pressures when making a decision; whether

[135] While strengthened competition plays an important role in solving some customer-related problems, others can only be tackled by means of consumer protection policies.
[136] For more detail see Online Choice Architecture: how digital design can harm competition and consumers, CMA, 2022
[137] See for example discussion of impact of pre-installation and default settings on user behaviour in mobile browser and browser engine competition in Mobile ecosystems market study.

there is time sensitivity in their purchase; how frequently customers purchase the product or service.

(b) **Process by which customers make decisions** e.g. how customers go about narrowing their options and the information they use or have available for this; at what point they are contractually or psychologically committed; how complex the decision-making process will be.

(c) **How customers weight different factors in their decisions** e.g. whether customers can access and judge salient information on price and quality; whether there are other market-specific reasons which may affect the importance placed on some product features[138].

(d) **Baseline level of customers' awareness and engagement in the market** e.g. what awareness customers have of the existing market choices; whether customers' choices are more passive, restricted or pre-determined (eg defaults).

(e) **How vulnerable customers might be when making decisions** e.g. whether customers have certain personal characteristics such as financial resilience, level of education and age or a context-dependent vulnerability such as bereavement or divorce.

9.4 These factors are likely to influence the way in which customers make decisions (for example, the resources they choose to use to inform choices; the importance attached to some features of the product over others). As a result they are likely to both influence and be influenced by firms in how they compete. This can include: firms facing competitive pressure on some aspects of a product offering but not on others; firms being able to manipulate the information available on salient product or service characteristics to improve how they are viewed by customers; firms being able to 'lock in' customers to purchase from them rather than a rival early in the decision-making process. Understanding this feedback loop of decision making and response is likely to be important in understanding why a weak customer response may arise and how it may lead to an adverse effect on competition.

---

[138] See for example the discussion of how people choose a funeral in the Funerals market investigation.

Issues which can lead to weak customer response

9.5 To drive effective competition customers need to be both willing and able to:

(a) access information about the various offers available in the market;

(b) assess these offers to identify the good or service that provides the best value for them; and

(c) act on this assessment by switching to purchasing the good or service from their preferred supplier.

9.6 These three requirements are each necessary conditions for effective competition and provide a useful framework when considering theories of harm relating to weak customer response. However, the CMA's analysis may not necessarily be framed rigidly around each of these individual requirements. That could be because the same underlying issue may affect more than one of these requirements. A lack of comparable price information, for instance, may be considered to affect customers' abilities to access relevant information on the offers available and also their ability to assess the options based on all relevant information – such that an assessment of the affected requirements in combination may be more appropriate. It may also not be necessary to specifically identify which of these requirements is being affected if the underlying cause, and the effect it has on customer choice and outcomes, is clear.

9.7 The above makes clear the importance of information in allowing customers to understand and assess the options available to them. However, as set out in further detail below, there is often an information asymmetry in markets, whereby firms have access to (or can understand) more information than customers.[139] Furthermore, customers' decision-making is often challenging: customers may need to make many difficult choices, and have limited time

[139] This is especially the case in digital environments where firms can use even more sophisticated tools to personalise information, customise every step in the customer journey and make changes in real-time to the digital design.

and cognitive capacity to do so. This can give rise to behavioural biases[140] in most, if not all, people.

9.8 Firms have the capacity to exploit information asymmetry by altering the environment so as to shape the information accessible to customers, influence their interpretation of that information and ultimately to steer the choices they make. Some customers may be particularly susceptible to such biases and can therefore be more vulnerable to certain practices by firms.[141]

9.9 In the following sections, we set out further detail on how the CMA will assess the effect of:

(a) information asymmetries;

(b) barriers to accessing information;

(c) barriers to identifying best value offers;

(d) barriers to switching suppliers.

Information asymmetries

9.10 Information asymmetries between suppliers and customers might have adverse effects on competition, particularly in markets for goods or services where firms have access to more information than customers about product or service characteristics, quality, availability, and production processes, as well as data on customer behaviour and preferences. Another example of information asymmetry is availability. Customers may be led by scarcity and popularity statements (e.g. 'Only X left, X people looking at this!') which might influence them to act more quickly. But only firms know what availability constraints they really have. In some cases customers may have no

---

[140] For example, inertia, present bias or overconfidence (see more details in Evidence review of Online Choice Architecture and consumer and competition harm, CMA, 2022).
[141] See Stango & Zinman (2020) We are all Behavioural, More or Less: A Taxonomy of Consumer Decision Making.

information about some of these factors – for example, customers may not be able to gauge the quality of a service when acquiring it.[142]

9.11 Buyers may not know, for example, how quality varies across suppliers. When, as a result of information asymmetries, customers are unable to form an accurate assessment of product quality, a market may operate inefficiently. Imperfect information about quality can be a particularly severe problem for infrequently purchased goods or goods the quality of which cannot be verified even after purchase—so-called ‘credence’ goods.

9.12 In extreme cases, asymmetric information about quality may lead to only the lowest quality product being offered, effectively meaning that a true market may not exist. This could arise where sellers of low-quality products are able to make their products appear indistinguishable from higher-quality products at the point of sale, and consequently sellers of the higher-quality products are unable to convince customers of their products’ worth. In this situation, customers are only willing to pay the price of the average quality product, which is not enough to cover the cost of the higher quality products, leading to these products not being supplied. Even if information asymmetries do not lead to all higher-quality products being forced out of the market, quality levels are lower than they would be in the absence of the information asymmetry.

9.13 A related issue (the so called ‘principal-agent’ problem) arises where a provider (the agent) acts on behalf of another party (the principal), thereby providing a service to it.[143] If the agent has better information than the principal about how well it is providing the service, the principal may be prevented from exercising effective choice. Moreover, where the two parties’ interests are not aligned, the agent may act against the interests of the principal if information asymmetries allow it to do so undetected by the principal. [144] A particular example of this may be where the agent provides

[142] See for example discussion of the back of house quality of funeral directors in the Funerals market investigation and information on quality available to consumers when buying a newbuild house in the Housebuilding market study.
[143] For example, a solicitor or financial adviser may act as an agent for a consumer in relation to a legal or financial transaction.
[144] Examples where a misalignment of incentives between end consumers and those who make purchasing decisions on their behalf led to consumers being poorly served include the discussion of the incentives of property developers, heat network operators and customers in the Heat Networks market study (paragraph 1.17)

signposting or advice on products or services which it supplies itself and so may have some interest in directing the principal to options that are more profitable for the agent, rather than those which best suit the principal's needs.[145]

9.14 The effects of asymmetric information are generally commensurate with the degree of asymmetry: the greater the asymmetry of information, the greater the effect. However, the potential effects of asymmetric information on competition may be mitigated by other factors, which the CMA will take into account in its analysis. Such mitigating factors include:

(a) The Government, consumer groups, industry groups or others may provide information in the form of standards (defining a metric, or scale, for evaluating a particular product) and certification (that a particular product has been found to meet a standard).

(b) Liability laws may serve the same function as explicit warranties, forcing the manufacturer to make good any defective products.

(c) Professional and other bodies can regulate entry into, and ongoing participation in, the relevant profession and require that practitioners obtain certain qualifications, thus guaranteeing quality of service to some degree (see also discussion of entry barriers, paragraphs 6.4(i) and). Such bodies require a degree of independence from the parties involved to effectively mitigate the asymmetry of information.

(d) A disinterested expert may be able to provide customers with reliable information, for example, a mechanic in the case of a used car.

(e) Warranties or guarantees may eliminate problems due to limited information or act as a signal of the item's quality at the time of purchase, for example 'satisfaction guarantees' might be offered by holiday providers.

---

and the lack of role for savers and their representatives in the selection of audit firms in the Statutory audit market study (paragraph 10).

[145] This could, for example, lead the agent to encourage the customer to buy more than they need (to make a short-term gain), or less than they need (to make them buy again in future, potentially at a higher price).

Barriers to accessing information

9.15 When customers face significant impediments or costs in their search for, and comparison of, alternatives, sellers may be able to set prices with only limited regard to competition[146]. In other words, firms can enjoy market power if customers cannot effectively compare their products with others on offer.[147]

9.16 Where it is difficult or costly to obtain information, customers may not search the market but simply choose a firm randomly; firms may respond by charging a high price to these customers. Search costs are likely to be substantial in cases where the information that could possibly affect purchasing decisions is relatively complex, or difficult to obtain or process.[148]

9.17 Prices in the market tend to increase with the cost of acquiring information. This is because the higher the search costs, the lower the net gain for customers from searching for a lower price and the higher the degree of market power that firms can exploit.

9.18 Firms may sometimes engage in practices that increase search costs so as to obtain market power (or fail to engage in practices that would reduce search costs). They may do so, for example, by:

(a) Visual manipulation of information. For example, not clearly displaying prices or referring to some prices (eg special offers) which are not necessarily available to all customers; or failing to make available all the relevant product information needed by customers to make an informed choice, in particular of one-off purchases;

(b) Information overload, or conversely, the oversimplification of information. When firms provide too much information about a product or service,

---

[146] Note that issues with accessing and assessing information can arise in relation to either price or quality.
[147] If, for example, one store raises its price for a commonly available good above the level of other stores, and all customers know this and switch to rivals, that store would lose all its business. In contrast, if some or all customers do not know that other stores charge lower prices and hence do not switch, the store may be able to raise its price without losing all its sales, ie the store has some degree of market power.
[148] Firms may be able to charge high prices even where some customers search for information but a significant number of less well-informed customers remain; a seller's profit foregone by losing informed customers who buy elsewhere may be more than offset by the higher profits accruing from less well-informed customers who do not shop around. For example, markets serving both tourists (with high search costs) and local residents (with low search costs). An increase in the proportion of informed customers will generally increase the level of effective competition in a market.

customers may have difficulty finding and assessing the most relevant information; when information becomes oversimplified, potentially lowering the accuracy of information, customers might find the level of information insufficient, in particular for more complex decisions.

(c) Framing of information. Firms that have complex pricing structures and are charging different prices for the same good at various locations or under different brand names, making it difficult to find the low-priced brand.

(d) Use of popularity, scarcity or endorsement information to increase search costs. With the additional information, firms can place pressure on customers and shift focus from price and quality.

9.19 Online price comparisons sites and advertising might be expected to reduce search costs.[149] However, their influence may be limited in this respect, for example because:

(a) Advertising and comparison tools, while a 'free' resource reducing buyers' search costs to some degree, may not tell customers everything that they want or need to know about a product. For example, hidden fees and drip pricing practices may mean that the full costs are only revealed once customers have invested time in researching the products. Another example is 'paid' ranking of products where firms pay extra in exchange for a higher position in the search results.

9.20 Comparison tools may have a legitimate commercial interest in protecting the intellectual property rights to the information they collect and distribute—for example, to prevent its use to publicize only the 'bottom' line (eg which brand is most or least reliable overall), or to prevent those who have not produced or paid for information from benefitting from it. As a result, there may be restrictions on what information is made available and to whom e.g. some

---

[149] It is worth noting that providing and obtaining information can have spillover benefits to others in the market. The 'positive externalities' associated with the provision of information in consumer markets affect both buyers and sellers: buyers because, for example, search by some individuals may improve the market for all customers; and sellers because, for example, advertised information that applies to more than a single brand may help sellers of competing brands or other competing products. Where these external benefits are significant relative to the private benefits enjoyed by those providing or using the information, such information may be underprovided and/or underused compared to what would be expected to make the market work well.

products may not be included in comparison services or access to the information may be restricted to only paying subscribers, depending on the comparison tool's business model.

(a) The large fixed costs typically associated with the creation of information, and the small marginal costs of distributing it, may prevent fully efficient pricing and may give sellers an incentive to limit the information they provide.

Barriers to identifying best value offers

9.21 Even if customers are able to access several offers, their assessment of those offers may be affected by asymmetries of information (as discussed in paragraphs 9.10 to 9.14 above) and by the exploitation of behavioural biases by suppliers, among other factors.

9.22 There are several reasons customers may find it difficult to assess offers, including features of markets that mean most or all customers experience a degree of vulnerability. Customers may, for example:

(a) have limited cognitive bandwidth, be in a stressful situation, or be in a 'hot state' while making decisions;

(b) find it difficult to assess the value of products that involve complex estimations of risk[150] or probability;

(c) be required to make a choice when they do not fully understand the options available to them; or

(d) have vulnerabilities or lower literacy or digital skills due to personal characteristics or situations.

9.23 There are many choice architecture practices employed by firms which may exploit the biases that are common in customers' purchasing decisions, harming competition to the detriment of customers. While it is not possible to

[150] This may, for example, be the case where they are making choices about products and services that affect the health or well-being or others', causing them to be more risk averse.

provide a comprehensive list of choice architecture practices which may distort purchasing decisions, some common practices include:[151]

(a) Choice overload: faced with too many choices, customers have difficulties making a purchasing decision by feeling overwhelmed and lacking the motivation or ability to carefully assess all options. While too many options might hinder decision making, especially when customers' preferences are not well-defined, too few options might limit customers' sense of control over their choices (eg choice deprivation).

(b) Framing of choices, including defaults (customers often adopt the default option); ranking of choices (customers' choices depend on where goods are placed on a list); composition of choices (customers' choices are affected by the presence of other choices presented to them e.g. decoy or extreme options).

(c) Bundling and/ or tying of choices: firms might group two or more products and/or services together in a single 'package' at a special price, making it more difficult for customers to compare it with the value of other products sold separately; or tying two or more products and/or services together and making it difficult to make only one choice at the time.

Barriers to switching suppliers

9.24 Costs of switching from one supplier or provider to another, in response to attractive offers, may act as a disincentive to do so.

9.25 The CMA recognises that switching costs can impact competition and/or different groups of customers in different ways. If there is scope to charge different prices to new as opposed to existing customers, switching costs may allow firms to charge high prices to existing customers, who are 'captive', while charging lower prices to new customers for whom competition is more intense. Even if the firm is unable to price discriminate between 'captive' and

---

[151] For a more detailed list and discussion of how choice architecture in online markets can lead to harm to competition and customers see Evidence review of online choice architecture and consumer and competition harm.

new customers, however, switching costs may enable it to charge higher prices than it would be able to in the absence of such costs.

9.26 Factors that can lead to high switching costs include:

(a) Changing the level of effort required to make a choice, including sludge (excessive or unjustified friction eg inconvenience and administrative obstacles, making it difficult for customers to get what they want or to do as they wish) or dark nudges (practices which make it easy for customers to make a choice that may not ultimately be in their best interests).[152] For example, by increasing the level of friction, firms can lock customers into subscriptions if the switching costs are too high to overcome.

(b) The presence of network effects (see paragraphs 3.5 to 3.10 above), which give rise to collective switching costs, locking customers into existing standards and the firms that control them.

(c) If customers have made a large investment in a piece of equipment or in product-specific skills, they may be deterred from switching if it involves a further substantial investment.[153]

(d) Contractual terms (eg low early settlement rebates[154]) or marketing devices, such as loyalty programmes, and negative advertising can have the effect of increasing switching costs or influencing switching decisions. Firms can create explicit commitments with long-term contracts or subscriptions with autorenewal defaults, locking customers in.

(e) Firms may frame information and apply pressure to make it less attractive to switch. For example, they may emphasise risks of switching to alternatives, even where such risks may be limited in reality. This will be more likely to be effective where consumers perceive the consequences

[152] For examples of dark nudge practices, see Evidence review of online choice architecture and consumer and competition harm.
[153] However, such a cost may not reduce competition if customers are able to make a fully informed choice about the lifetime costs of all the alternatives at the time of the initial investment.
[154] For example. PPI market investigation, paragraph 53: ‘The final barrier to switching we identified was the rebate policy on single-premium policies. Rebates are not given on a pro-rata basis ... if a consumer cancels a PPI policy, the rebate given is not enough to take out an identical policy ...’

of making a poor choice as severe (such as impacting health or wellbeing).

10. Factors which may mitigate or prevent competitive harm arising

10.1 In assessing the potential sources of harm, the CMA also considers factors that may, on the other hand, benefit competition and operate to the benefit of customers. While such factors are considered in both market studies and market investigations, in market investigations the CMA will assess whether the benefits to competition outweigh the harm as part of the AEC test.

Efficiencies

10.2 In some circumstances, features investigated by the CMA will have positive effects such as efficiencies. Where this is the case, the CMA will consider in market investigations whether the positive effects of efficiencies on competition associated with a particular market feature may outweigh its harmful effects.

10.3 Efficiencies can enhance rivalry when they induce one or more firms to follow a course of action of benefit to customers (eg lowering prices or increasing innovation) in response to actual or expected actions by rivals. Examples of such rivalry-enhancing efficiencies include:

(a) **Lower prices:** The CMA will generally view features which lead firms to have lower marginal or variable costs as being more likely to result in an incentive to reduce price or make short-run improvements in quality than reductions in fixed costs. Some fixed cost savings or other efficiencies may enhance the ability of firms profitably to innovate or invest in entry or expansion (see next bullet), although cost reductions from a reduction in output will not be considered as efficiencies.

(b) **Greater innovation or quality**: Large incumbent firms may benefit from significant economies of scale or scope in the innovative process. For example, these firms might bring together complementary assets in research and development activities or otherwise reduce incremental costs in innovation.[155]

(c) **Cost savings and the elimination of double marginalisation**: Since cross-market relationships may involve complementary products, services or activities, each firm would like the other to lower the price of its product. Such a relationship can therefore have the effect of lowering prices that would be charged to customers if the firms acted independently and in this way can sometimes benefit customers.[156] Other ways in which cross-market relationships may give rise to efficiencies are considered in section 8 above.

Framework for assessing efficiencies in market investigations

10.4 The CMA will use the following criteria when it assesses efficiencies. Efficiencies must:

(a) enhance rivalry in the supply of products;

(b) be sufficient to mitigate the harm to competition and customers where they currently occur or be timely, likely and sufficient to mitigate it, where they are expected to occur in the future;

(c) be unlikely to accrue without the feature or features concerned; and

(d) benefit consumers in the UK.

10.5 In considering potential efficiencies, the CMA will therefore need to ascertain that the market feature(s) with which it is concerned results, or is likely to result, in lower prices, higher quality, wider choice or greater innovation, and that such efficiencies are unlikely to arise in the absence of the market feature(s) concerned. If efficiencies are to be relevant in the CMA's

[155] For example, integrated digital ecosystems can bring about benefits through well-integrated products and services which can lead to a simple and convenient user experience and additional or better functionality, but may prevent third parties from providing products or services which compete with those incorporated into the ecosystem.
[156] For example, non-compete obligations may help to resolve the 'free-rider' problem in markets where suppliers require their distributors to incur certain costs if advice and other pre-sale services are to be provided in a sustained way, although they restrict competition between distributors.

competitive assessment, those efficiencies must be expected to affect competition in the relevant market.

10.6 In general, the CMA would expect parties to put forward for consideration any efficiencies they think relevant. Parties doing so will be expected to provide convincing evidence regarding the nature and scale of any efficiencies that they claim to result from the market feature(s) concerned.

10.7 The greater the expected adverse effect of a feature, the greater the expected efficiencies must be. It may also be relevant to the CMA's assessment whether the efficiencies associated with a feature or features of the market could occur in the absence of that feature or features.

Relevant customer benefits (RCBs)

10.8 Should the CMA decide that, despite the existence of some efficiencies that benefit customers, there is still an AEC in the market, these efficiencies may be taken into account as RCBs when the CMA considers possible remedies (see paragraphs 3.45 to 3.61 in the Markets Remedies Guidance).

Entry and expansion

10.9 The prospect of entry or expansion (see paragraph 6.1) — and therefore of stronger competition in the longer term — may also sometimes offset the competitive harm associated with a particular market feature or features. However, where the CMA has concerns over how competition is working in a market, the CMA would need convincing evidence as to why entry or expansion is likely to be effective in driving the market towards good outcomes in future.

Framework for assessing entry and expansion

10.10 The CMA will use the following framework to determine whether entry or expansion would offset competitive harm. The entry or expansion must be:

(a) **Timely**: The CMA will consider whether the effect on competition and the market will be timely. It is not just a case of entry or expansion occurring in a timely manner but the effectiveness of that entry or expansion on market outcomes must be timely. Generally, the further out in time that entry or expansion is expected to occur the less weight the CMA can attach to such entry or expansion as an offsetting factor to the competitive harm in the market.

(b) **Likely**: In considering the prospect of entry or expansion, the CMA must be satisfied that the firm(s) expected to enter or expand have both the ability and incentive to do so. The CMA will consider the scale of any barriers to entry and/or expansion (see section 6 above).

(c) **Sufficient**: Entry or expansion should be of sufficient scope and effectiveness to outweigh the competitive harm. Entry or expansion needs to be successful over a sustained period of time. Sufficiency may come from a single entrant or firm expanding or from several, in aggregate.

10.11 These conditions are cumulative and must be satisfied simultaneously.

10.12 The CMA will seek to ensure that the evidence is robust when confronted with claims of entry or expansion being timely, likely and sufficient to mitigate an AEC. It is likely to place greater weight on detailed consideration of entry or expansion and experience of past entry and expansion (including how frequent and recent it has been).

10.13 Furthermore, if considering the threat of potential entry or expansion as a factor that may prevent competitive harm from arising, the CMA will need to be assured that this is sufficient to exercise a constraint on the incumbent firms in the present. For example, even though no actual entry of sufficient scale has been observed in the recent past, such a constraint could arise when entry would be swift and low-cost so as to exploit any commercial opportunity in the market.

10.14 There may also be instances in which either a customer itself enters (self-supply) or a firm is encouraged and supported by customers to enter or expand (sponsored entry).[157] The above considerations are applicable to these scenarios. In addition, the CMA will consider whether, after self-supply

---

[157] Where a customer has the ability and incentive to trigger new entry, it may be able to ensure there is effective competition in the market. Most other forms of buyer power that do not result in new entry – for example, buyer power based on a customer's size, sophistication, or ability to switch easily – are unlikely to prevent or mitigate an AEC. This is because a customer's buyer power depends on the availability of good alternatives they can switch to. In that sense, market power and buyer power are two sides of the same coin, and an AEC can be interpreted as customers' buyer power being ineffective or insufficient.

begins or sponsored entry occurs, supply will be available to the market or only to the individual customer. Even if self-supply or sponsored entry protects particular customers, it may not prevent higher prices or poor quality of service for other customers.

10.15 In addition, the CMA is also likely to consider whether such mitigating strategies by customers will be effective in mitigating the competitive harm in a dynamic context. A customer self-supplying may be far less effective over time than a firm entering or expanding into the market, especially if the self-supply activity is not the customer's core business. For example, if product innovation or ongoing efficiencies to reduce costs (especially, but not only, if substantial economies of scale are present) are important elements of competition, self-supply is unlikely to be effective in the longer term.

11. Market definition

The role of market definition

11.1 In making a market investigation reference the CMA must specify in the Terms of Reference the goods or services for whose supply or acquisition competition is adversely affected. This will require consideration of the definition of the relevant market (or markets). However, as explained further below, the CMA does not have to provide a precise or detailed definition of the market or markets to which any market investigation reference relates. In many market studies the CMA has not concluded on a formal market definition.

11.2 The starting point for market definition in a market investigation will be the goods and services or areas of supply set out in the Terms of Reference. However, the CMA may conclude that the market definition goes wider or is narrower than those goods and services.

11.3 Market definition involves identifying the most significant competitive alternatives available to customers of the goods or services under consideration. While market definition can be an important part of the overall assessment, it is not an end in itself. The evidence gathered as part of the competitive assessment, which will assess the potentially significant constraints on the relevant firms' behaviour, captures the competitive dynamics more fully than formal market definition.

11.4 Market definition can sometimes be helpful in developing certain types of evidence that may be relevant for the competitive assessment. For example, the relevant market can be used as the basis for calculating market shares or for constructing other measures of concentration, which may be helpful in some cases (especially where products are homogenous). On the other hand, measures of concentration can often be interpreted without concluding on a bright-line market definition, for example by calculating concentration measures on multiple different bases (see paragraphs 5.7 to 5.8 above).

11.5 In some cases, market definition may be less relevant to the competitive assessment. For example, when assessing closeness of competition (especially where products are differentiated), internal documents discussing competitors; views from customers or competitors on the closest substitutes for firms' products; analyses of bidding data; evidence on diversion between the firms; and data on customers won and lost may be more insightful.

11.6 The outcome of any market definition exercise does not determine the outcome of the CMA's competitive assessment of a market in any mechanistic way. The CMA's competitive assessment may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. In many cases, especially those involving differentiated products, there is often no 'bright line' that can or should be drawn. Rather, it can be more helpful to describe the constraint posed by different categories of product or supplier as sitting on a continuum between 'strong' and 'weak'. The CMA will generally not need to come to finely balanced detailed judgements on what is 'inside' or 'outside' the market. Not every firm 'in' a market will exert an equal level of constraint and the CMA will assess how closely different firms compete. The constraint posed by firms 'outside' the market will also be carefully considered.

11.7 There may accordingly be no need for the CMA's competitive assessment to be based on a highly specific description of any particular market definition (including, for example, descriptions of the precise boundaries of the relevant markets and bright-line determinations of whether particular products or services fall within the relevant market). The CMA may take a simple approach to defining the market – for example, by describing the market as comprising the most important constraints on relevant firms providing goods or services subject to the MIR. This is likely to be informed by the same or similar evidence that will be taken into account when conducting the competitive assessment.

Defining markets

Product markets

11.8 Product market definition starts with the relevant goods or services under consideration (for market investigation these will be the goods or services set out in the Terms of Reference). In identifying the most significant competitive alternatives for these goods or services that should be included in the relevant market, the CMA will pay particular regard to demand-side factors (the behaviour of customers). The CMA may also consider supply-side factors.[158]

Demand-side factors

11.9 The relevant product market is identified primarily by reference to demand-side substitution. One framework the CMA may use for considering substitution involves considering evidence on the response of customers to a small but significant increase in price (or equivalent reduction in the value offered to customers in terms of quality, range or service) of the products under consideration. The CMA will often consider qualitative evidence on demand-side responses and often will not seek to produce quantitative estimates of what customers would do in response to price increases or how such responses would affect the profitability of a supplier or suppliers. Types of evidence the CMA might consider when evaluating the closeness of substitution between products are described at paragraph 5.14.

Supply-side factors

11.10 The boundaries of the relevant product market are generally determined by reference to demand-side substitution alone. However, there are circumstances where the CMA may aggregate several narrow relevant markets into one broader market based on considerations about the response of suppliers to changes in prices. The CMA may aggregate markets when:

(a) firms routinely use their existing production assets to supply a range of different products that are not demand-side substitutes[159] and there is evidence that firms in practice shift their existing capacity between these different products depending on demand for each; and

(b) the same firms compete to supply these different products and the conditions of competition between the firms are the same for each

---

[158] Where more than one market is identified for investigation, the CMA will start from the narrowest possible set of goods or services in each market, and will also consider the inter-relationship between these markets where relevant (see for example paragraphs 3.9 and 3.11 to 3.14 for factors relevant in assessing two sided markets and local markets respectively).
[159] Production assets may include traditional physical assets such as premises and equipment, it may also include other assets. Some examples might include human capital, know-how or intellectual property, technology, reputation and experience.

product; in this case aggregating the supply of these products and analysing them as one market does not affect the CMA's decision on either a market investigation reference or an AEC.[160]

11.11 These conditions are cumulative. Examples of cases where the two conditions may be satisfied might include:

(a) where a set of retailers all offer the same broad range of products (eg different types of outdoor clothing) and each retailer shifts between offering different specific products simply by changing the products in stock, without any significant adjustments to their supply chain, distribution network, retail stores or brand, and none has a particular strength in any subset of products;

(b) in a market where suppliers bid competitively to supply services which are bespoke to the customer and are therefore not demand-side substitutes, but where those suppliers use the same production assets to compete across tenders, and competitive conditions are similar across those tenders; or

(c) a two-sided market, for example of social media platforms, where the services provided to the two customer groups are different (and therefore not substitutable), but competitive conditions are very similar on both sides because the same set of social media platforms compete for both sets of customers, and the platforms are similarly competitive for both groups.[161]

---

[160] When this second condition is not met but the first is then the CMA may still consider these supply-side constraints within its assessment, see paragraph 5.15. In cases where firms do not currently shift their capacity across different products as a matter of routine, it may be more appropriate for the CMA to consider the prospect that they may start doing so using the CMA's framework for assessing entry by rivals (see paragraphs 10.9 to 10.15).
[161] In other cases, each side of a two-sided market may constitute a different relevant market and the CMA will in each case determine the most appropriate approach (see paragraph 11.13 below).

Parameter flexing

11.12 Where multiple product markets cannot be aggregated on the basis of demand-side or supply-side considerations, the CMA may aggregate them if the main parameters of competition are set uniformly across those markets.

Two-sided markets and local markets

11.13 The CMA's approach to market definition is likely to reflect its approach to conducting the competitive assessment where there are:

(a) Two-sided markets (see paragraph 3.5 above). To the extent the CMA assesses the two sides separately, it may be more likely to define two separate markets.

(b) Aspects of national and local competition or where firms are active across multiple markets or segments of other types (see paragraph 3.11). This may include defining more than one market for the same product or service such as where some aspects of competition are determined at a local level and others at a national level.

Geographic markets

11.14 As with product markets, the CMA's focus in defining geographic markets is on identifying the most important competitive alternatives available to customers of the relevant products/services. The CMA may consider evidence such as:

(a) information on the competitive performance of firms supplying from different geographic areas or over different distances;

(b) information on differences in pricing, sales, advertising and marketing strategies by area, as well as information on delivery costs or barriers to entry when supplying into an area, over different distances or across borders;

(c) the views of market participants on customer preferences; and

(d) product characteristics such as perishability.

11.15 When determining whether supply-side substitution is sufficient to aggregate geographic markets, the CMA will have reference to the same conditions set out at paragraph 11.10.

11.16 If there are a large number of local geographic markets the CMA may examine the geographic catchment area within which the great majority of a store's/site's custom is located. Catchment areas are a pragmatic approach to identifying the most significant competitive alternatives available to customers. Where multiple geographic markets cannot be aggregated on the basis of demand-side or supply-side considerations, the CMA may aggregate them if the main parameters of competition are set uniformly across those markets (see paragraphs 3.11 to 3.14 above).

Effects outside the relevant market

11.17 The CMA may also consider effects in neighbouring markets, including those which are upstream or downstream of the relevant market (see paragraphs 8.1 to 8.2 above). For example, a firm may face limited competitive pressure in a market for a manufactured good because it has a strong advantage in purchasing an important input for that good. If the input market has been referred to it, the CMA may consider effects in the downstream output market.

Annex 1: The measurement of profitability

1. In measuring profitability, the CMA's approach will often be to start with accounting profit produced in line with generally accepted accounting principles,[162] and then to make adjustments to arrive at an economically meaningful measure of profitability, usually in terms of rates of return on capital.[163] The CMA may inform its judgment on what is an 'economically meaningful measure of profitability by examining the management accounting records of the firms in question. The manner in which industry participants – including firms, analysts, and investors – assess profitability for the purposes of monitoring and reporting performance may also inform our view as to what is an appropriate measure and timescale for evaluating profitability in an industry.[164] For example, in the financial sector the CMA has previously considered return on equity over a five-year period as its primary measure of profitability. In other industries, the CMA has considered the return on capital employed over a similar period.[165]

2. The appropriateness of a given measure will also depend on the nature of the industry and the pattern of investment. Where investment is characterised by large one-off expenditure, or the industry has experienced a period of growth, it may be desirable to consider profitability over a relatively long period of time, or on a project appraisal basis. For example, it may be appropriate to use a cash-flow based model to compute a measure of the internal rate of return (IRR) where reliable data is available on this basis.[166]

3. An important factor to consider when selecting an appropriate model will be data availability. Where possible, the CMA will base its calculations on financial data that can be reconciled to audited financial statements, albeit with appropriate adjustments. For example, where the market of interest is a division or segment of a company it may not be possible to obtain reliable

---

[162] For example, UK GAAP, US GAAP, and IFRS,

[163] Where the capital base is valued appropriately.

[164] See, for example, the Payment protection insurance (PPI) market investigation (CC).

[165] See, for example, the Funerals market investigation.

[166] Int the Mobile radio network services market investigation, the CMA adopted a discounted cashflow approach over a given segment of an activity's lifespan (also called a truncated IRR, or TIRR).

cash flow data at this level and the CMA may therefore adopt a return on capital approach for this reason.

4. Whatever measure of profitability is used, the calculation of profitability for the purposes of competition analysis is often not straightforward because of the need to obtain an appropriate value for capital employed, as described below. In industries with a relatively low level of tangible assets, such as some service, knowledge, and technology-based industries, the book value of capital employed may only bear a limited relationship to the economic value because of the presence of significant intangibles that have not been fully reflected in accounting valuations. In some cases, the replacement cost of assets may be different from historical costs due to the length of time elapsed and changes in asset prices and efficient technologies over time.

5. Obtaining a value for capital employed can present difficulties irrespective of the choice of model. For example, the use of a truncated IRR requires the assets to be valued appropriately at the beginning and end of the period selected. Similarly, a return on capital approach – whether return on equity or return on capital employed (ROCE) – requires an economically meaningful value for the capital base which may not accord with the value ascribed in the financial records.

6. Hence, it may be necessary to make adjustments to accounting data produced in line with generally accepted accounting standards. In particular, the following adjustments may be considered:

   (a) Under current accounting standards, most assets are held at historical cost and this may differ substantially from the 'replacement cost' or 'Modern Equivalent Asset value',[167] which the CMA considers to be the economically meaningful measure for its purposes in most cases. In these circumstances, and where this would be likely to have a material effect on its calculations, the CMA will consider whether replacement cost values can be derived reliably.

[167] These terms are used interchangeably to mean the current cost of acquiring assets which yield equivalent services to those currently used by the firm, based on the most efficient technology and optimal configuration.

(b) The CMA may consider the inclusion of certain intangible assets where the following criteria are met:

(i) it must comprise a cost that has been incurred primarily to obtain earnings in the future;

(ii) this cost must be additional to the costs necessarily incurred at the time in running the business; and

(iii) it must be identifiable as creating such an asset separate from any arising from the general running of the business.

In establishing a value for intangible assets meeting the above criteria, the CMA will have regard to similar principles as for other types of assets.

(c) Other adjustments may be considered on a case-specific basis.

7. In situations where capital employed cannot be reliably valued, the CMA may consider alternative measures, such as the return on sales or other relevant financial ratios. For instance, comparisons with businesses operating in different but similar markets may on occasions be helpful. In some circumstances, the CMA will consider it appropriate to use a range of measures in one case.[168]

8. In assessing levels of profitability, the CMA will have regard to its view of firms' cost of capital. The CMA will generally look to the capital asset pricing model (CAPM) when considering the cost of capital, since this is a widely understood technique with strong theoretical foundations. However, the CMA will have regard to alternative models where appropriate.

[168] For example, in the Funerals market investigation, the CMA measured funeral director profitability using a number of different metrics including average revenues, cost-plus, ROCE, and economic profits.