

Guidelines to maintain a competitive environment and define and tackle anti-competitive practices

Introduction

The *Statement on Competition Policy* (“the policy statement”) promulgates the Government’s sector-specific approach to competition. It stipulates, inter alia, that the determining factor of whether a business is anti-competitive is not the scale of operation or share of the market per se but whether a business or practice is limiting market accessibility or contestability and impairing economic efficiency or free trade to the detriment of the overall interest of Hong Kong. To facilitate implementation of this policy statement, the following guidelines (with specific pointers) are developed to –

- (a) assess Hong Kong’s overall competitive environment;
- (b) define and tackle anti-competitive practices; and
- (c) ensure consistent application of our competition policy across sectors.

Guidelines

1st Pointer: Assessing the overall competitive environment

2. This pointer assesses whether the economy is competitive. By meeting certain criteria, the overall business environment of Hong Kong would be deemed conducive to competition and free trade. The essential elements to assess the overall competitive environment are:

- (a) a stable and effective political environment;
- (b) a regime based on the rule of law;
- (c) a free and open macroeconomic environment;
- (d) abundant market opportunities;
- (e) positive policy towards private enterprise and competition;

- (f) positive policy towards foreign investment;
- (g) no foreign trade and exchange controls;
- (h) a transparent investment and tax regime;
- (i) easy access to financing;
- (j) a sophisticated labour market;
- (k) transparent and fair labour and immigration policies;
- (l) a strong physical infrastructure; and
- (m) free flow of information.

3. The key to competitiveness in a market is the high degree of easiness of entry and exit. When entry and exit barriers virtually do not exist, the incumbent firms will maintain prices close to the competition level. While competition could still exist and may even be intense with few participants in the market, the prevalence of numerous small and medium enterprises could be an illustration of the pro-competition attributes of the business environment in Hong Kong.

2nd Pointer: Measuring the effects of restrictive practices on the market

4. This pointer measures the **effects** of restrictive practices on the market to show whether the practices require Government action. A three-step broad economic test is provided under the policy statement as the means to determine whether the Government will take action against market conduct:

- (a) **Step 1** – when such market conduct limits market accessibility;
- (b) **Step 2** – impair economic efficiency or free trade; and
- (c) **Step 3** – to the detriment of the overall interest of Hong Kong.

5. For **Steps 1 & 2** of the test, the following factors can be used to determine whether competition in particular sectors has been, or likely to be, prevented or lessened substantially –

- (a) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the existing market participants;
- (b) the extent to which acceptable substitutes for products/services supplied by the existing market participants are or are likely to be available;
- (c) restrictive government measures, including
 - (i) cumbersome government or public sector systems or measures;
 - (ii) tariff and non-tariff barriers to international trade by governments; and
 - (iii) government's regulatory control over entry;
- (d) any barriers to entry into a market, including
 - (i) **economic barriers** such as the (investment) cost of entry;
 - (ii) **structural barriers** such as sunk costs that reduce the ability to exit, the need to achieve economies of scale, the need to overcome brand loyalty of existing products; and
 - (iii) **strategic barriers** such as behaviour of incumbents that pose a credible threat to successful entry, the pre-emption of facilities by which an incumbent over-invests in capacity in order to threaten a price war if entry actually occurs, and the artificial creation of new brands and products in order to limit the possibility of imitation;
- (e) the extent to which effective competition remains or would remain in a market that is or would be affected by actions or proposed actions by existing or potential market participants;

- (f) any likelihood that actions or proposed actions by existing or potential market participants will or would result in the removal of a vigorous and effective competitor;
 - (g) the nature and extent of change and innovation in a relevant market; and
 - (h) any other factor that is relevant to competition in a market that is or would be affected by actions or proposed actions by existing or potential market participants.
6. There are circumstances where free competition may not be practicable or may not be the best solution, such as in situations where:
- (a) one firm can produce at lower average costs than could more than one;
 - (b) there is a need for prudent supervision;
 - (c) there is a need to protect the long-term interest of consumers; or
 - (d) there is a need to provide incentives for innovation.
7. In the cases mentioned in paragraph 6, a qualitative assessment of the balance between a justified monopolistic situation on the one hand and the benefits of quality services and fair prices on the other is required. This would apply to **Step 3** of the test, which aims to determine market conducts that may be to the detriment of the overall interest of Hong Kong. The following public policy considerations are relevant:
- (a) the need for prudential supervision in the sector;
 - (b) the need to maintain service reliability;
 - (c) the need to meet social service commitments;
 - (d) safety needs; and
 - (e) other public interest considerations.

3rd Pointer: *Specific activities that restrict competition*

8. This pointer helps detect specific instances of anti-competitive practices and abuse of market position.

Anti-competitive practices

9. The following is an non-exhaustive list of examples of **anti-competitive practices**:

- (a) price-fixing intended to distort the normal operation of the market, increase the cost for purchasers, and have the effect of impairing economic efficiency or free trade;
- (b) actions preventing or restricting the supply of goods or services to competitors, and have the effect of impairing economic efficiency or free trade;
- (c) agreements to share any market sector between participants on agreed geographic or customer lines, and have the effect of impairing economic efficiency or free trade;
- (d) unfair or discriminatory standards among members of a trade or professional body intended to deny newcomers a chance to enter or contest in the market, and have the effect of impairing economic efficiency or free trade;
- (e) joint boycotts intended to distort the normal operation of the market, deprive supply or choice to the targets of the boycott, and have the effect of impairing economic efficiency or free trade; and
- (f) bid-rigging,¹ market allocation, sales and production quotas intended to distort the normal operation of the market, increase the cost for and reduce the choice and availability to purchasers, and have the effect of impairing economic efficiency or free trade.

¹ Certain bid rigging activities, as far as public bodies are concerned, are criminal offences under the Prevention of Bribery Ordinance.

Abuse of market position

10. Generally speaking, in considering whether a company is **dominant**, the Government shall take into account relevant matters including, but not limited to –

- (a) the market share of the company;
- (b) the company’s power to make pricing and other decisions;
- (c) any barriers to entry to competitors into the relevant market;
and
- (d) the degree of product differentiation and sales promotion.

11. A company who is in a dominant position would be deemed to have **abused** its position if it has engaged in a conduct which has the purpose or effect of preventing or substantially restricting competition in a market. As illustrative examples, the conducts to be taken into account in considering an **abuse of dominant market position** include:

- (a) predatory pricing – a deliberate strategy, usually by a dominant firm, to drive competitors out of the market by setting very low prices or selling below the firm’s incremental costs of producing the output. Once the predator has successfully driven out existing competitors and deterred entry of new firms, it can raise prices and earn higher profits;
- (b) setting retail price minimums for products or services where there are no ready substitutes;
- (c) price discrimination, except to the extent that the discrimination only makes reasonable allowance for differences in the costs or likely costs of supplying the goods or services;
- (d) conditioning the supply of specified products or services to the purchase of other specified products or services or to the acceptance of certain restrictions other than to achieve assurance of quality, safety, adequate service or other justified purposes;² and

² It is necessary to take into account the commercial practice of “cross-selling”, particularly when in

- (e) making conclusion of contracts subject to acceptance by other parties of terms or conditions which are harsh or unrelated to the subject of the contract.

Mechanism for initiating action against anti-competitive practices and appeal

12. As mentioned in the policy statement, the Government is committed to pro-actively nurture and sustain competition for the purpose of enhancing economic efficiency and free trade. The Competition Policy Advisory Group (COMPAG) chaired by the Financial Secretary –

- (a) directs **all government entities (including all statutory bodies)** to adhere to the policy statement and the above guidelines; and
- (b) calls upon **all businesses** to abide by the policy statement and this set of guidelines and cease existing, and refrain from introducing, restrictive practices that impair economic efficiency or free trade.

13. The following mechanism deals with action against anti-competitive practices and appeals against such actions³:

- (a) **complaints** – alleged restrictive practices in the public and private sectors may be referred to the concerned policy bureau or government department for consideration. Separately, the COMPAG Secretariat will keep track of all referrals and bring these to the attention of COMPAG should there be substantial policy or systemic implications;
- (b) **initiating action** – where justified, the Government will take administrative or legal steps as appropriate to remove anti-competitive practices if necessary; and

the form of bundled products/services which are typically offered to increase the attractiveness of the individual products/services. Very often these service/product packages address customers' preferences as well as lower the cost of servicing to the benefit of the customers.

³ The mechanism for complaints against restrictive practices and appeals in this set of guidelines is in reference to the work of the COMPAG in general. It shall be without prejudice to the action of statutory bodies like the Telecommunications Authority and the Broadcasting Authority which work to sector-specific competition laws.

- (c) **appeals** – all parties subject to action against anti-competitive practices by the Government may appeal to the COMPAG for review of the action concerned;
- (d) Bureaux/departments are expected to implement the recommendations of the COMPAG. In general, the implementation of recommendations by the COMPAG is subject to judicial review or appeal mechanisms built into certain specific laws (e.g. Administrative Appeal Board Ordinance and applicable laws regulating specific sectors).

COMPAG Secretariat
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