



An Economic Instrument to Evaluate the (Pro)Competitive Nature of Industries: The Aggregate Index of Competitive Pressure

**Romanian Competition Council
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We constructed an Aggregate Index of Competitive Pressure (AICP) to measure the propensity to competition in different industries. The index allows comparisons between industries and may prove to be an useful instrument for the competition authority.

In what follows, we need to think in the broader terms of sectors or industries, not in terms of markets.

General comments:

- AICP is a newly developed instrument (second half of 2013).**
- AICP is based only on internal information available to the competition authority.**



General comments (continued):

- AICP rests on solid (micro)economic theory.
- The first application (20 industries) led to robust results.
- AICP is a good addition to a competition authority's toolbox:
 - May help management in making decisions on resource allocation.
 - May be used to quantify competition authority's actions on different markets.
 - May enhance competition authority's efforts to promote a culture of competition in the business environment.
 - May spur leniency applications, given its inhibitory function.



Index construction

- We measure the propensity to free competition by using a battery of 20 indicators.
- 8 of these are considered to be more important.

Class A indicators
Number of active firms
Degree of concentration
Barriers to entry
Degree of innovation
Degree of transparency
Price elasticity of demand
Product homogeneity
Buyer power

Class B indicators
Symmetry of market shares
Stability of market shares
Multi-market contacts
Structural links
Profitability
Symmetry of costs
Spending in marketing and communication
Existence of “maverick” competitors
Changes in aggregate demand
General price level, relative to other countries
Existence and impact of business associations
Import rate



Index construction (continued)

- Many of the indicators we use are usually discussed in the literature and observed by competition authorities.
- Focus on general factors ensures comparability among industries.
- Focus on easy-to-evaluate factors ensures responsiveness.
- Each indicator is measured on a 7-point scale (lower bound is associated to the highest risk to competition, and vice-versa).
- Expert opinion approach: information provided by competition inspectors in charge with the specific sector.

Example: Barriers to entry

A



C

D

E

F

G

It is very difficult for other companies to enter this market

It is very easy for other companies to enter this market

When answering this question, please take into account any type of barrier to entry: high fixed costs, need of a network, need of approvals and authorizations, other regulations, importance of reputation, brand power of existing players and such.

Example: Degree of transparency

A

B

C



E

F

G

Competitors can perfectly observe essential elements of others' activity

Competitors cannot observe essential elements of others' activity

When answering this question, please consider how easy and how accurate can companies observe the costs, prices and sales of their competitors.



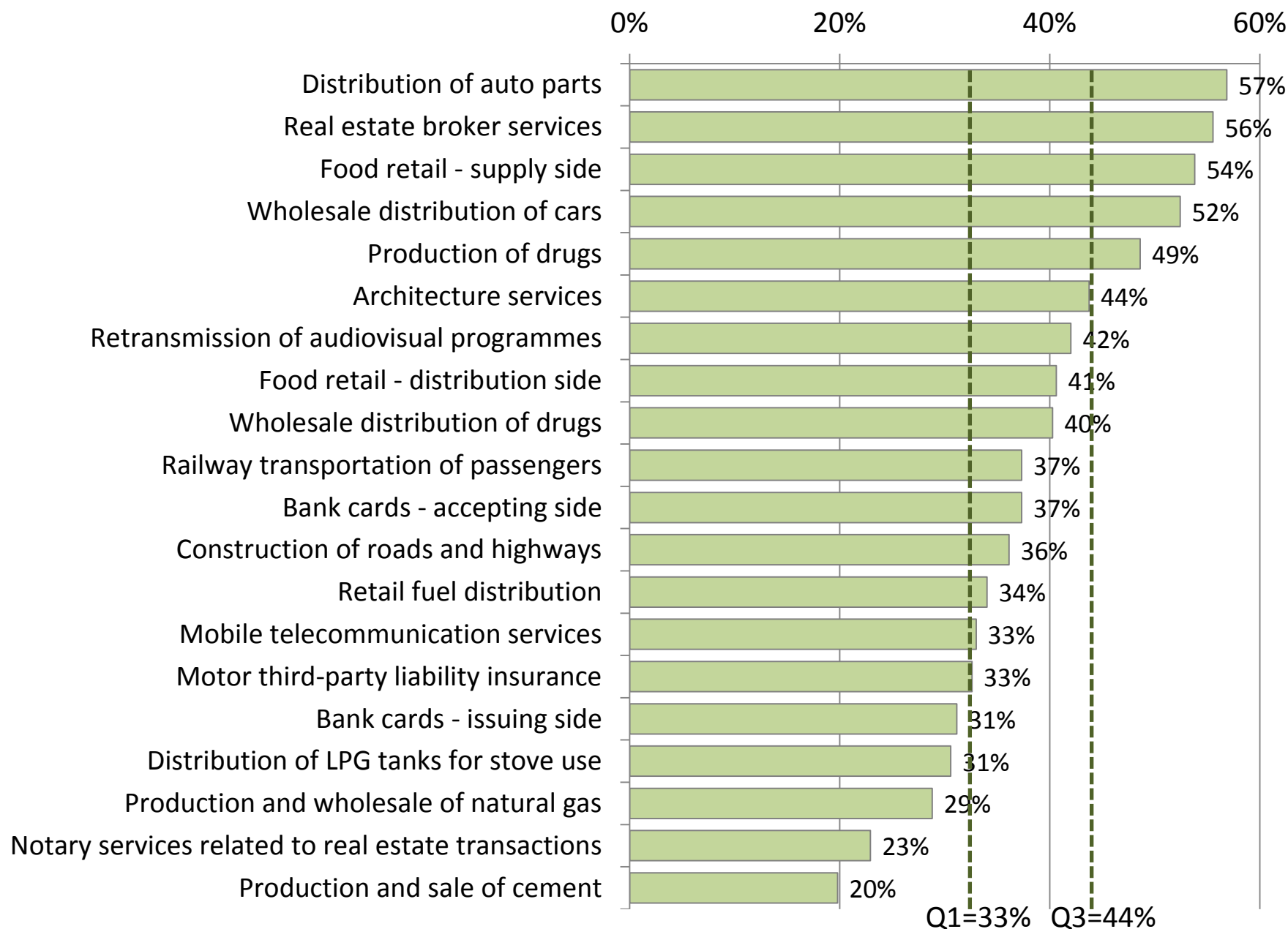
Index construction (continued)

- We allocate points to each step of the scale, increasing the number of points as we go to the right of the scale (as problems become less and less acute).
- Most important indicators (class A) receive 50% more points than the other indicators (class B) at each level of the scale.
- Finally, the index is normalized (computed as % of total maximum possible). A value closer to 0 is “bad”, closer to 1 is “good”.

Results

- AICP constructed for 20 industries.

Applying AICP for 20 industries in the Romanian economy, 2013





Additional comments

- **Dissemination of results should be done with caution: no accusations based on AICP, no blank checks either.**
- **AICP can be further tweaked in many ways:**
 - **Add indicators?**
 - **Remove indicators?**
 - **More indicator categories?**
 - **More detailed scales?**
 - **Another system to allocate points?**
 - **External validation of answers?**



Thank you!