Title: Relevant Market Definition in Merger Policy - A Case of Financial Services

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Abstract

It is believed that financial globalization, deregulation and technological advance would cause a continuous consolidation of financial industries in the next decade with the potential positive and/or negative effects on competition in these markets. In order to provide efficient and smoothly operating financial market that would support growth of economies and help to increase welfare competition authorities are called for economic analysis of almost all areas of competition. A key part of the analysis of competition is believed to be the relevant market definition. The paper focuses on financial industry and addresses two issues. The first is the identification of the key problems arising in the definition of the relevant market for financial services, especially in the EU. The second is a formulation of some recommendations for competition authorities in defining relevant market of selected financial services, in particular when they judge the proposed concentrations.

Key words: *relevant market, financial industry, mergers and acquisitions, concentration, competition policy, banking, insurance*

Introduction

Financial globalization, deregulation, technological advance, and shareholder value creation are the major factors that have fuelled the unprecedented level of mergers and acquisitions among financial institutions over the past few years. Thus competition authorities should rethink their regulatory structure in response to the emergence of large financial groups in order to assure stability of financial systems and preserve competition on financial markets.

A constitutive part of regulatory control is the economic analysis of competition for a competition review, which involves the definition of relevant market as typically the first step2 in making preliminary estimate of post-merger market power. In this perspective, market definition has becomes a key part of the merger analysis in almost all areas of competition, in particular in countries, where competitive assessment is made on the basis of market shares.

The paper starts by discussing the relevance of market definition from the normative point of view. It continues by reviewing the practice in determining the relevant product and geographic markets in financial industry with particular focus on banking, insurance, pension funding and other financial services both in the EU and some other countries (US, Australia and Canada). The paper ends by highlighting the industry specific competition issues arising in market definition and by an attempt to give some recommendations for competition authorities dealing with financial concentration cases.

Relevant market definition and competition policy

In (industrial) economic literature, there are several concepts of market used in different contexts. The classical definition of a market finds a clear articulation in Marshall's Principles and leads to the definition of economic or trading market, which could be defined as "...a collection of individuals (or associated geographic area) who face the same net price for any particular good or service; i.e. the area over which the law of one price holds, (Gerosky 1998, 679)". Strategic market follows the needs of strategic corporate decisions inside firms. Although there are several ways of defining strategic market boundaries3, it could be argued that a strategic market is: "...a smallest area within which it is possible to be a viable competitor" (Kay 1990, 3).

The concept of relevant market, defined for the purpose of competition policy is designed to identify positions of market power. Market definition is closely related to the objectives pursued under competition policy of a country and often has a decisive influence on the assessment of a competition case.

In the US, antitrust markets have first been defined by the Department of Justice as "...product or a group of products and geographical area in which it is sold such that a hypothetical, profit maximizing firm, not subject to price regulation, that was the only present and future seller of those product in that area would impose a 'small but significant and non-transitory' increase in price above prevailing or likely future levels (US department of Justice 1984, 13).

In determining, whether a hypothetical monopolist would be in a position to exercise market power, the competition authority evaluates the likely demand responses of consumers to a price increase. The nature and the magnitude of the demand responses respectively determine the scope of the product and geographic market. In contrast, where a hypothetical monopolist would likely discriminate in prices charged to different groups of buyers, distinguished, for example, by their users or locations, the competition authority may delineate different relevant markets corresponding to each buyer group (Horizontal merger guidelines, 1997).

European Union competition authority sees the objective of market definition as "to identify those actual competitors of the undertakings involved that are capable of constraining their behaviour and of preventing them from behaving independently of an effective competitive pressure" (Commission notice on the definition of the relevant market for the purpose of Community competition law, 1997).

In this context a relevant product market "...comprises all those products and/or services which are regarded as interchangeable or substitutable by consumer, by reason of the products' characteristics, their prices and their intended use" (Commission notice on the definition of the relevant market for the purpose of Community, 1997).

A relevant geographic market "...comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably in those areas" (Commission notice on the definition of the relevant market for the purpose of Community). In the case of retail markets, we have repeatedly defined geographic markets as a number of individual concentric circles limited by the distance the consumers are prepared to travel in order to reach the outlet of a competing firm (+-20km).

To assess the demand substitution the European Commission usually apply so-called "SSNIP test" or "dominance" test.4 The Commission examines whether the involved firms' customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small (in range 5 - 10%), permanent relative price increase in the products and areas being considered (EC 1997, 3-4). Current test for assessment of demand substitution thus focuses on the structural component of a concentration.

Additionally to demand substitutability, the Commission takes into account supply side substitutability when its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy. This means the suppliers are able to switch production to the relevant products and sell them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices.

Defining the relevant market for financial services

The criteria to define the relevant market are generally used for the analysis of certain behaviour in the market and for the analysis of structural changes in the supply of product. However, this methodology might in practice lead to different results depending on the nature of the competition issue being examined. Therefore the application of economic-wide merger guidelines and practices has to be tailored to the specifics of the financial industry, such as the role of legislation and regulatory supervision, the technological advance in distribution networks etc.

The number of cases in financial industry in EU is relatively small as a considerable number of concentrations in the industry still take place on a national level5. However, the Commission has an important role to play in shaping the financial markets of the enlarged European Community as further globalization of the industry is expected.

The EU record on defining relative markets in financial industry is relatively less informative as in the most cases the proposed concentrations did not raise significant competition concerns even on the narrowest market definition.6 Therefore, Commission has left the precise market definition open in most cases even though merging parties have proposed their own market definition. There are at least three reasons: i) activities of the involved companies were only minor on the level of European union, ii) activities of the involved companies overlapped, or iii) the markets were highly fragmented and there were many active competitors. Nevertheless, the review of Commission's decisions regarding concentrations in financial industry could give the national competition authorities an important guidance in defining the relevant markets.

In the following section, the overview of EU practice in defining relevant markets of three main categories of financial services is presented: financial intermediation (J.65 NACE Classification), insurance and pension funding (J.66 NACE Classification) and activities auxiliary to financial intermediation (J.67 NACE Classification).

Banking

The European Commission has traditionally divided banking services into four main subsectors: retail/customer banking, corporate banking, investment banking and financial markets.7 the division into variations of these major groups (corresponding to individual country characteristics or competition authority needs) is usually found in decisions of the competition authorities also in other countries, such as US, Australia and Canada. Kahwaty et al. (2003) similarly find that competition authorities divide the banking services into consumer services, banking services for small/medium enterprises (SME), and electronic payments and fund transfers both in the EU and the above mentioned countries.

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Retail banking - services for individual customers

The most segmented market is the retail/customer banking. Here individual products have distinct characteristics and are best treated separately. The parties in the EU cases suggested a number of possible subdivisions, including universal banking market (current/transaction accounts), the deposit market, credit to private individuals...9 Kahwaty et al. (2003) study customer banking in EU, Australia and Canada and find that the competition authorities tended to treat product markets according to individual products.

It is interesting that the EU Commission, in addition to following the individual product approach, assessed the mergers also across the various retail product markets 8they combine different product markets). They based their reasoning on the fact that several retail banking services (both for individuals and SMEs) are closely linked at the distribution level (one branch of o bank, one phone or internet banking facility). The most frequently cited product markets included: current/transaction account, personal loan, residential mortgage and saving account/investment markets.

Current/transaction accounts were in most cases treated as a relevant individual product market.10 the main purpose of the current/transaction accounts is to facilitate money transactions and in this function they have relatively low substitutability. These accounts are also used in dealing with financial institutions regarding other financial services (like obtaining loans or purchasing a mortgage) and are frequently seen as "gateway" financial products by the banks.11 Current/transaction accounts are usually obtained locally, that determines their definition of their geographic market.

Savings accounts are in their nature closer to investment products then to the transaction accounts. They have very different characteristics and are consistently treated separately and sometimes even along with other investment products12. Similar to loans, also savings and investment products tend to have larger number of suppliers and stronger competition than current/transaction accounts. Among saving products, various fund types constitute the same product market in the EU due to high substitutability. Take for example mutual fund, which, unlike direct investments, enable the customer to choose from a mix of various financial investments and provide him with fund management services. Savings and investment products are geographically distributed through remote channels and therefore require wider definition of the relevant geographic market than local.13

Loan and residential mortgage markets are usually treated as two separate markets due to their distinctive nature and uses14. Canadian competition authority noted that there is only limited substitutability between traditional bank loans and mortgages. This seems to be true also for credit cards (much higher price), which are also consistently treated as a separate relevant market. Although the overdraft facilities are included in the same product market as loans, the leasing and factoring services are considered as separate individual markets. These markets are more competitive than the current/transaction accounts due to the presence of a variety of non-banking suppliers. Geographic market for these products is rather wide since especially consumer loan products and credit cards are distributed over much larger distances.

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Financial sector experienced very dynamic financial innovations and development of electronic banking. The range of financial products ever closer resembles the continuity between the transaction accounts on one extreme of the spectrum and pure investment/saving accounts on the other. This complicates the competition analysis since the clear division between the two is blurred. The "hybrid" products that share characteristics of transaction and investment functionality are difficult to separate.

Australian competition authority set an important precedent deciding that transaction accounts and bank issued deposit/term products are in separate product markets. The parties involved argued that broader relevant markets should be considered to include a wide range of household investment products pointing out the chain of substitutability. The authority explicitly rejected this argument and found little evidence of close substitutability among the various investment products. In rather strong contrast, the EU Commission within savings products identified a separate market for deposits comprising current accounts, savings accounts and time deposits, characterized by a high degree of supply-side and demand-side substitutability. Thus, there remains a degree of uncertainty as to where to draw the line to divide this spectrum of financial products into "mostly transaction" and "mostly saving/investment" region.

Corporate banking

We will distinguish between the corporate banking (for large corporate customers) and retail corporate banking (for small and medium enterprises - SME). The approach conforms to the EU Commission's distinction between the two although the EU traditionally includes SME's in the retail banking (along with private individual customer banking). However, due to the corporate nature of the SME banking we discuss it here.

Corporate banking for large corporate customers includes investment loans, roll-overs, short-term products (i.e. straight loans and discount credits), guarantee credits, swaps, collective investment funds and commercial paper. Due to small number of relevant cases in corporate banking and the relevance of SMEs for competition practice (as they are more vulnerable to the exercise of market power than large corporate clients, who may turn to the stock markets for their liquidity needs), the SMEs will be our focus in what follows.

The SMEs usually purchase different financial services from the same bank where they also have their business transaction accounts (Kahwaty et al. 2003). The main reason for this is twofold: i) there are economies of scope for the bank - more favourable conditions, ii) the banks can monitor the economic performance of the SME and the associated risks through the business transaction account.

Within the banking services for SMEs competition authorities on the EU level, in the EU countries, Canada, UK, US and Spain were concerned primarily with most frequently purchased loans and transaction accounts and did not find good substitutes for bank loans for business.16

Therefore in most cases the product market was defined in terms "clusters" of products that included loans, deposit accounts and occasionally some other services.17

A number of competition authorities found that geographically the SME financial services have very strong local orientation.18 Again this was somewhat broader for loans and relatively narrow for the transaction accounts. On the contrary, he EU competition authority acknowledged strong local tendencies for these products, but due to the nation-wide activities of the providers considered the relevant geographic market to be national.

Financial markets and electronic banking

Financial markets and investment banking include money markets operations, bond, other debt, equity and foreign exchange trading, equity underwriting, debt underwriting, and derivatives. There have not been many cases of mergers in this area that would raise competition issues. There are at least three reasons for this: i) extremely quickly changing landscape of financial products, ii) globalization of financial services and iii) from the previous resulting stiff global competition.

Product markets here can be as diverse as a range of new financial services and instruments. As an example can serve the EU cases19 in which the product markets were determined as "global custody services"20 and "fund administration"21. But also in these cases no final definition of the product market was determined, since it did not raise serious competition issues. These services are provided locally, nationally and internationally, therefore the determination of the geographic markets may be very cumbersome.

For Electronic funds transfer and payment systems Kahwaty et al. (2003) found two distinct markets to be identified: retail payment system markets (including credit and debit cards) and wholesale markets. The EU Commission identified two markets related to the payment cards: the market for issuing of general international payment cards (competition between the different payment systems, such as MasterCard and Visa) and market for provision of card related services (competition between different banks and financial institutions).

For Electronic funds transfer and payment systems Kahwaty et al. (2003) found two distinct markets to be identified: retail payment system markets (including credit and debit cards) and wholesale markets. Retail payment system markets are used in determining the conditions and prices of networking like the conditions of access, the fees charged...Wholesale markets may focus on data processing, network switching, ATM machines or even shared electronic network services. For example, access to ATMs was identified as a separate market if the banks needed to access their competitors' networks. With extremely fast development of computer support for these activities, their international nature and global integration of financial markets the relevant geographic market her are likely to be at least national and May easily transgress the national borders.

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Insurance and pension funding

The European Commission has traditionally divided insurance sector into two main subsectors: direct insurance and reinsurance.

Direct insurance

In the direct insurance a distinction is to be made between life and non life (general) insurance22. However, according to Commission decisions both life and non-life insurance can be divided from the demand side into as many product markets as there are different kinds of risks covered as their characteristics, premiums and purposes are distinct and there is typically no substitutability for the consumer between the different risks insured.

In the life-insurance most of the markets are still fragmented and there are many competitors active.24 Notifying parties have suggested several possible life-insurance markets, such as individual and group life insurance, (Fortis AG/General Bank), unit linked policies, other life policies and pension products (CU Italia/Banca delle Marche/JV), life individual, lifegroup and unit linked (Fortis/ASR) and life assurance policies, investment policies and pensions (CGU/Norwich Union and Axa/GRE).

In several other cases (AEGON UK/GRE, Winterthur Life/Colonial, CGU/Hibernian, AEGON/Guardian Life)29, the notifying parties suggested life assurance products and pensions products should be regarded as similar products for several reasons. First, from the demand perspective they are both long-term business products involving a premium payment by the insured and a liability on the part of the insurance company, which becomes payable many years later. Furthermore, both products involve certain degree of risk on the part on the insurance company in respect of the length of life and the individual insured. Supply side considerations also indicate strong substitutability as both products are generally offered by the same companies and providers are subject to the same regulatory regime. Finally, within both life assurance and pensions products a distinction can be made into products sold to individuals and those arranged for groups.

However, the Commission has left the market definition open as the proposed concentrations, even on the narrowest market definition, did not create or strengthen a dominant position and thus raise serious doubts as to its compatibility with the common market. On contrary, in the case Generali/Ina the Commission divided life insurance market in the Italy into the market for the insurance on the duration of human life (i.e. the so-called "Ramo I", which includes death, life and mixed insurance) and the market for life insurance products connected with investment fund. In the area of non-life insurance market can be segmented to aerospace, marine, commercial & real estate, credit insurance, accident health, fire and other damages to property, general liability, motor vehicle liability, transport liability etc. According to Commission decisions, the non-life insurance products could be further subdivided into private (personal) and commercial insurance. One of few areas within the non-life insurance, where the Commission did not left the product market definition open, is the definition of relevant markets for delcredere insurance which is part of credit insurance business.

In its first decisions the Commission defined delcredere insurance as comprised by domestic credit insurance, export credit insurance and capital goods insurance. Subsequently in the case Gerling/NCM the Commission accepted the reasoning that capital goods insurance should constitute a separate market. In contrary to other delcredere insurances that are covering only short-term account, capital goods insurance namely covers insolvency risks deriving from the purchase of infrastructure in the home market or abroad and operates on a medium- and long-term basis. In addition to that, the capital goods insurance policies relate to one specific contract, which is evaluated individually, whereas, in contrast, delcredere cover is provided for a portfolio of customers.

In general, the Commission concluded, that from the supply side perspective many different types of non life insurance should be included in the same product market. The conditions for insurance of different risk types are namely quite similar and most large insurance companies are active in several risk types. The insurance products require a common set of skills and resources

including risk management, administration I.T. systems and claims management. Therefore any insurer could easily switch market insurance coverage for one type of risk to another.
Concerning geographic dimension of relevant market, insurance markets are becoming more open to intra-community competition, particularly for industrial and commercial policies, as a result of current and future measures to facilitate cross-border selling. Nevertheless, as far as direct life insurance and most of non-life insurance for household and individual is concerned, the relevant geographic market seem at present to be mainly national, in view of the established market structures, the need for adequate distribution channels, fiscal constraints in some cases and differing national systems of regulatory supervision.
When considering direct insurance of (large) commercial risk, the Commission has not excluded that the markets could be wider than national. As far as aviation insurance is concerned, the Commission in the Allianz/Vereinte case and Berkshire Hathaway/Converium/Gaum JV considered that it has Community-wide dimension as far as large risks are insured. In the Axa/UAP decision40 this view was confirmed for other high risk transport insurance markets such as navigation and space insurance.

Reinsurance

The reinsurance is a market separate from (direct) insurance because of its purpose to spread risks between insurers and is conducted between insurers and reinsurers on an international basis because of the need to pool the risks. The reinsurer accepts either the whole or part of the direct risk insured by another insurer and thereby provides the primary insurer with the ability to increase the amount of insurance which he underwrites and to diversify his risk over time and geographic area. Reinsurance is traded between industry specialists, it is written only with other insurance companies, no premium income is derived from reinsurance sales to the public and no channels for retail distribution are required. The regulatory framework is less stringent than that of life or non-life direct insurance. For these reasons the reinsurance market gives rise to different conditions of competition compared to direct life and non-life insurance.
Also the reinsurance market can be further subdivided into the life and non-life segment. The same distinction as in the case of direct insurance applies also for the further delineation of reinsurance markets according to demand and supply side substitutability. The notifying parties in the case CGU/Norwich Union43 however suggested, that reinsurance should be

subdivided into treaty reinsurance (reinsurance of a portfolio of business, covering a number of risks) and facultative reinsurance (reinsurance on an individual policy basis).

However, the Commission believes, that while some reinsurers may specialise in particular types of covers, the relevant non-life product market is that of the supply of reinsurance as a whole since any reinsurer could readily and swiftly offer reinsurance coverage for any type of risks44.

Barriers to enter new risk are quite low, because:

a) Approval to offer reinsurance cover for the new type of risk is easy to obtain

b) No specific additional distribution channels are needed since reinsurance cover for a new type of risk could always be sold via brokers

c) Relevant expertise required to offer reinsurance cover for a new type of risk could be acquired by recruitment relatively easily and rapidly.

Since reinsurance products are traded between industry specialists and not sold to the general public, the controls by national authorities over the conduct of pure reinsurance tend to be much less extensive than in direct insurance. This, together with the fact that reinsurance business can be conducted without the necessity of maintaining a large distribution force, tends to indicate that the market has a global character. The existence of a world market is also evidenced by the presence of international broker firms, which mediate reinsurance volumes on a worldwide scale.

Within the European Union freedom of establishment to provide reinsurance services was enacted by Directive EEC 225/6445.

Within the insurance sector Commission also investigated the insurance distribution46 and underwriting and management services to insurers/reinsurers.47 in all cases the Commission considered that insurance distribution and underwriting services represent market distinct from the provision of insurance or reinsurance. The latter market their own products and have a commercial interest in selling these products to their clients, whereas the first act as intermediaries between (re)insurers and clients.

The insurance distribution market could be further subdivided according to i) distribution channels, ii) the type of product or iii) client size. The Commission namely found indications that brokers are by far the preferred provider of insurance and risk management services for large corporations and multinationals, because they can offer them additional services that go beyond the actual placement of insurance cover (such as identification and assessment of risk, security rating of insurers, independent actuarial services etc.). On the other hand, brokers' services to private customers (individuals and even small enterprises) are more easily substitutable by direct dealing insurers, insurance agents or other intermediaries because the risks covered are more standardized.48

Because of wide variation in the methods of insurance distribution from Member State to Member State, the relevant geographic market would be national.49 Whether the relevant geographic is larger than national was left open since, in all alternative geographic market definitions considered, serious doubts about the compatibility with the common market were excluded. For the reinsurance distribution and underwriting and management services to insurers/reinsurer the relevant geographic market is worldwide. This is inline with the Commission' previous decisions regarding reinsurance.

Other financial services

Within other financial services we present the definition of relevant markets in the audit and accounting services sector due to the increased interest in these services raised by Enron and Andersen crises. The Commission traditionally defined the following relevant product markets50: i) audit and accounting services; ii) legal advisory and compliance services and iii) corporate finance advisory services. In two cases, management consultancy services and insolvency markets were identified additionally.51

Audit and accounting services consist of the performance of statutory and other audits of companies' accounts and other "audit-related" accounting services, such as general accounting services, systems assurance, business risks assessment, internal audit, transaction services, in particular due diligence services and preparation of reports for stock exchange listings, and advice in international accounting standards. The legislation in certain countries52 limits demand side substitutability between these two services and there might be need for separate relevant markets for each service. But as supply-side substitutability between both kinds of services exists the Commission decided they belong to single market.53

However, within audit and accounting services market separate relevant market exists for audit and accounting services to quoted and large companies, whether national or international in dimension. The decision was based on the special needs of these firms such as i) all large companies need significant resources; ii) especially the quoted companies need audit and accounting services provided by a firm with the necessary reputation in the financial markets, iii) multinationals need the geographic breath to cover the companies' needs worldwide and iv) large companies in general and, in particular, regulated sectors such as banking and insurance, need the depth of expertise in the particular sector. According to Commission only worldwide active audit and accounting firms known as the Big Five54 can offer services in these market as they have both the geographic coverage and the degree of reliability with respect to financial statements required by the international capital markets.

Within the legal advisory and compliance service the Commission considers the provision of tax advisory services as distinct relevant market. The tax advisory services require strong specialisation and a constant up-date of know-how due to frequent and significant changes in tax legislation. Therefore the level of supply-side substitutability with other legal advice is very limited. In legal advisory and tax advisory additional distinction can be made for services provided predominantly with regard to national (tax) legislation or, and services with international dimension.

Because of the particular significant national differences for the services' main features such as the specific professional expertise required, applicable regulations, and the relevant laws, the Commission defined that markets for audit and accounting services (to quoted and large companies and to small and medium-sized companies), legal and tax advisory and compliance services, are national in scope. For the corporate finance advisory services and management consultancy services the geographic scope of the market can be bigger than on national level.

Conclusion

Relevant market definition is believed to be a key part of the concentration analysis in almost all areas of competition law, in particular in countries, where competitive assessment is made on the basis of market shares. The framework governing the examination of concentrations in financial industry and the determination of relevant markets in particular is the same as in other industries. The most challenging issues the Competition authorities on the EU and national levels will probably face in the future is to create efficient and competitive firms at the national and international level while protecting competition at the retail and SME level. Whereas competition in financial markets is frequently international, consumers and SMEs are exposed to market power exercised by banks and insurance companies with local presence. Barriers-to-entry at this level (asymmetric information, banking infrastructure) can be quite high.

The practice of merger analysis in the EU shows that the proposed concentrations in the financial industry have not so far raised serious doubts as to its compatibility with the common market. The precise definition of the relevant markets has thus been left open in many cases.
Examining the practice for many bank and insurance mergers indicates the distribution power (access to profitable customer base) to be the key source of market power in this industry, whereas "producing or switching" a new or different product is comparatively easy for existing players. Therefore, it would be advisable that competition authorities in general follow the practice of the European Commission, Canadian Competition Bureau and UK Competition Commission and assess the impact of mergers in banking and insurance sector both on the level of individual product markets and across the various retail product markets.
Retail banking is of particular relevance for competition practice as mergers in this part of financial industry are susceptible to producing adverse effects on consumers both private individuals and SMEs. The latter are thus more vulnerable to the exercise of market power than large corporate clients, who may turn to the stock markets for their liquidity needs. However, data in the continental Europe show that even large firms predominantly use banks as source of funds.
It seems reasonable to expect that SMEs also in small open economies, especially some of the acceding EU countries, would acquire most of its services from one bank. This is likely to be true for majority of the money transactions services and business loans. Based on this assumption, "clustering" the product markets for SME banking services would be appropriate. Is there a need to additionally assess a particular merger in retail banking for SME across a variety of products based on the distribution level (EU model) remains an open question? In very small economies we might see a relatively larger share of the loans to be obtained across the border. But the market share is likely to be limited since the fact that SME does not have a transaction account with a bank abroad to a certain degree prevents its effective monitoring. Additionally, operating across the border means working under different legal arrangements, cultures... This would merit somewhat broader definition of the geographical market for loans and saving/investment instruments for SME's (as oppose for local for transaction accounts and some aspects of the payment systems).
Somewhat adjusted definitions of the relevant market would be needed also for large corporate customers that have access to international capital markets. In the new EU member countries and

other transition economies in the EU proximity, the financial markets are relatively less developed and there is a need for import of capital. The latter is done through the direct business loans from abroad, selling bonds on international markets or a number of other ways. Therefore, although money transaction services are mostly purchased locally, the credits and investment instruments may be readily obtained abroad. This requires broader definition of the markets for such products.

The above is likely to be applicable also for individual customer banking. In the acceding EU countries people traditionally, for a variety of reasons, kept their savings in form of foreign exchange and often search for credits abroad. The financial sector in these countries is relatively less developed and some financial instruments are not available or relatively new. Among these are residential mortgage credits and mutual funds. Especially dealing with the mutual funds the transition economies would have to distinguish between the "normal" mutual funds and "privatization" mutual funds when defining relevant markets.

For small economies the definition of geographic markets that is smaller than nation-wide has hardly any sense (e.g. in Slovenia). The areas may be very small and the geographical accessibility of different financial services and institutions is guaranteed. The question has to be turned around: How far abroad should reach the relevant market? The answer is that it depends on the "tightness" of the borders. The countries merging into the EU may need to expand the traditional definitions of the relevant geographical markets. In contrast, those that will face the strict Schengen regime on their border may need to contract them.

In the view of development in financial sector, there remains a degree of uncertainty as to where to draw the line to divide the spectrum of financial products into separate product markets. The competition authorities should also be aware of new products such as "bank assurance" that arise from mergers of banks and insurance companies. Additional impetus for creating new product markets are also reforms of social security and health systems in most of the old and especially in the new EU countries.

Finally, most of the methods for determining the effects of a possible merger require determination of the relevant market in their first stage. The practice suggests market definition is a highly empirical issue that should be addressed by examining consumers' actual willingness to substitute in response to changes in relative prices.

However, some simulation methods for estimation of the merger effects can be used to circumvent this treacherous terrain. As Lexecon (2003) argues: "Merger simulation is a merger assessment technique that can bypass the need for a protracted debate over market definition. It is technically demanding approach, which combines demand elasticises with an assumption about the nature of competition to estimate directly the unilateral effects of a proposed merger on the prices and outputs of market participants".

The assumptions involved seem rather restrictive. However, authors (Froeb and Werden, 1996; Werden, 1997; Davis and Wilson, 2000...) report a very successful application to the mergers of the enterprises in the markets with differentiated products55. Such differentiated products are a very common characteristic in the financial markets. Thus the methodology has (it has been used by the Antitrust Division of the Department of Justice in the US) and may in the future still find a fruitful use in analyzing the mergers in financial sector.

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