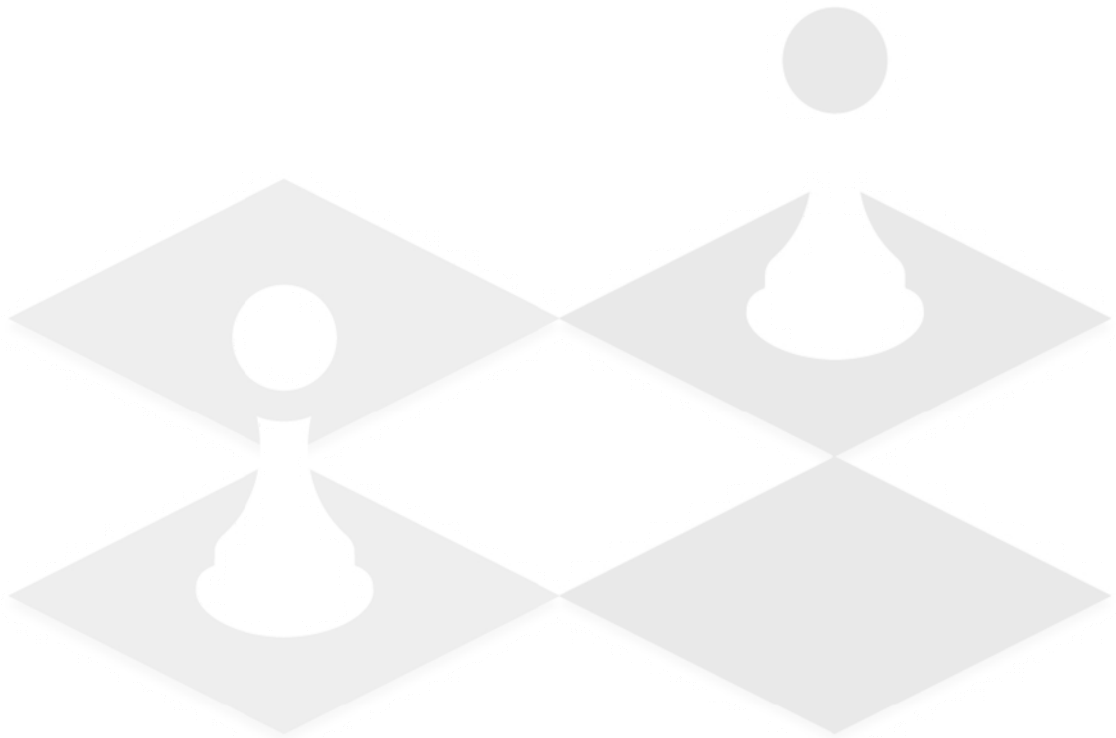


# How to Assess “Turnover” for Exclusions from the Competition Ordinance Conduct Rules



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The Competition Commission has published this Guidance Note to assist undertakings, particularly Small and Medium-sized Enterprises (SMEs), determine whether they fall within the turnover-based exclusions in the Competition Ordinance (the turnover thresholds).

This note summarises and explains the rules about calculation of turnover in the Competition Ordinance and the Competition (Turnover) Regulation.

This Guidance Note does not deal with the calculation of turnover for the purposes of section 93 of the Competition Ordinance [pecuniary penalties].

### What are the turnover thresholds for undertakings?

Under Schedule 1 of the Competition Ordinance:

- Unless Serious Anti-competitive Conduct is involved, the First Conduct Rule (FCR) does not apply to agreements and concerted practices if the combined turnover of the undertakings involved does not exceed \$200,000,000 in the relevant turnover period.
- The Second Conduct Rule (SCR) does not apply to conduct of an undertaking with turnover not exceeding \$40,000,000 in the relevant turnover period.

Serious Anti-competitive Conduct is defined in the Competition Ordinance as price fixing, market sharing, restricting output and bid-rigging. For more information about the FCR (including the meaning of “Serious Anti-competitive Conduct”) and the SCR, see the Commission’s *Guideline on the First Conduct Rule* and *Guideline on the Second Conduct Rule* (available at [www.compcomm.hk](http://www.compcomm.hk)).

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## How do I work out my turnover?

Schedule 1 of the Competition Ordinance defines turnover as the **total gross revenues** of an undertaking whether obtained in Hong Kong or outside Hong Kong. These are the amounts derived by the undertaking from its ordinary activities (that is, any activities undertaken by an organisation as part of its business and any related activities in which it engages). The turnover period is a financial year or a calendar year, as applicable (see further below).

For most SME companies who have financial statements prepared under the HKICPA Small and Medium Sized Entity Financial Reporting Standard (SME-FRS) turnover will be the figure appearing as “revenue” in the SME’s Income Statement for the financial year that ended in the previous calendar year.

In other words, this “revenue” figure captures amounts derived from ordinary activities.

### Hypothetical Example 1: FCR

ABC Limited, XYZ Limited and 123 Limited make an agreement in July 2016 that may harm competition and may be subject to the FCR. The agreement does not involve “serious anti-competitive conduct”. A review of their Income Statements for the financial year ended 31 December 2015 show that ABC reported revenue of \$29,000,000; XYZ reported revenue of \$57,000,000 and 123 reported revenue of \$44,000,000. The combined turnover of the undertakings involved in the agreement falls under the turnover threshold and the exclusion from the FCR would apply.

The following additional considerations may be relevant for some SMEs, particularly if they do not report revenue according to the SME-FRS :

- In calculating total gross revenues, sales rebates directly related to the revenues may be deducted from the amounts derived by the undertaking from its ordinary activities (see Competition (Turnover) Regulation). Such rebates would ordinarily be excluded from the calculation of “revenue” in an Income Statement, and therefore it is not necessary for most SMEs to separately consider the impact of rebates.

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- In calculating total gross revenues, taxes directly related to the revenues may be deducted from the amounts derived by the undertaking from its ordinary activities (see Competition (Turnover) Regulation). The figure appearing as “revenue” in an Income Statement will ordinarily already have any sales tax, goods and services tax and value added tax deducted and therefore it is not necessary for most SMEs to separately consider the impact of taxes.
- Any grant, subsidy or financial assistance provided by a public body in return for the supply of goods or services is to be treated as an amount derived from the undertaking from its ordinary activities. Government grants would normally be included as “revenue” in an Income Statement and therefore it is not necessary for most SMEs to separately consider the impact of grants.

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## What if I have a group of companies?

The turnover thresholds in the Competition Ordinance are concerned with the turnover of *undertakings*. Two or more companies will be part of the same undertaking if they constitute a single economic unit. Further information about the concept of single economic unit may be found in the Commission's *Guideline on the First Conduct Rule*.

Under the Competition (Turnover) Regulation if an undertaking consists of two or more entities and each of those entities prepares accounts, the total gross revenues of the undertaking for the purposes of the turnover thresholds are the total combined gross revenues of all of the entities. However, no account is to be taken of revenues resulting from transactions between those entities (eg intra-group transactions).

Under usual accounting principles, company groups report revenue on a consolidated basis, where revenue flows between companies in the group are excluded from the calculation of total revenue. Thus for a group of companies, in most cases the consolidated revenue of the group as it appears in the Income Statement is the relevant figure to use.

### Hypothetical Example 2: SCR

Company group ABC consists of a parent company and five subsidiaries that produce different grocery items to supply to supermarkets in Hong Kong. The companies are closely interrelated and provide services and materials to each other. Their income statement reports group revenue of \$100,000,000 on a consolidated basis.

One of the subsidiary companies has a large share of the market for a particular grocery product. A question has arisen as to whether its conduct is excluded from the SCR or not. The relevant turnover to consider is that of the group, which is the "undertaking" for the purposes of the Competition Ordinance, not the individual subsidiary. In this case the exclusion would not apply as the turnover is more than \$40,000,000. However, this does not necessarily mean that the undertaking has a substantial degree of market power for the purposes of the SCR.

### What if I am not a company?

For SME undertakings that are not companies, a check of annual sales, revenue or income, however recorded, should be your first step. Only if this amount brings you close to the threshold would it be necessary to more exactly determine your turnover by ascertaining whether this is the amount derived from your ordinary activities excluding rebates and taxes related to the activities.

#### Hypothetical Example 3: FCR

Mr X is a builder operating as a sole trader. The money he has received from providing building services for the past year is \$15,000,000. He enters an exclusive agreement with two building supply companies who each have annual revenue of \$25,000,000. A question is asked as to whether the supply agreement, which does not amount to serious anti-competitive conduct, might raise any competition concerns.

Mr X does not need to take any further steps to calculate his turnover. He and his two suppliers are clearly under the turnover threshold and the exclusion from the FCR therefore applies. Since the combined turnover of the relevant undertakings is well below the turnover threshold for agreements (\$200,000,000) Mr X needs not calculate turnover with precision and it is fine for him to rely in his own case on the figure representing the amount of money he has received from providing building services.

A partnership will usually operate as a single economic unit and therefore the partnership and not the individual partners will be the relevant “undertaking” for the purposes of the Competition Ordinance. The partnership revenue as disclosed in the partnership accounts will usually be the relevant turnover amount.

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#### Hypothetical Example 4: SCR

A law firm operates as a partnership. The partnership has received revenue of \$60,000,000. A question under the SCR has arisen in relation to the conduct of one of the partners of the firm.

As the law firm is the relevant “undertaking”, it is the total revenue of the partnership that is the relevant turnover. The partnership would not be able to take advantage of the turnover threshold of \$40,000,000 to be automatically excluded from the SCR. However, even though it is above the threshold, unless the law firm also had a substantial degree of market power, and had engaged in conduct amounting to an abuse, it would not be at risk under the SCR.

#### What is the “turnover period”?

For most SMEs and other undertakings the turnover period is their financial year that ended in the previous calendar year.

If the undertaking involved does not have a financial year that ends in the previous calendar year, the turnover period is the preceding calendar year.

If the undertaking has a financial year ending in the preceding calendar year that is less than 12 months, the turnover period is nonetheless that financial year of the undertaking.

If the undertaking involved does not have a financial year, the turnover period is the preceding calendar year.

#### Hypothetical Example 5: FCR

Three companies, Red Ltd, Blue Ltd and White Ltd made an agreement in September 2016. It is not Serious Anti-competitive Conduct so they wish to work out whether their combined turnover falls below the threshold for exclusion from the FCR.

Red Ltd has a financial year ending on 31 December. It would consider its revenue for the financial year that ended on 31 December 2015.

Blue Ltd was formed in August 2015 and has a financial year ended 31 March. As it does not have a financial year that ended in the previous calendar year (that is 2015), the turnover period is the preceding calendar year. Blue Company would consider its revenue between August 2015 and 31 December 2015.

White Ltd was formed on 1 July 2015 and has a financial year that ends on 31 December. White’s financial year that ended in the preceding calendar year was therefore the six month financial year from 1 July 2015 to 31 December 2015. The relevant revenue figure for White is for that financial year.

If the conduct occurs over more than one year, it is necessary to consider the relevant turnover period for each year of the conduct. It is possible that undertakings may fall under the turnover threshold for one year of the conduct but not the other.



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## How is turnover assessed for associations of undertakings?

Unless Serious Anti-competitive Conduct is involved, the FCR does not apply to a decision of an association of undertakings if the turnover of the association does not exceed \$200,000,000. The turnover of an association of undertakings means the **total gross revenues of all the members of the association** whether obtained in Hong Kong or outside Hong Kong.

Using the approach outlined above, the turnover should be calculated taking account of revenue reported for each separate undertaking for their respective “turnover periods”. For example, if the relevant undertakings have a financial year, the turnover will generally be the revenue reported for each undertaking in the financial year that ended in the previous calendar year to the date of the decision of the association of undertakings that is under consideration.

## Further information

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