

## **Bundeskartellamt Paper on Platform Market Power - Results and Recommendations**

### **Background**

- The Internet and digitalisation have profoundly changed the way in which we engage in economic activity. In many sectors they have contributed to a significant expansion of supply, the development of new products and business models and the dynamic development of markets and competition.
- New digital products and business models as well as the special characteristics of digital markets have created new challenges for competition policy and enforcement. The Internet plays a role in many current cases. Large US Internet businesses such as Google, Facebook and Amazon have a strong presence in Germany and Europe. Their competitive conduct and strategies have provoked intense discussion about the competitive harm caused by such strategies and the question of whether they are legal or should be dealt with under a regulatory framework. Much concern has been expressed about the alleged paramount market position of firms active in digital markets.
- In their competition law assessment of cases, competition authorities and courts have to consider the underlying market principles and the complexity of business models and economic relations in these markets. In order to support the Bundeskartellamt's decision divisions in this task, the Bundeskartellamt set up a "Think Tank" in early 2015 in which legal experts and economists study the latest economic research on platforms and networks and discuss how to best apply the results to antitrust case practice. With the help of the Think Tank the Bundeskartellamt aims to further develop existing examination concepts and, where necessary, develop new ones to enable it to quickly and efficiently assess cases involving the digital economy. The main focus of the Think Tank is on online platforms and networks as the most common digital business models.
- The Think Tank's Working Paper on Market Power of Platforms and Networks presents the work results achieved so far and describes significant factors for market definition and market power assessment in the case of digital platforms.

### **Market definition in digital platform and network markets**

- Multi-sided platforms and networks are omnipresent in digital markets.
- The key features of platforms are that, unlike conventional one-sided markets, they enable the direct interaction between two user groups (e.g. between buyers and sellers, audience and advertisers or individual users of a dating platform) and that these user groups are linked by indirect network effects.
- Indirect network effects exist where the value of the platform service for one user group depends on the size and composition of the other user group. The effects are positive if the value that a user on one side realises from the platform increases with the number of potentially interested parties on the other side. Negative indirect network effects are also conceivable if the value of the platform for one user group decreases if the other user group grows. The network effects can be unilateral or bilateral.
- In general terms, there are two types of platforms: (1) so-called matching platforms and (2) so-called audience providing platforms (e.g. advertising platforms). Matching platforms connect two user groups for the purpose of a specific interaction. This requires the participation

of both sides and leads to bilateral indirect network effects. Examples are real estate platforms and dating platforms. Audience providing platforms are mainly funded by one side which pays the platform for the provision of advertising space. The platform enables the advertising side to gain the attention of the platform's users. Usually, audience providing platforms only generate positive unilateral network effects for the advertising side - the value of the platform increases for the advertisers with the number of advertising contacts/users. The users, on the other hand, can experience negative unilateral network effects because the value of the platform decreases if too much advertising is placed on the platform.

- Networks, in turn, enable the interaction between one and the same user group. One prominent example for this kind of interaction are social media networks. Networks typically generate direct network effects. Accordingly, the (positive or negative) value of a network for a user depends on the number of other users also using the network.
- The conceptual tools for market definition as applied for traditional markets can be adjusted to fit digital platforms and networks.
- Many of the digital platforms and networks that have recently been set up, however, offer their services to one user side for free. This has two main implications for antitrust enforcement:
  - First, the assessment of digital platforms under economic and antitrust aspects often requires that the platform side which uses the platform for free is included in the assessment. This is to take adequate account of the interdependencies between the two platform sides. Previous (national) case law has not recognised free platform use as a market. In light of the specifics of the digital economy this approach is no longer adequate.
  - Second, in some case constellations in the digital economy innovative start-ups that offer their products for free or realise only marginal turnover can be taken over by large incumbents without any control by the competition authorities. This is because to date only those mergers are subject to merger control where the parties generate a turnover above a certain threshold. In the case of start-ups this is often not yet the case. Nevertheless, on account of their high market potential, their business ideas can be of great economic value for their purchaser. Under certain circumstances such takeovers can impede effective competition.

### **Assessing the market power of online platforms**

- In principle the usual approach for the assessment of market power also applies to platforms and networks. The decisive criterion is whether or not the company's scope of action is still sufficiently controlled by competition. In particular with a view to the 'everything for free' culture on the Internet an assessment of platform market power does not necessarily have to focus predominantly on price competition and whether there is a potential scope for price increases. In the digital economy innovation competition in particular has a significance of its own and needs to be considered alongside price competition.
- Many digital business models are challenged by strong innovation dynamics. At the same time, digital markets are prone to high levels of concentration. Against this background, the absolute market share should not be treated as the most relevant factor when assessing market power in the digital sector. Digital markets require a case-by-case assessment which, in addition to the usual market power factors, also takes account of other, more specific factors.

- The following factors should be considered in order to take adequate account of the specifics of digital platforms and networks and of the actual innovation competition existing in each case:

(a) **Network effects**

New users tend to choose platforms or networks that already have a large user base. For this reason, network effects can trigger positive feedback-loops in a market, which can ultimately even lead to a monopolisation (tipping) of the market. At the same time, network effects can make it easier to introduce innovative products to the market and can thus support the growth of smaller or new competitors. Their impact on market power is therefore ambivalent.

What is more, network effects can raise switching costs for users and barriers to entry for potential competitors. As a consequence, market entries become less likely and users switch less frequently to other suppliers, which has a market power enhancing effect.

(b) **Economies of scale**

An incumbent supplier's economies of scale can make it more difficult for new and smaller suppliers to enter the market. This also applies to digital markets. Digital platforms and networks often generate high economies of scale because the setting up and operating of a platform or network involves high fixed costs but low variable costs. This effect is further enhanced by specialisation and learning processes which small and new suppliers have not (yet) undertaken.

(c) **Single-homing, multi-homing and the degree of differentiation**

Users either use one single platform or network ('single-homing') or several platforms or networks ('multi-homing'). The type of use has an impact on positive feedback loops and is therefore relevant for the question of whether the market is in danger of tipping. Multi-homing can counteract feedback loops because it enables users to easily switch platforms, which in turn lowers barriers to entry. Single-homing increases the risk of tipping because it raises switching costs and barriers to entry. In practice, however, users do not behave homogeneously and the effects of their behaviour should be examined in each individual case.

The occurrence of multi-homing usually depends on the degree of differentiation of a platform or network. The degree of differentiation mirrors the heterogeneity of demand and supply in the market. The higher the degree of differentiation (i.e. the more the platforms in a market differ from one another), the higher is the likelihood of multi-homing and the lower is the risk of a monopolisation of the market.

(d) **Access to data**

Customer and user data, but also third party data, are a valuable source of information for businesses. Digitalisation and, above all, the Internet have taken data collection and use to a whole new level. Besides that, many digital products are based on data. If such data are a component or input of a digital product, the exclusive control over specific data can represent a barrier to

entry for competitors. This applies in particular if the market affected is characterised by indirect bilateral network effects.

Control over data *per se* is not an indication of market power. It can, however, play an important role in the overall assessment of all circumstances. It must be examined in each individual case which data are collected, what their relevance for competition in the market is, whether they can be duplicated and whether it is possible for a business to pool data from different sources and commercialise them.

In a joint project the French Autorité de la concurrence and the Bundeskartellamt have analysed to what extent access to data can serve as a source of market power and have published a joint paper on "Big Data". In addition, the Bundeskartellamt is currently taking a close look at how the social network *Facebook* handles data.

**(e) Innovation potential of digital markets**

Many digital markets are highly dynamic and innovative. Innovative products and services can create new digital markets within a short period of time. However, online services can also rapidly lose their significance. Crucial factors in this process are the global connectivity and accessibility of digital markets and the high pace of innovation typical of the Internet.

This notwithstanding, the innovation potential of a digital market still needs to be assessed individually. Possible market dominance of online platforms and networks with substantial or even monopolistic market positions cannot be denied simply on account of the fact that these positions can be challenged by the innovative power of the Internet and the disruptive changes brought about by the Internet.

**Recommended actions**

- In the Bundeskartellamt's view, the current antitrust tools are in principle also suitable for the assessment of digital platforms and networks.
- There are only a few areas where there would seem to be a need to complement or clarify the existing legal provisions.
  - **Clarification that non-monetary transactions can also qualify as market activities**

Currently there are legal uncertainties as to whether non-monetary transactions can qualify as a market within the meaning of the German Competition Act (GWB). In the Bundeskartellamt's view a legal clarification is required to remove these uncertainties.
  - **Amendment of merger control thresholds**

There is a risk that innovative start-ups with a high market potential are taken over by large incumbents without this being subject to any control by the competition authorities. In the Bundeskartellamt's view it is therefore necessary to extend merger control to those cases where the transaction value of a takeover (for example the purchase price) is particularly high. This will ensure that also those cases are subject to merger control where one of the parties generates no, or only insignificant, turnover but where the competition potential of that party and the market relevance of the concentration are particularly high.

- **Specification of market power criteria**

To take adequate account of the economic specifics of digital platforms and networks when assessing their market power, there is a need to specify the criteria according to which market power is determined. It should be clarified by law that the competition authorities need to take particular account of the following factors when assessing the market position of a company which operates a platform or network: (a) direct and indirect network effects, (b) economies of scale, (c) the prevailing type of use (single-homing/multi-homing) and degree of differentiation on the market, (d) access to data and (e) the innovation potential of digital markets.