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The Evolving Concept of Market Power in the Digital Economy – Note by Korea

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1. Introduction

1. To prevent a monopolistic market structure, the Monopoly Regulation and Fair Trade Act (MRFTA) of Korea prohibits abuse of market dominant positions and imposes remedies and fines so that consumer welfare is protected and market competition is promoted. When determining whether there is an abuse of dominance, the first step is to examine market dominance.

2. A company with market dominance refers to a company that has a power to determine transaction terms such as price, supply and quality in a particular market. Such market dominance is determined based on various factors, e.g., market share, revenue, entry barrier, size of a competitor and possibility of cartel conduct. These factors, which the assessment of market dominance has been relying on, were suitable for traditional industries, but now the digital economy is emerging with its own unique characteristics. That is why new factors should be accounted for when examining market dominance in the digital economy.

3. Online platforms in particular, as part of the digital economy, are not constrained by space and overcome temporal and spatial limits, so transaction cost is significantly reduced and innovation is facilitated. On the other hand, however, they are likely to tip the market into monopoly due to the cross network effect and economy of scale, which are prevalent in online platforms. Therefore, once a monopolistic market structure is created, it is difficult to restore competition and return to a competitive market.

4. The basic enforcement framework that has been applying to traditional industries is still effective for cases involving abuse of market dominance in the digital economy, and law enforcement is not inadequate in abuse of market dominance in digital areas. However, it is true that law enforcement faces difficulties in the digital economy due to its unique characteristics different from traditional industries.

5. In recognition of such difficulties, we will narrow the scope of discussion to online platforms, the core part of the digital economy, and review how market dominance is assessed in the sector. By taking a close look into how the online platforms have advanced and what factors are now additionally considered in the assessment, we would like to find better ways to measure market dominance in the platform sector that make up for limitations of the conventional approaches.

2. Factors to consider when assessing market dominance in online platform sector

6. To respond to abuse of market dominant positions of online platforms within the framework of the MRFTA, we need to first look at the characteristics of the digital economy that affect dominance assessment.

7. Online platforms as multi-sided markets connect various groups of users each other, and this leads to the cross network effect: an increase in the number of users in a group increases benefits other user groups enjoy. Such online platforms earn profits from running advertisements and collecting data while providing services that are seemingly free.

8. If we go through the next steps such as defining a market, assessing market share and considering entry barriers without giving full consideration to these characteristics, we

cannot accurately see how dominant an online platform is. Also, services are constantly converging on online platforms while blurring boundaries between industries, and new services are ceaselessly emerging driven by market dynamism. This poses a challenge to accurate assessment of market dominance based on competition laws.

9. Assessment of market dominance of a company consists of two steps: defining a market first, and determining whether the company has the power to control transaction terms and conditions. As the two steps are closely intertwined, we need to thoroughly review the process step by step. To that end, we will respectively review each of the two to see how the digital economy affects the comprehensive process.

2.1. Factors to consider when defining a market in online platform market

10. The scope of markets that the assessment is based on is the areas where a company is in a competitive relationship with others, so the scope is determined considering characteristics of goods, geographic areas where goods are sold and the supply chain of manufacturing, wholesale and retail. Online platforms, by nature, affect demand- and supply-side substitutability which reflect how customers and suppliers respond to an increase or decrease in product price: how easily customers switch to substitutable products; how easily suppliers switch production to a new product without incurring significant costs.

11. When defining a market in online platform markets, we need to consider factors as follows:

12. First, multi-sidedness of online platforms affects product substitutability due to cross-network effects between multiple sides of a platform. Therefore, it begs a question whether to define each side as an independent market or to define the platform itself a single market.

13. Second, assessment methodologies such as critical loss analysis can hardly be applicable to platforms that indirectly produce profits through advertising and data collection while providing users with free services. In this case, variables such as users' perception of the quality of goods and services as well as product price and sales should be taken into account.

14. Third, aside from the above, market definition in platform markets could be less precise than in traditional markets, given the dynamism and rapid changes in the platform markets. As services are constantly converging and increasingly complex in themselves, not only precise market definition but also actual impact of platforms on competition, such as consumer welfare and innovation, should be considered.

15. The lock-in effect, another major characteristic of platforms, is likely to lower product substitutability. Given that it is hard to evaluate demand-side substitutability when a market is at its nascent stage, the *innovation market definition* could apply, which analyzes *competition over innovation*. Traditional approaches analyze *competition over price* of goods and services that are already on the market, so the innovation market definition is required to analyze competition over innovation yet to be commercialized.

2.2. Factors to consider when determining market-dominating enterprise in online platform market

16. According to the MRFTA, enterprises with market dominance are determined considering multiple factors—market share, entry barrier, size of a competitor, adjacent product markets and available financial resources—after defining a market. The unique

characteristics of online platforms affect how to evaluate these factors—market share and entry barrier in particular—and the size of a competitor will be measured considering market concentration.

17. For such reasons, when determining a dominant player in online platform markets, we need to consider factors as follows:

18. First of all, in order to calculate a market share, variables such as sales volume, the number of users, page views as well as revenues should be included, because online platforms usually provide free services.

19. Second, we need to look at whether a platform prevents its users from multihoming. Multihoming reduces the lock-in effect, so the platform's actual dominance is likely to decrease compared to its market share.

20. Third, the cross network effect—demand on one side stimulates demand on other sides—and economy of scale—an output increase reduces average costs—are important factors we cannot rule out. When positive network effects or economies of scale occur, actual entry barriers are likely to be higher than they look on the surface.

21. Fourth, online platforms' influence on adjacent markets should be reviewed. Online platforms often employ a vertical integration strategy to offer wide ranging services, which means they can easily extend their influence in one market into others.

22. Additionally, we need to consider the fact the gap tends to widen between early movers that gained an early foothold and their followers in terms of data collection, retention and utilization, so users would be reluctant to switch to rival services. The influence of platforms as a gatekeeper and intermediary, which can lead to market dominance, is yet another factor.

3. Cases of assessing market dominance in online platform market

23. When enforcing laws, the KFTC analyzes markets considering online platforms' characteristics mentioned above. We would like to review the Commission's previous enforcements and discuss issues regarding the assessment in online platform markets through major enforcement cases involving Google LLC and Naver (No.1 online search engine in Korea) Shopping and real estate.

3.1. Market dominance Assessment: Google LLC

24. Google required smartphone manufacturers to sign its AFA (Anti-Fragmentation Agreement) or ACC (Android Compatibility Commitment) as part of contracts for app store licenses with intention to prevent them from developing alternatives to its Android operating system. Google was fined KRW 224.93 billion (USD 177 million) for engaging in such unfair trade practices that disadvantaged counterparts and banned from using the AFA and ACC.

25. In this case, the Commission defined three relevant markets for licensable smart mobile OS's, Android app stores and licensable non-mobile OS's. When it comes to defining the market for non-mobile OS's, unlike other two markets, it was difficult to measure the market demand as non-mobile OS's were in the developing stage and not released yet. To resolve this difficulty, the Commission took the approach to innovation market definition and focused on supply-side substitutability of innovation in the development stage, as it is impossible to measure the demand for a market in which players compete over innovation not commercialized yet.

26. When evaluating the firm's market share, factors such as the number of downloads and the rate of mobile devices with pre-installed app stores as well as revenues were analyzed. Lastly, the degree of entry barriers were analyzed based on direct and indirect (cross) network effects and the massive investments in OS development.

27. On the other hand, Google—the subject of investigation—argued it is difficult to conclude that entry barriers are high, because OS's are open source. However, the cross network effect and economy of scale—major characteristics of the digital economy—lead to market tipping, so it will be challenging for new competitors to enter the OS market. For such reasons, the KFTC concluded Google had market dominance.

3.2. Market dominance Assessment: Naver Shopping

28. Naver designed its comparison shopping search algorithms that prefer vendors who use its own open market service, so that their products appear at the top of the search results. The KFTC imposed a remedy for its unfair practice that prefers its own service while discriminating against vendors who are not registered as its open market sellers, as well as a fine of KRW 26.63 billion (USD 20.82 million).

29. To assume the market share of the firm in online shopping, the Commission not only factored in seller fees and ad revenues but also supplementary indicators such as page views. We also paid attention to the fact that its high market share leads to high entry barriers, driven by cross network effects and economies of scale.

30. During the investigation, Naver argued various shopping service markets should be regarded as a single relevant market, as the boundaries between shopping services are blurred with the growth of online shopping. The KFTC saw the firm's dominance in the search engine market leads to dominance in comparison shopping market, and the intention of Naver's argument seemed to reduce the effects of its extended market power by expanding the scope of comparison shopping services.

31. When the boundaries between markets are not clear due to the dynamic changes in the digital economy, market definition should focus on the tangible anticompetitive effects that limit competition after considering characteristics of each service and harm to consumer welfare. When it comes to Naver Shopping, commercial users and consumers both recognized the comparison shopping and open market services were in complementary relations. Even the firm itself did not consider the two services similar. Considering the complementary relations between them, the Commission defined comparison shopping and open market services as two separate markets.

3.3. Market dominance Assessment: Naver Real Estate

32. Naver required real estate content providers (CPs) to agree to restrictive contract terms that once they provide real estate property information to Naver, they do not provide the same information to a third party. The KFTC imposed a fine of KRW 1.03 billion (USD 811,000) and banned such exclusive dealing that prevents CPs from sharing information with competitors.

33. To evaluate Naver's market dominance in real estate, the characteristics of online platform markets were reviewed. The real estate platforms are two-sided markets where the actual transactions between CPs and content users are made outside the platforms. The Commission, hence, separated the two sides of CPs and users in the market definition process.

34. As users are offered information for free on the platform, the number of properties put on the market, page views and unique visitors were considered to calculate the market share. The Commission also considered the fact that the firm's market power in general search services is easily transferred to real estate platforms.

35. In the hearing process, the firm highlighted that Naver Real Estate provides users with information for free, and the high market share was just an outcome of its innovation for user convenience, so it cannot be viewed as a market dominant player.

36. As mentioned above, a platform can have market dominant position, even if it offers free services. That is why wide ranging variables (e.g. access to data) other than service fees should be examined in assessing market dominance. As for the argument the high market share naturally resulted from its contribution to the innovation in the real estate platform market, the Commission considered that such efforts to drive innovation intended to cement its position in adjacent areas including general search markets so concluded it has market dominance in the real estate platform markets.

4. Guidelines for market dominance assessment in digital economy

37. The Commission has been making efforts to establish Guidelines on Abuse of Market Dominance by Online Platforms, which are playing an important role in the digital economy, to detail what constitutes abuse of dominance. The Commission studied enforcement cases in the digital sector as well as competition laws and legislative trends at home and abroad. The provisions were drafted based on this research, and the Guidelines were already announced to take effect.

38. With the purpose to prevent anticompetitive practices in the platform sector, the Guidelines stipulate criteria for market definition and dominance assessment that consider unique characteristics of online platforms. Detailed examples are also provided based on previous enforcement cases.

39. First of all, the Guidelines articulate the characteristics of online platforms such as the cross network effect, economy of scale and importance of data. Especially data can determine the competitiveness of enterprises, as they are used in every industry and business. These three key characteristics of online platforms are likely to give rise to the potential outcome of market tipping.

40. With regard to market definition of multisided online platforms, the Guidelines specify criteria as to how to define an online platform, i.e., whether each side of the platform should be defined as a separate market or the platform itself should be defined as a single market. Also, they explain why a relevant market can be defined regardless of whether a platform provides services for free. As long as transaction of value occurs between platforms and users, there are variables to be considered other than the cost of services. Lastly, the Guidelines point out actual anticompetitive effects that limit competition should be at the core of determining whether a practice is unfair, aside from drawing clear boundaries of markets, which has become a tricky task due to today's dynamic market changes.

41. The Guidelines highlight that the existence and degree of entry barriers should be determined considering the cross network effect and economy of scale and scope when assessing market dominance. They also explain the influence of platforms as a gatekeeper, which can control access to user groups, is yet another factor. Along with them, the capability to collect, retain and utilize data and possibility of new services introduced to the market are also suggested.

42. Furthermore, the Guidelines explain what factors are required to be considered in reviewing competition-restricting practices and what are the major types of violations in the digital sector, which will increase the predictability of enforcement. The Guidelines are expected to enable more effective countermeasures against abuse of market dominance in the online platform sector. They will be enacted within this year, after collecting stakeholders' opinions and passing the plenary session.

5. Implications

43. Online platforms' unique characteristics affect market definition and assessing market share and entry barrier analysis. How dominant a player is should be determined after defining a market considering the cross network effect, economy of scale, and provision of free services. Given rapidly evolving online platform markets, the actual anticompetitive effects that limit competition should be the focus in the process of assess whether there is an abuse of dominance.

44. The KFTC has been trying to assess market dominance considering characteristics of the digital economy, and it prohibits abuse of market dominance in actual enforcement that reflects online platforms' characteristics (e.g. multi-sided market and market tipping). The Commission has also been making efforts to revise the Guidelines so that the criteria for determining market dominance will improve.

45. Some argue that an online platforms' abuse of market dominance as a gatekeeper's should be considered illegal *per se*. Given the dynamic characteristics of online platforms, however, such idea requires careful consideration, as applying the *per se* rule and regulating digital industries without case-by-case analysis might end up stifling innovation.

46. In conclusion, a balanced approach to the digital economy is required to keep things dynamic and innovative but prevent anticompetitive practices. The KFTC will continue to endeavor to make more accurate assessment of market dominance in the digital economy as well as to improve guidelines.