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The Evolving Concept of Market Power in the Digital Economy – Note by Mexico (COFECE)

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More documents related to this discussion can be found at https://www.oecd.org/daf/competition/market-power-in-the-digital-economy-and-competition-policy.htm

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1. Introduction

1. The concept of market power is used by the vast majority of competition authorities to identify questions that could be related to some anticompetitive practices, such as the abuse of market power that has the effect of displacing competitors or preventing the access to new competitors. However, the digital era would seem to demand a more detailed analysis that considers other factors to determine whether or not an economic agent has substantial power in one or more digital markets.

2. In the case of Mexico, the Federal Economic Competition Law (LFCE, per its initials in Spanish) establishes different parameters to determine the existence of market power, an analysis that is useful to determine the existence of practices of abuse of market power or the *ex ante* study of concentrations, but also when using hybrid tools, such as the market investigations provided in Article 94 of the Law, that allow the imposition of behavioral and structural remedies for conducts or market structures that generate negative effects on the competition process.

3. The factors to consider for the determination of substantial market power allow to incorporate part of the elements that both, academia and the best international experiences from enforcers, have estimated to establish new models of substantial market power in digital markets. Additionally, these factors have part of the analysis carried out by the Board of Commissioners of the Federal Economic Competition Commission (Commission of COFECE) in some transactions. However, it is possible that, as studies are carried out within the Commission and in other jurisdictions, in the near future it will be necessary to evaluate whether the current method is in line with the challenges and characteristics of the digital economy markets.

2. Academic and international experiences

4. Motta (2004) defines market power or substantial market power as the ability of a company or economic agent to profitably increase the price of a good or services above the price level in a competitive market or the level of the reference price. Given that a company's marginal cost of production is the lowest price it can charge for a good or service,[1] in general, market power is usually defined as the difference between the price set by a company and its marginal cost of production. Similarly, Motta indicates that market power could alternatively be defined as the difference between the current price and the monopoly price.[2]

5. However, in digital markets it is possible to have prices equal to or close to zero and the creation of competitive advantages that could constitute barriers to entry, due to the generation and ownership of information, mainly of customers and competitors. Therefore, various studies [Morton et al. (2019), Furman (2019), Sousa (2020)] indicate that the

[1] Model in which the companies offer perfectly identical products, they do not have fixed costs and compete in prices (Bertrand competition model), in equilibrium, the price is equal to the marginal cost. Likewise, in perfect competition, the equilibrium prices is equal to the marginal cost.

[2] Motta, M. (2004). *Competition Policy: Theory and Practice*. Cambridge University Press, p.41 y 42.

concept of market power in traditional markets may not represent the market power in the presence of digital markets.

6. At the international level, competition authorities have considered that market power emerges when a company's actions are not limited by unilateral decisions on price or quality by competitors or their consumers when switching to an alternative product, and that market power must be long-lasting and not temporary. In general, the method to determine whether an agent has substantial power is to analyze a set of characteristics (market shares above a certain threshold, barriers to entry, substitution choices).[3]

7. In the case of digital markets, although it is observed that various competition authorities (United States, China, Singapore, South Africa, Australia, the European Union, Korea, India, Japan) are in a review process to modify and incorporate specific regulations to online platforms,[4] the concept of substantial market power has not been modified; however, the way to measure it and the elements considered for its analysis have changed. For example, one of the elements analyzed is the determination of whether a platform has a position in the market that allows it to be considered as a *gatekeeper*, capable of controlling access to current or potential competitors to its consumers,[5,6] of *single-homing* or *multi-homing*, the probability that the market reached a tipping point in favor of certain economic agents (*tipping point*), among others.

8. In Mexico, the LFCE does not establish a definition for substantial power or market power, but Article 59 and Articles 6 and 7 of the Regulatory Provisions of the LFCE do indicate a series of elements that must be considered to determine the existence of substantial power, which are:

- The market share of one or more economic agents and whether they can fix prices or restrict supply in the relevant market by themselves, without competitors being able, currently or potentially, to counter said power.
- The existence of barriers to entry and elements that may alter said barriers as well as the supply of other competitors.
- The existence of competitors and their power.
- The possibilities of access to sources of inputs for the economic agent or agents and their competitors.
- The recent behavior of the participants in said market.
- The degree of positioning of the goods or services in the relevant market.

[3] OCDE (2020), *Abuse of dominance in digital markets*, p. 13, 19 y 21. Available at: http://www.oecd.org/daf/competition/abuse-of-dominance-in-digital-markets-2020.pdf

[4] *Market power of online platforms: global trends in competition policy*, Cullen International. Webinar, April 13th, 2021. Disponible en: https://www.youtube.com/watch?v=l01H7c3Pc2g

[5] *Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary (2020). Investigation of Competition in Digital Markets, Majority Staff Report and Recommendations*, p. 35. Available at: https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf

[6] Indicates that, by controlling infrastructure in the digital age, platforms can surveil their current and potential competitors' business models to acquire them or replicate them, and thus eliminate competitive threats. *Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary (2020). Investigation of Competition in Digital Markets, Majority Staff Report and Recommendations*, p. 6. Available at : https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf

- Lack of access to imports or the existence of high import costs.
- The existence of high differentials for costs that consumer could face when going to other providers.
- If two or more economic agents independent from each other are differentiated from the rest of economic agents that participate in the relevant market.
- That said economic agents present a similar and continued behavior.

9. As for the analysis of market shares, Article 59 of the LFCE establishes that, to determine market shares, the Commission may consider sales indicators, number of clients, productive capacity, as well as other factor deemed relevant by the Commission.

10. In the case of multisided platforms, it is important to take into account that platforms bring together two or more groups of users interrelated precisely by the platform, so when estimating market shares it must be considered: (i) the indicator used; and (ii) whether the market shares should be estimated for each one of the markets or for the platform as a whole.

11. Some scholars, international organizations and even competition authorities have suggested using certain indicators to determine market shares in multisided platforms, as well as the cases in which market shares should be estimated for each one of the markets or for the platform as a whole: (i) income; (ii) users and volume of use; (iii) network effects; (iv) multi-homing; (v) access to data; and (vi) potential competitors and the dynamism of digital markets, which are briefly described in Annex I of the contribution.

12. The following section presents an example from COFECE regarding the determination of substantial market power (in particular, on market shares and barriers to entry) in digital markets, and the application of the elements provided in the Mexican competition regime.

3. Experience of the Commission

3.1. Walmart -Cornershop Case (CNT-161-2018)[7]

13. The amount of the sales of each self-service store and price club made through Cornershop, Rappi and Mercadoni was taken into consideration to determine the market shares. This indicator was used because using sales for the calculation of market shares allowed to estimate the competitive pressure exerted among themselves by platforms in the market, as they reflected consumer choice between the different available platforms.

14. The number of users was not used as a measurement of market share because it was not indicative of the competitive pressure effectively exerted by the different platforms available in the market. This because: i) not all the registered users effectively used the platform services, and ii) platforms such as Rappi offered products from self-service stores and prices clubs and additionally offered other services, which made it impossible to distinguish the number of users who effectively used the platform as a substitute for Cornershop.

[7] In November 5, 2018, Wal-Mart International Holdings, Inc. notified the Commission of its intention to acquire the total social shares representative of the social capital of Delivery Technologies, S. de R.L. de C.V. (Cornershop MX). This operation was objected by the Commission. CNT-161-2018. Public version available in Spanish at: https://www.cofece.mx/CFCResoluciones/docs/Concentraciones/V6008/9/4845885.pdf

15. The most important barriers to entry identified were the importance of being able to access capital or financing; consumer trust on service quality; the capacity to develop a logistical network; and network effects. These and other barriers are briefly described below:

- *High investment amounts*. The costs for a potential entrant to develop and maintain a platform similar to Cornershop's, were developments costs and maintenance and expansion costs.[8]
- *Consumer trust*. The economic agents agreed on the mistrust that consumers have towards: (i) service quality of this type of apps and the difficulty to modify consumption patterns; (ii) bancarization; and (iii) the delivery service.
- *Logistical network*. To be able to compete in the market, platforms need to develop an algorithm that optimizes the times and distances between users, stores and final destination for a delivery, as well as to have users, *shoppers* and stores that allow the implementation of the logistical network.
- *Network effects*. The market of logistical service of shopping and immediate delivery offered by self-service stores and price clubs through internet websites and apps for mobile devices to final users is characterized by being a two-sided market with indirect network effects.
- *Presence of negotiations*. Platform established negotiations with self-service stores to agree on contracts for the provision of services, which allowed platforms to offer better services and general conditions to users. This generated disadvantages for new entrants, as they had to charge an overprice and incur in costs to negotiate with self-service stores for better conditions.
- *Switching costs*. For users towards other platforms through the use of memberships and loyalty programs, which deterred user mobility.
- *Access to data*. The economic agent resulting from the transaction could induce the exit of Walmart's competitors from the Cornershop platform, through the strategic use of the information provided and produced on the platform for the sale of the products.

4. IV. Final remarks

16. The LFCE does not indicate a definition of substantial market power in digital markets nor the elements to consider in digital market, as international agencies do, such as the *Bundeskartellamt* in the Agreement against restrictions to competition. However, Article 59 of the LFCE indicates the elements that must be considered for its determination, among them, it indicates the estimation of market shares and the assessment of barriers to entry, but also leaves a question in relation to those platforms based on zero-price structures for any of the platform sides.

17. The Commission will continue analyzing the concept of market power in the digital economy markets, as well monitoring the development of this subject in other jurisdictions and international organizations, with the aim of determining whether the concept currently

[8] Development costs included administrative and staffing costs; planning and technological development of the platform; and launch of operation costs. For its part, maintenance and expansion costs included the capital needed to enter new cities, as well as marketing activities for the acquisition of users and commercial allies.

established in the LFCE is sufficient or not to correct the problems present in some digital markets in Mexico.

Annex A.

1. Income

18. **Income with neutral and non-neutral price structures.** Peitz, M. and Franck, J. (2019), highlight that if the price structure is neutral,[9] market shares in terms of income on one side of a platform may not be important to reflect the competitive pressures faced by companies, as income on one side can be substituted one by one by the turnover on the other side. Therefore, platform's total income must be considered. In the case of non-neutral price structure, the platform chooses the price structure that maximizes the total profitability, so the authors consider that in both cases it is best to use market shares in terms of the platform's total income, and not only for one of the markets.[10]

19. **Zero-price models.** In those cases where the business model offers on one side of the platform its service at zero-price, the estimation of market shares in terms of income per market does not provide information concerning the relative position of the company analyzed, so, as in the previous cases, market shares in terms of income should be measured at platform level and not at market level.[11]

20. Additionally, in those cases in which the only reasonable option is to use the sum of the income from all sides of the platform, care must be taken with its interpretation, as two interdependent markets are added. Large market shares appear to be a significative indicator of market power if all the considered companies serve the same sides. However, they are often not significant if the companies active in the relevant markets follow different business models.[12]

2. Users and volume of use

21. Another way to estimate market shares in digital platforms is through the total number of active users in relation to the total number of users. In these cases, even if all the companies operate as two-sided or multisided platforms, market shares must be estimated for each side separately. Measuring shares in this way can give clarity about the

[9] A price structure is neutral if it considers the total price on both sides, but not the individual prices charged to each side of the platform. The price structure is not neutral if a platform uses subscription fees, membership fees or registration fees.

[10] Peitz, M. and Franck, J. (2019), *Market Definition and Market Power in the Platform Economy*, p. 70. Available at: https://www.cerre.eu/sites/cerre/files/2019_cerre_market_definition_market_power_platform_economy.pdf

[11] Peitz, M. y Franck, J. (2019), *Market Definition and Market Power in the Platform Economy*, p. 74. Available at: https://www.cerre.eu/sites/cerre/files/2019_cerre_market_definition_market_power_platform_economy.pdf

[12] Peitz, M. y Franck, J. (2019), *Market Definition and Market Power in the Platform Economy*, p. 74. Available at: https://www.cerre.eu/sites/cerre/files/2019_cerre_market_definition_market_power_platform_economy.pdf

relative strengths that companies have on each side of the platform. On the other hand, the dynamism of digital markets makes the number of users increase over time at an accelerated pace. This makes it more adequate to estimate shares with relation to the potential size of the market. While the potential size of the market may be hard to estimate, an alternative is to obtain lower and upper limits on the potential market.

22. Likewise, Peitz, M. and Franck, J. (2019) suggest that in those cases where the intensity of use of the platforms by users is heterogenous amongst users, it is preferable to use usage volume as indicator to measure market shares at market level (each side of the platform) or platform.[13]

23. In the case of digital platforms, high market shares are less importance for the assessment of market power than it is often the case for traditional markets, The reason for this is due to, among other things, the users' ability to use different platforms (*multi-homing*), access to the data generated by the platforms and these markets' dynamism.[14] These elements must be analyzed together, as, on their own, none of these elements can indicate or create a dominant market position. Below, is a brief description of each one of the elements that must be considered to determine if one or several platforms have market power.

3. Network effects

24. The term network effect refers to the case in which the value of the product, service or platform depends on the number of buyers, sellers or users who use it.[15] These network effects can be divided in two types: indirect and direct effects.

25. Indirect network effects exist when the value of a service or product to a specific group of users increases (positive network effects) or decreases (negative network effects) with the number of users of another group. As a result, the demands of each group of clients are interconnected and this generates a feedback loop between them.[16] These positive bilateral effects occur particularly when the platform serves to bring together two or more groups of users with the aim of having these groups directly interacting.[17] *Matching platforms*, such as dating apps, are an example of this type of platforms. Likewise, there may be cases in which indirect effects are positive for one group of users and negative for another group of users of the same platform. An example of this situation is the case of advertising, where users may consider having more advertisements as negative.

[13] Peitz, M. and Franck, J. (2019), *Market Definition and Market Power in the Platform Economy*, p. 71. Available at: https://www.cerre.eu/sites/cerre/files/2019_cerre_market_definition_market_power_platform_economy.pdf

[14] Bundeskartellamt (2016), *The Market Power of Platforms and Networks*, p.9. Available at: https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Berichte/Think-Tank-Bericht-Zusammenfassung.pdf?__blob=publicationFile&v=4

[15] Stobierski, T. (2020), *What are Network Effects?* Harvard Business Scholl. Available at: https://online.hbs.edu/blog/post/what-are-network-effects

[16] OCDE (2017), *Measuring market power in multi-sided markets*, p.2. Available at: https://one.oecd.org/document/DAF/COMP/WD(2017)35/FINAL/en/pdf

[17] Bundeskartellamt (2016), *The Market Power of Platforms and Networks*, p.3. Available at: https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Berichte/Think-Tank-Bericht-Zusammenfassung.pdf?__blob=publicationFile&v=4

26. On the other hand, direct network effects arise if the consumers of a product or service benefit directly if a greater (positive) or smaller (negative) number of users use this product or service.[18] For instance, a social network will have more value for its users as more users use it to interact through it.

27. Frequently in industries with large network effects, once they reach certain critical mass of users, the entry into that market is significantly inhibited. The possibility of a competitor offering the same service and exerting competitive pressure is reduced, as the already developed network generates greater benefits to the users. The foregoing favors a dynamic known as *winner takes all*, in which the process of competition does not occur in the market but for the market, in which participants have important incentives become the first to seize it. It is therefore natural that all network services providers seek to reach this tipping point.

4. Multi-homing

28. One of the great challenges faced by dominant platforms is how to manage competition from new participants. When a new platform enters, clients on both sides of the platform can choose whether they switch to the new platform (*single-homing*) or adopt both platforms (*multi-homing*).[19]

29. Evans, D. and Schmalensee, R. (2007) point out that *multi-homing* is a factor that can reduce the market power of platforms.[20] However, it is hard for a perfect *multi-homing* to exist due to switching costs. If the *multi-homing* is possible and it is not associated to higher switching costs for users, a user may independently from her/his expectations, select the best deal and, therefore, interact with a new platform when she/he prefers it.[21]

30. The possibility of users doing *multi-homing* reduces barriers to entry, as a new entrant can establish a platform without needing to induce consumers to use its new platform exclusively.[22]

31. The Organisation for Economic Co-operation and Development (OECD) highlights that in markets where there are strong indirect network effects it is important to measure the degree of *multi-homing* in each one of the platform sides before considering *feedback-*

[18] Bundeskartellamt (2016), *The Market Power of Platforms and Networks*, p.4. Available at: https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Berichte/Think-Tank-Bericht-Zusammenfassung.pdf?__blob=publicationFile&v=4

[19] K. Francis, Seamans, R y Zhu, F. (2018), *Multi-homing and Platform Strategies: Historical Evidence from the US Newspaper Industry.* Available at: https://www.hbs.edu/ris/Publication%20Files/18-032_d71914fe-d56c-42ad-ae20-deb5b979fab9.pdf

[20] See Evans, D. and Schmalensee, R. (2007), *The Industrial Organisation of Markets with Two-Sided Platforms*, p. 151-179. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=987341 ; Armstrong, M. (2006), *Competition in two-sided markets*, p. 668-691. Disponible en: https://www.jstor.org/stable/25046266?seq=1#metadata_info_tab_contents

[21] Peitz, M. y Franck, J. (2019), *Market Definition and Market Power in the Platform Economy*, p. 76. Available at: https://www.cerre.eu/sites/cerre/files/2019_cerre_market_definition_market_power_platform_economy.pdf

[22] Bundeskartellamt (2016), *The Market Power of Platforms and Networks*, p.14. Available at: https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Berichte/Think-Tank-Bericht-Zusammenfassung.pdf?__blob=publicationFile&v=4

loops.[23] The foregoing can be done through the recollection of information about questions such as the following:[24] What proportion of users from the zero-price platform side does *single-homing*?; What proportion of users on the paid platform side does *single-homing*?; How important is the platform to attract consumers on the positive price side?; How loyal are the users towards the platform?; How easy is it for consumers to search for products or services in different platforms?

5. Access to data

32. Both Germany's *Bunderskartellamt* and France's *Autorité de la concurrence* have highlighted the importance of data in the digital economy. Access to a great volume or variety of data is an important aspect to guarantee competitivity in these markets, therefore, data gathering can generate barriers to entry when new participants do not have the capacity to gather or procure similar quantities of data than other established companies already have.[25] In this context, both agencies jointly prepared a document in which they highlight the importance of data in the digital economy.[26]

33. Access to a large volume or variety of data is an important aspect to ensure competitiveness in these markets, so data collection can create barriers to entry when new entrants do not have the capacity to collect or acquire similar amounts of data that other established firms have. This access to data can be considered an important factor for a firm to have market power when access to this data is an important aspect for new entrants to enter the market.[27] However, for competition authorities in the world it is not yet clear, the Commission included, whether procompetitive interventions must include rules of access to this type of data.

34. Crémer, de Montjoye and Schweitzer (2019) point out that data can be classified as voluntary, observed and inferred data, and this distinction have implications concerning the questions about whether competitors can gather or obtain the same information independently or if a single set of data can be unique and access to it indispensable to effectively compete.[28]

35. In addition, an important point to take into consideration is that data are not only a raw material for innovation, but its informative content can turn data exchange or the

[23] OCDE (2017), *Measuring market power in multi-sided markets*, p.8. Available at: https://one.oecd.org/document/DAF/COMP/WD(2017)35/FINAL/en/pdf

[24] OCDE (2017), *Measuring market power in multi-sided markets*, p.9. Available at: https://one.oecd.org/document/DAF/COMP/WD(2017)35/FINAL/en/pdf

[25] Bundeskartellamt and Autorité de la Concurrence (2016), *Competition Law and Data*, p. 11. Available at: https://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Berichte/Big%20Data%20Papier.pdf;jsessionid=6022A23E2D761A37312C885456F7C5B3.1_cid371?__blob=publicationFile&v=2

[26] Louven, S. (2018), *Shaping competition policy in the era of digitalization*, p.4. Available at: https://ec.europa.eu/competition/information/digitisation_2018/contributions/sebastian_louven_oldenburg_centre_for_law_of_the_information_society.pdf

[27] Bundeskartellamt (2016), *The Market Power of Platforms and Networks*, p.17. Available at: https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Berichte/Think-Tank-Bericht-Zusammenfassung.pdf?__blob=publicationFile&v=4

[28] Crémer, de Montjoye y Schweitzer (2019), *Competition Policy for the Digital Era*, p.75. Available at: https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf

agreement of data grouping into a vehicle to exchange commercially sensible data as information about costs or prices, which could facilitate collusion between companies.[29]

6. Potential competitors and dynamism of digital markets.

36. Authorities such as the *Bunderskartellamt* consider that the existence of one or several platforms with market power or even monopolies cannot be denied simply by pointing out that these positions can be contested by the innovative power of the internet and that the possibility for disruptive changes is inherent to the internet. The internet's innovative potential must be examined in each individual case. In all the markets, the internet is generally very dynamic and is characterized by a great quantity of innovations. Products and services can create and establish new digital markets in a short time.[30]

37. In this sense, when assessing the dominance in a digital market, the *Bunderskartellamt* suggests taking into consideration the competitive pressure driven by innovation over and between companies currently active in the reference market as much as the potential competitive pressure exerted by new innovative businesses.[31]

38. On the other hand, when assessing potential competitors, it must be considered that the competitive pressure from companies with insignificant size can limit the market power held by companies with large market share. Moreover, in digital markets in which there are continuous technological changes or quality improvements, competitive pressure can come from companies who currently do not participate in the market. For example, generally, the platforms with an installed users base is an advantage for the dominant economic agent, the fewer users are available. However, in those emerging markets with a rapidly growing users base, it is more likely that an established platform is replaced by a new entrant, as it happens in social networks.[32]

[29] Crémer, de Montjoye y Schweitzer (2019), *Competition Policy for the Digital Era*, p. 96. Available at: https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf

[30] Bundeskartellamt (2016), *The Market Power of Platforms and Networks*, p. 17. Available at: https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Berichte/Think-Tank-Bericht-Zusammenfassung.pdf?__blob=publicationFile&v=4

[31] Bundeskartellamt (2016), *The Market Power of Platforms and Networks*, p. 20. Available at: https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/Berichte/Think-Tank-Bericht-Zusammenfassung.pdf?__blob=publicationFile&v=4

[32] Peitz, M. y Franck, J-U. (2019), *Market Definition and Market Power in the Platform Economy*, p. 79 y 80. Available at: https://www.cerre.eu/sites/cerre/files/2019_cerre_market_definition_market_power_platform_economy.pdf