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English - Or. English

28 October 2023

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

The Role of Innovation in Enforcement Cases – Note by Indonesia

5 December 2023

This document reproduces a written contribution from Indonesia submitted for Item 3 of the 141st OECD Competition Committee meeting on 5-8 December 2023.

More documents related to this discussion can be found at
<https://www.oecd.org/competition/the-relationship-between-competition-and-innovation.htm>.

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Consideration in Case and Merger Analysis

1. Innovation Paradox and Competition Law

1. It is still debated whether innovation will breach competition policy. In various regimes around the world, there are still many competition laws that adopt a standard approach based on theories that have been maturing for decades. The structure-conduct-performance (SCP) paradigm that prevailed in the 1950s and 1960s considers that industry structure determines firms' conduct, which in turn determines market performance. The SCP paradigm assumes that the lower the market structure, the more competitive the companies operating in that market are. Market deconcentration is an effort that is considered valuable, regardless of the costs associated with the emergence of diseconomies of scale. In other words, smaller firms that have weaker market power are believed to provide a greater level of competition, which in turn can spur innovation. This structuralist view received a lot of criticism, and a more dynamic view emerged.

2. The dynamic approach states that in assessing markets it must be understood that perfect competition is the enemy of good competition, while imperfect competition is a source of innovation. Competition law must recognize that market power is critical for innovation because it enables investment in research and development to bring new ideas to market. Meanwhile, competition law also must comprehensively take into account the important role of innovation in the economy, not only powering growth but also disrupting market power. Innovation to be a prime goal of the competition. Adopting a dynamic approach to competition law requires reforming the tools and metrics that regulators use to define and assess markets to better understand potential competition and follow the general rule of reason in enforcing competition laws. Competition agencies should focus on the long-term impact of enforcement and keep pace with the evolution of global markets. Specifically, on the innovation benefits derived from firms that have at least some market power and the threat to market power from disruptive innovations, including new entrants.

3. This dynamic approach takes innovation into account, especially in technology or high-tech markets. This does not mean that non-tech markets cannot be impacted by the creative destruction of new technology-enabled business models, products or services. But technology market and high-tech markets often face disruptive and unavoidable headwinds. This approach is increasingly meaningful with the development of the digital economy throughout the world. Competition agencies need to follow this development by adopting their regulatory framework and toolkit. Innovation should no longer remain a paradox but should constitute the cornerstone of both the theory and practice of competition policy.

2. Innovation and Its Consideration in Indonesia's Competition Law

4. Competition law in Indonesia recognizes the importance of technological development. In this case, the technology development process must be undertaken by all stakeholder, including businesses in the market. It is believed that healthy business competition will bring new innovations to the market. However, it is important to realize that in market conditions that are not competitive, or highly concentrated, it will be easier for competition barriers to distort the market and hinder technological development.

Therefore, Indonesia's Competition Law is clearly stated that businesses are prohibited from using a dominant position directly or indirectly to take action, one of which could limit the market and technological development, or in other words hinder innovation.

5. Indonesia Competition Commission (ICC) also considers innovation factors in the initial assessment stage, particularly when defining the relevant market. The existence of innovation factor will lead us to define the relevant market by considering the time approach, or what is mentioned as a temporal dimension in Article 3 of Chairman's Regulation Number 4 Year 2022 on Defining Relevant Markets. This dimension is related with period of time which marks certain conditions of competition in the market. The condition of competition may be affected by the fluctuation of supply and demand in the market in a certain period of time, which could be in certain days, months, or years, and this fluctuation may be caused by innovation in intergenerational products. For example, a pharmaceutical company makes a new formula for medicine X, which is proven as more effective compared to the old formula. Demands on X has been spiking due to the innovation in its formula. In this type of case, we will consider the temporal dimension in defining the relevant market. Taking into account the development of the digital economy, our chairman regulation also stated that innovation factor should be considered while defining the relevant market of digital platforms, together with other factors such as competition between digital platforms, differentiation of products, and economies of scale.

6. With the current rapid and dynamic development of the industrial sector, it is nothing new when competition between companies is no longer limited to price competition but also includes non-price competition. Although price is still a fundamental aspect, in some markets, factors such as innovation, quality, variety of products, or even privacy may play an important role in the competition between firms. On some online platforms, products are provided for free to consumers, or what we call "zero price", and this may exhibit competition on quality and innovation in the form of functionality or even privacy. While markets with pricing regulations may offer limited opportunities for companies to compete on price, quality or innovation may play a greater role in this type of market.

7. In this case, when consumers' demands possess a high degree of price elasticity, the unilateral pricing effects of a merger may be limited and manifest themselves in different ways, such as a reduction in quality or innovation, since the loss of consumers that would result from a post-merger price increase may make such an increase unprofitable. While markets with a high degree of product turnover, either in terms of product changes, the addition of functionality, or the introduction of new products that constitute completely different markets, would likely involve substantial competition in innovation. Therefore, these non-price factors need to be included or considered in cases of alleged competition violations and the assessment of merger and acquisition transactions, especially in innovative and dynamic industries that have the market characteristics mentioned above, such as the agro-industry, pharmaceuticals, plant fertilizer, telecommunications, alternative energy, digital banking, e-commerce, and others.

8. Long before the development of the digital economy, ICC had already considered the importance of innovation. In 2013, in its decision, the ICC recommended to the Ministry of State-Owned Enterprises to instruct that every procurement must be carried out using open bidding which provides equal opportunities to competent providers of goods/services including the opportunity to conduct product introductions (trials). At that time, the ICC discovered a case where the procurement of goods carried out by one of the State-Owned Enterprises had implemented tying-in for the products being auctioned, where one of the products being tied in an online transaction system (e-POS). By renting a business premises, the tenant is required to use certain e-POS services and supporting

devices so that the tenant cannot use other providers to provide e-POS services. The Commission notes that this tying-in closed the opportunity for other providers who are developing e-POS systems. Therefore, the ICC asks the Ministry of State-Owned Enterprises to pay attention to this matter and open up opportunities for product development, even products that are still in the trial stage.

9. Then in 2017, the ICC also sent a letter of recommendation regarding product technology considerations in the bidding for the procurement of an Electronic Road Pricing (ERP) system. The bidding process which was carried out within one year was based on the Regulation of the Governor of Jakarta Province which stipulates that the technology used is Dedicated Short Range Communication (DSRC) frequency 5.8 GHz. The ICC sees a potential violation of Law no. 5/999 due to the restrictions on the use of technology in implementing ERP, namely only DSRC technology, even though there are other more up-to-date and efficient technologies that can be used in ERP such as Radio Frequency Identification/ RFID technology, Global Positioning System/ GPS (Satellite), and etc. ICC also obtained information that DSRC technology is starting to be abandoned by countries that implement ERP systems. These countries initially used DSRC, then during the 2010-2016 period switched to Navigation Satellite and 4G LTE and RFID. Article 22 of Indonesia's Competition Law explains that bidding that has the potential to create unfair business competition or hinder business competition when it is discriminatory and not all businesses with the same competence can participate, and or bidding with technical or brand requirements and specifications that are directed at certain businesses so that preventing other businesses from joining. Referring to the above, there are restrictions on the use of technology which must use 5.8 GHz frequency DSRC technology which has the potential to limit businesses with competitive technology from being able to enter or take part in ERP bidding. In fact, the aim of bidding is to provide equal opportunities for businesses to be able to offer competitive prices and quality. Therefore, the ICC sent a letter of recommendation to the Jakarta Provincial Government to provide opportunities for businesses who have competitive technology to be able to participate in bidding, not limited to businesses who only have DSRC technology.

10. In 2022, ICC also assessed mergers in the telecommunications sector between PT Indosat Tbk and PT Hutchison 3 Indonesia. The merger is intended to create a new world-class digital telecommunications and internet company for Indonesia. PT Indosat, Tbk. Based on the result of the initial assessment, particularly with regard to the calculation of the market concentration through the Herfindahl-Hirschman Index (HHI), ICC concluded that the HHI value for the transaction is above 2,500 and the change in HHI before and after the transaction is above 150. This means that, based on the concentration analysis, the assessment of the transaction should be conducted through a comprehensive assessment. The comprehensive assessment was focused on several factors, such as barriers to market entry, including government policies in the cellular telecommunications services market, anti-competitive behaviour potentials, efficiency, technology development, and/or bankruptcy.

11. In reviewing the merger transaction, ICC found that PT Indosat Tbk will have a better position and will be able to implement 5G technology according to their customers' needs. Without this merger, companies will have difficulty implementing 5G technology due to limited bandwidth.

12. This transaction will accelerate the launch of 5G, starting with 800 BTS (Base Transceiver Station) in 2022 and increasing to 6,133 BTS by 2025. In 2022, the development of 5G network and services will focus on a total of 13 (thirteen) regions, including six (6) provincial capital cities on the island of Java Island, and five (five) priority super tourist destinations, and two (2) other locations. The 5G network and services in six

provincial capital cities on the island of Java will be developed gradually to achieve optimal population coverage by 2025. In 2023, several satellite cities around the six provincial capital cities on the island of Java will start to receive 5G services and will be developed gradually. In 2024, several major cities outside Java Island will enjoy 5G services and will be developed gradually. The plan was made with the following assumptions:

1. by retaining all Indosat and Hutchinson's current spectrum; and
 2. by obtaining a fair share of the following spectrum:
 - a. 700 MHz will be auctioned at the end of 2022, and the merged company will begin to deploy 5G at 700 MHz in 2023.
 - b. 3500 MHz will be auctioned at the end of 2023, and the merged company will begin to deploy 5G at 3500 MHz in 2024.
13. At the end of this comprehensive assessment, apart from the conclusion that there was no allegation of anti-competitive practices in this merger transaction, ICC's analysis concluded that this merger is good for the development of telecommunications technology in Indonesia.
14. In 2023, the ICC revised its merger analysis guidelines and innovation will be one of the factors that being analysed in our comprehensive merger assessment stage. The regulation stipulates that ICC shall conduct a comprehensive assessment stage in reviewing the impact of a merger or acquisition transaction, and in analysing whether the transaction potentially causes monopoly practices and unfair business competition or not. Analysis is conducted on several factors such as market concentration, barriers to market entry, potential anti-competitive behaviour, efficiency, bankruptcy, policy on the improvement of competitiveness and the strengthening of the national industry, development of technology and innovation, protection of micro, small, and medium enterprises, impacts on manpower, and implementation of laws and regulations. In the comprehensive assessment stage, the analysis regarding the impact of innovation will be carried out when the merging parties state that the merger is aimed at developing technology and/or innovating the products of the parties.
15. Merger control to preserve the competitive environment in a dynamic market is challenging; under what circumstances the new approach will be effectively implemented is subject to discussion. Despite the criticism regarding loopholes and shortfalls in enforcement, the introduction of the innovation theory of harm is part of the competition authorities' effort to counterbalance the vigorous industry's development. ICC acknowledges the growing awareness of the importance of technology and innovation as market features. Nevertheless, the enforcement of innovation theories of harm in merger review should be carefully exercised in order to assure that the market is cautiously examined. Therefore, the merger's pro-competitive impact is being recognized, and the authority could effectively hinder the anti-competitive impact of such a transaction on the market.

3. Conclusion

16. There are different theoretical bases regarding the impact of innovation on business competition in the market. The application of this concept has attracted attention and discussion among economists and experts regarding whether consideration of innovation factors needs to be implemented by competition agencies. Consideration of these impacts is unavoidable in some cases in line with economic and technological developments. Innovation, as one of the non-price factors, particularly those aimed at developing new

products, represents an effort by a company to either capture a greater share of an existing market or create an entirely new market in which they will have market power. However, the incentive and ability of companies to undertake these efforts will depend on the rivalry they face in current product markets. Analysis of specific market conditions is needed to understand the potential impact of innovation on business competition in the market. Therefore, business competition agencies need to conduct a case-by-case analysis when considering the impact of innovation in case analysis and merger transaction assessment.