

**LSE European Institute *Perspectives on Europe* public lecture**

## **Competition in the online world: European and global perspectives**

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Ladies and Gentlemen:

I would like to thank Professor Calhoun for his kind invitation to return to the London School of Economics.

The economic forecasts released by the European Commission last week indicate that Europe no longer suffers from the double-dip recession that affected it since the beginning of the crisis.

According to the forecasts, next year GDP will grow by 1.1% in the euro area and by 1.4% in the EU-28. Slightly better figures are expected for 2015.

The projections also indicate a gradual recovery of investment and positive figures for job creation, although unemployment will still remain above 10% in 2015.

What can the EU do to sustain the recovery and increase its growth potential? What measures should be taken to improve expectations and increase opportunities?

Of course, I will not elaborate this evening on the full list of policy decisions and strategic options that are on the table of EU institutions and national leaders. It would be an impossible task in half an hour.

But when I started to think about the message for this lecture, I concluded that today I would tell you about one aspect of Competition policy enforcement – which is my direct responsibility as member of the European Commission – that has a significant impact on the overall performance of Europe's economy and that should help the EU take the road towards a sustainable recovery.

I am referring to the part of our action that keeps competition vibrant in the digital economy.

As you know, the European Commission has the responsibility to keep the Single Market a level playing field for every company with operations in the EU.

On top of the adoption and implementation of EU regulations, as a Competition authority we carry out this task analysing and sanctioning business practices that flout EU antitrust law; such as cartels and abuses of dominant position.

In addition, we assess proposed mergers so that the companies that result from them do not distort competition in the relevant markets.

Finally, we make sure that when Europe's governments intervene in the economy by means of subsidies or tax advantages, they do not give a selective advantage to any company or sector that would affect competitive conditions in the internal market.

My point is that, in today's juncture, competition policy enforcement through these instruments can greatly improve the business environment in growth-promising and innovative sectors – and the digital economy is certainly close to the top in this league.

### **The digital economy**

What happens in the online world today has important implications for virtually every other sector of the economy.

The Internet is the infrastructure of the knowledge economy in the 21st century.

And competition enforcement is a powerful tool to safeguard the proper functioning of the online sector and help it deploy its growth potential in full.

Although the basic principles and objectives of competition policy remain the same across sectors, a number of features are quite specific to the digital economy.

First is the churning process. Winners emerge quickly in the digital industry, but they can disappear just as quickly. There are many reports in the press of once popular companies that suddenly find themselves on the verge of failure.

Another feature of digital markets is the rapid pace of technological change which brings to market new and more powerful gadgets as well as immaterial advances, such as new services, applications, and ecosystems.

Thirdly, business models and sources of revenue change faster in the digital markets than elsewhere. Think for instance of the advertising revolution that search engines and social media have made possible with their ability to target ads to the specific needs and preferences of individual users.

The benefits of economies of scale are also characteristic of some online services.

For instance, the more people use a search engine the better it gets, because engineers need search data to refine their algorithms. In the same fashion, online retailers can obtain larger discounts from suppliers as they grow bigger.

Finally, competition analysis of digital cases must also take into account network effects, which are especially strong in the sector. For instance, the value of a social network website such as Facebook to a user depends to a large extent on how many users the same site has in total.

### **Gatekeepers of the online world**

Several of these features make it easier for companies to become gatekeepers in their respective markets than it is in the brick-and-mortar economy – and by 'gatekeeper' I mean a specific type of dominant firm which holds a strategic position along the value chain.

We can distinguish different types of gatekeepers in the online world: search engines, patent holders, network operators, and operating systems.

As the list makes clear, gatekeeper positions can be reached in several ways, such as strong economies of scale, holding a patent, being technically in the position to steer traffic on your network, and network effects.

Just as being dominant is not an abuse in itself, being a gatekeeper is not an abuse in itself either; but abusing these positions is. It is only the abuse, not the creation of a dominant position which is forbidden under EU competition rules.

In other words, it is perfectly legal for a firm to build up its position on the market through innovation, investment, or marketing. There should be no doubt about it. No firm can be sanctioned just because it's better, more successful, or even luckier than others.

Conversely, abusing one's position is illegal regardless of how one reaches it. The anti-competitive effect of the abuse is what matters.

Dominant companies have a special responsibility to ensure that the way they do business does not prevent competition on the merits and does not harm consumers and innovation.

One of the priorities of competition control is to ensure that dominant firms and gatekeepers do not abuse their positions; especially that they do not prevent other firms from entering the market with new and innovative products and services.

Let me give you some examples of cases where we are investigating the business practices of gatekeepers.

### ***Google search***

The first case I will talk about involves Google, which acquired its position as gatekeeper – among other things – because of the strong economies of scale in user information that allow search engines to improve the service they bring to their users. Rivals, such as Bing and Yahoo, have a significantly weaker position in web search.

One of the competition concerns we have in this case is that Google may divert internet traffic through favourable treatment – within its web-search results – to its own specialised web search services as compared to the links of competing services; such as those specialised in helping users find restaurants and shops.

Enforcing antitrust rules here means preserving choice so that users can pick their preferred services based on their merits. It also means preserving the incentives to innovate across the board, so that users can enjoy new and better services as they appear on the market.

### ***Samsung/Motorola SEPs***

The next example I will give you illustrates how companies can acquire gatekeeper status through legal means. I am referring to two ongoing cases involving certain patents owned by Samsung and Motorola.

The purpose of the patent system is rewarding innovation and guaranteeing a return on the investment that produced it. The system does so by granting patent holders a temporary exclusive right to use the innovation.

This is the general picture, but the patents involved in our cases are of a specific type, because they have been submitted to a standard-setting body with a commitment to let other companies use them under fair, reasonable and non-discriminatory terms.

These patents are needed by any manufacturer of mobile devices to make their products interoperable with the ubiquitous 2G and 3G mobile and wireless communications standards.

Our competition concerns materialised when the two companies subsequently sought injunctions against a licensee who was willing to accept FRAND terms for the use of these patents.

The two cases are at different stages. We informed Motorola of our concerns and we are studying their response.

As to Samsung, the company has offered commitments to allay our concerns and we are currently asking other market players to give us their feedback.

We will then decide whether to accept the commitments offered by the company. Until then, the only remark I can make is that I hope to reach a good solution in this case because it can bring clarity to the patent war that has been rocking the industry for quite some time.

### ***Internet Connectivity***

I will give you one last example drawn from ongoing investigations involving gatekeepers in the digital world. This one involves certain telecom operators that control the wires through which content is delivered to us.

Access providers such as Deutsche Telekom, Orange or Telefónica sit between end users and content providers.

We all know what a connection to the internet means for us as end users – it usually involves a contract with a monthly fee. Content providers typically “connect to the internet” by purchasing a transit service.

In addition to providing access to end users, some telecom operators also offer their own content.

This summer a team from the Competition services of the European Commission carried out unannounced inspections at the premises of the three telecoms operators I mentioned.

We wanted to make sure that these companies were not abusing a dominant position by degrading the quality or limiting the speed of third-party content, for example to favour their own content.

We are now reviewing the evidence obtained during the inspections. If an abuse of dominance is confirmed at the end of our investigations, we will have to intervene.

Impairing connectivity at the gateway to incumbents' networks would create unnecessary bottlenecks, undermining the objectives of the Digital Agenda and impairing the infrastructure of the knowledge economy. If confirmed, these practices would also raise questions related to the net-neutrality debate.

### ***Quick reference to past cases***

I would like to close this review of cases in the digital economy with a quick look at past decisions that have opened up markets blocked by dominant players.

I will mention the two Microsoft cases of 2009 and 2004.

Four years ago we accepted Microsoft's commitments that would allow users to choose their preferred internet browser.

Basically, Microsoft had a dominant position in the PC operating system market; Windows at the time was installed on more than 90% of personal computers.

This position was achieved thanks to strong network effects: as more people used Windows, more developers wrote applications for it, which in turn made Windows more valuable and so on.

Microsoft took advantage of this feedback loop by tying Internet Explorer to Windows and creating an artificial distribution advantage that was not related to the merits of its browser.

The commitment offered by the company allowed users to choose which web browser they wanted to use. This improved people's experience of the internet and also acted as an incentive for other companies to innovate and offer other browsers.

In the other case involving Microsoft, back in 2004, we did not accept commitments; instead we adopted what we call a Prohibition Decision and fined the company €497 million.

In that decision we found that Microsoft had leveraged its near monopoly in the market for PC operating systems onto the markets for workgroup server operating systems and media players.

In all these cases – old and new ones – our main objective is protecting consumers and promoting innovation and choice, not protecting competitors.

These examples of gatekeeper positions show the existence of general barriers to entry which apply to all businesses regardless of whether they started in a garage in Silicon Valley, Seoul or Stockholm.

## **Europe and the digital economy**

Ladies and Gentlemen,

In the second part of my presentation I would like to ask a few key questions about the relations between the digital sector and Europe's economic competitiveness.

- Why has the digital economy failed to develop in the EU as it has in other parts of the world?
- Can such factors as lower incentives, fragmented markets, and lack of funding account for this state of affairs?
- How can regulatory efforts and competition policy cooperate to create the best possible environment for Europe's digital entrepreneurs?

The EU has been preoccupied with riding the wave of the digital revolution at least since the first Lisbon Agenda of the year 2000 – it must be said with scant success.

The same goals were confirmed in the Europe 2020 Strategy that followed it in the present decade as the overarching strategy for growth and jobs in the EU.

Indeed, the so-called Digital Agenda for Europe is one of its priority initiatives. Its overall aims include the delivery of innovative digital services through fast and ultrafast internet and interoperable applications.

But who will deliver these digital services? Today we observe few European companies among the giants of the internet. In fact, we see mainly American giants such as Google, Apple, Facebook and Amazon or Asian winners like Samsung who are active all across Europe.

This is in sharp contrast, for example with our telecom operators. The telecom market includes over one thousand fixed operators, and several hundred mobile operators.

Although many of them are ultimately controlled by a handful of large telecom groups which serve a large proportion of European customers and users, they still run their activities separately in each Member State and do not operate as pan-European players.

Why is that? I can see three possible reasons to account for this state of affairs.

### ***Different approach to antitrust enforcement***

The first reason has to do with possible differences in the approaches to antitrust enforcement followed in Europe and America.

There is a general agreement between the EU and the US on the fundamental objectives of antitrust laws and policies; that is, to ensure consumer welfare in terms of price, quality, innovation and choice. In addition, we both believe that a sound analysis based on economic effects is crucial.

But some aspects of our abuse of dominance action are specific to the EU. Most notably, exploitative practices – such as unfair or excessive pricing – are covered by Article 102 of the EU Treaty; but not by Section 2 of the Sherman Act, which sets out the rules for this type of infringement in the US.

Even though the number of exploitative pricing cases in the EU has been relatively modest, the mere fact that authorities may intervene directly against excessive prices can have an impact on the companies' incentives to invest.

If firms anticipate that a competition authority is ready to cap their prices when they are successful and earn high profits, their incentive to invest and innovate may be affected.

Of course, there is a fine line here. In certain cases, it is right for a competition authority to intervene if prices are excessive and barriers to entry high.

In addition, competition enforcement in this area should be complemented by regulatory intervention to lower barriers to entry and allow more competitors to come into the market and drive innovation.

We have many instances where the regulation and competition services of the Commission join forces to allow innovation to thrive.

Competition enforcement is not the reason why there are not European companies among the so-called over-the-top players.

Nor will we succeed in this domain granting “regulatory holidays” or going back to a situation where incumbents receive again a special treatment from public authorities.

Let's see the two other questions I mentioned a minute ago.

### ***Fragmented national markets hinder companies to achieve scale quickly***

The second reason I can think of for the fact that there are so few European giants in the digital industry is the fragmentation of the internal market.

Today, Europe does not have an integrated single digital or telecoms market. This fragmentation makes it difficult for national companies in Europe to achieve scale and therefore scale benefits.

When starting in a garage in Silicon Valley, a small firm can expand to the entire US without major regulatory obstacles and reach 300 million Americans.

In contrast, in Europe a small company starting in a single Member State would need to check compliance with national laws and face extra administrative burden before being able to gradually increase its footprint across Europe.

We have 500 million potential consumers of digital services in the European Union, but it is a struggle to reach them beyond national borders.

I have no doubt that the lack of a single digital and telecom market constrains growth of European companies. This is particularly true in internet content.

Currently, to protect an invention in the 28 countries of the EU, one must translate and validate a patent country-by-country.

The EU has been trying to address the fragmentation issue for many years, but no results or solutions have been available until now.

Fortunately, a patent reform package was adopted less than a year ago. The initiative is designed to create an EU Unified Patent Office.

Also, the Commission has launched the License for Europe initiative. Together with the industry, the aim is to bring copyright and licensing up to date for today's digital world.

In September the Commission adopted a regulatory package which aims at achieving a single telecoms market by harmonising rules in national markets.

However, this is not the end of the journey. Even if all our initiatives are adopted soon and start to be implemented, we will still have 28 national telecom regulators and national allocation of spectrum.

### ***Demand for funding and supply of funding***

The third and final reason I will give to you looks at the mismatch between the demand and supply of funding for start-ups.

In Europe roughly 80% of financing comes through the banking system. In the United States, precisely the opposite is the case. Private investors, not banks, provide the lion's share of corporate finance.

Particularly in the current economic situation in Europe, bank funding is limited. And small companies do not have access to capital markets through equity or bonds issuance.

The scarcity of alternative sources of finance apart from banks – and the less developed Venture Capital market on this side of the Atlantic – means that many small businesses cannot find investors for their projects.

Not only the supply of funding appears less advanced, we also observe problems on the demand side.

Young enterprises must learn how to draw up a sound business plan to search for external funding. Some are hesitant as they must share control with an outside investor who usually can have a say in company decisions.

Here, the role of EU competition policy is to accompany policy efforts with an adequate design of the State aid control framework. This is why, as part of the overall State aid Modernization project, we are updating our State aid guidelines to support SMEs in their efforts to access risk capital.

These guidelines specify the cases in which EU governments can create incentives for private players to invest in innovative SMEs.

These efforts to improve the funding situation for SMEs are complemented by regulatory actions to create an internal market for venture capital funds.

Ladies and Gentlemen:

I will conclude.

I have tried to elaborate on the nexus between EU competition policy and the digital industry.

In closing, I would just like to repeat that the work that competition authorities carry out in these sectors is of paramount importance, because the proper functioning of markets in the online world can have a fallout in the performance of many other sectors.

At the end of the day, this is the challenge of the knowledge age. Growth, innovation, and competitiveness in Europe are crucially dependent on our ability to stay in the digital economy race.

We must trace better pathways in the Single Market that our start-ups can follow to become European champions and world leaders.

This was one of the priorities of the first Lisbon strategy back at the start of the century – and it didn't materialise.

But this should only reinforce our determination to turn the EU Digital Agenda launched in 2010 into a success.

Public policies at national and European level should be geared towards this goal; including competition policy and regulatory efforts.

We must continue to lower barriers to entry. We must harmonise national markets to complete the Single Market especially in the most growth-promising industries. We must address funding problems so that the next success stories of the digital economy are European stories.

Thank you.

**END**