

The Internet

Opportunities and Risks for Competition

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Introduction

One of the key areas of economic activity today is the growth of the information and communications technology sector and the development of electronic commerce. Technical innovation in this area enables opportunities for new businesses and more vigorous competition in diverse areas including high technology, Business to Business (B2B), and Business to Consumer (B2C) commerce. Generally this will be beneficial for consumers and business and for the efficiency of the world and national economies.

In some respects, this can reduce the need for intervention by competition regulators. However, on important occasions these new forces can give rise to new forms and new areas of market power, anticompetitive conduct and consumer exploitation, so there is a need to apply the traditional principles of competition and consumer protection law and policy to these cases.

The challenge is to get the right balance between intervention and a "hands off" approach.

This paper looks briefly at some of the opportunities and risks for competition in high technology activities; in the use of the Internet in traditional commercial activities; and the consumer protection issues which impact on competition in these areas.

This involves testing a lot of issues in competition and consumer protection law and policy that are not necessarily new, but are becoming increasingly important. These include assessing the implications of technical innovation and network effects on market power, the balance between intellectual property rights and competition, pro and anti competitive effects of price transparency enhancing mechanisms, and the challenge to achieve international coordination to combat competition and consumer protection issues that cross national boundaries.

Issues in High Technology Industries

As outlined above, a feature of the high technology sector is the rapid growth of new products and services, new suppliers and more competitors. However, the new technology can also give rise to a new important set of competition issues as recently illustrated in the Microsoft case.

One view is that competition law should not apply in these sectors. Some economists, most notably those inspired by the Austrian school of Hayek and Schumpeter, believe that competition law should have no role in high technology areas. They argue that any market power will soon be displaced by further advances in new technology itself. Moreover, they contend that regulators and courts will be quite unable to understand and foresee the effects of technology and their decisions are likely to be mistaken.

However, another view is that some areas of new technology can give rise to a large accumulation of market power and consumer detriment in a short time and it sees a need for fast, strong and effective application of competition law in these situations. The actions of the antitrust division of the Department of Justice in the United States in launching the Microsoft case reflect that view. Moreover, the case shows that despite the technological complexity it became quite clear what was happening by the examination of internal documentation and the emails within Microsoft. Competitors, as well as customers were able to fully inform the Department of Justice about what was really happening.

The heart of the debate is not only whether innovations may be quickly superseded in an abstract technical sense, but whether the existence of network efficiencies mixed with intellectual property protections and conduct calculated to maintain and accumulate market power ensures that such alternatives are significantly delayed from getting to market.

And I think another challenge for us going forward will be to really think about what we mean by "significant" in the high technology context. Should we be saying that because it is likely that technology markets will change quicker than the rail or oil industries that we should be content to leave them be? Or should each market be assessed in the context of how quickly it would be moving but for the particular conduct in question?

The issues here are complex and the final outcome of the Microsoft case will no doubt provide further guidance to regulators on how to approach these matters in the future.

Issues for Business

It is interesting that the title of this session identifies the Internet as "the new strategic factor". A year ago, the Internet was considered to be a new world, the so-called "New Economy" in which dot.com businesses were poised to outmanoeuvre their old economy rivals perceived to be anchored down by high overheads and expensive bricks-and-mortar distribution networks. However, with the recent poor performance of e-commerce stocks in capital markets, the initial assumptions about what the Internet is and what competitive opportunities it

offers are now being questioned, as well as the competitive risks.

In a recent article Michael Porter warned that we need to move away from thinking of an Internet industry or e-strategies as a separate activity rather than as an integrated part of business. Instead the Internet should be analysed as a powerful set of tools that can be used wisely or not so wisely in almost any industry. That is, the Internet should be considered as part of a business's strategy, not an end in itself.

For a competition regulator, Porter's analysis has some interesting implications. He suggests that the Internet is most effective as a complement be used as a strategy to enhance existing competitive advantages enjoyed by existing market participants. In some cases, it may be used as a tool to develop internal efficiencies and better quality services giving smaller companies a chance to compete more vigorously against their larger rivals on a global scale, new entry and greater choice for consumers. But Porter also warns that many of the advantages provided by the Internet may easily be reproduced by competitors. This could mean that rather than facilitating a new kind sustained market entry, the Internet simply adds to the tools of existing businesses.

Even so, the impact of the Internet on competition is not necessarily neutral. Further thought needs to be given to questions including: whether greater price transparency enhances the potential for collusion (as well as increasing the ability of customers to make informed choices); whether participation in consortium Business to Business (B2B) electronic hubs (ehubs) may increase or enable firms to maintain combined or individual market power; and how to ensure that consumer protection laws encourage informed markets rather than a higher level of misinformation.

So what kinds of opportunities and risks does the Internet offer?

One aspect is the development of electronic B2B transactions. B2B is a strategy that can be adopted in many ways, but perhaps its most interesting manifestation for competition purposes is as a vehicle for a group of competitors to get together to establish a trading hub. A trading hub may enable significant efficiencies in supply chain management. It may increase internal efficiencies by reducing errors in purchasing, reduce time spent leafing through lengthy paper catalogues and increase employee productivity. It may also provide a mechanism for creating a greater level of price transparency and hence market efficiency. By this I mean that a buyer can access prices from a range of sellers located anywhere in the world at the press of a button. This can clearly stimulate competition as buyers have an opportunity to compare prices and other offerings from the widest range of sources instantly, and accordingly are put in a better negotiating position. Equally, suppliers may obtain immediately accessible customers from all around the world.

I say "may" because of course it depends on how the B2B is structured. The potential pro competitive advantages of B2B hubs outlined above could be quite a threat to existing incumbents and there is a high incentive to control such developments themselves in order to maintain their market position. Joint

ownership of B2B hubs by market participants may enable them to engage in tacit or actual collusion and/or exclusionary practices against third parties.

Whether these issues are likely to arise will depend on a range of factors including existing market structure and network effects. Where the ownership consortium has no market power in the market for the goods or services to be traded via the B2B, then collusion is less likely to occur. Equally, it is difficult to see what competitive effect excluding or discriminating against competitors would have if those competitors have sufficient standing in the market to form their own B2B. Network effects may however impact upon this analysis, because as a hub attracts more buyers and sellers, it becomes less attractive to trade via other mechanisms. This could in fact raise barriers to entry if controlled by existing market participants.

Even where participants do not own or control a B2B, it could be argued that the existence of such structures will, by increasing price transparency open up more markets to the risk of tacit collusion, particularly when markets are already concentrated. However, I think that there would need to be very careful thought given to whether in fact an independent B2B is likely to change the competitive environment that much. There are a range of existing price transparency enhancers already available when firms have the incentive to engage in such practices.

The tools for competitive strategy are becoming more technically complicated, but in many cases, it comes back to an issue that competition regulators have always faced that ways to create efficiency and competitive advantage can also raise competition issues. For example, the debate as to whether price transparency creates competition or collusion did not start with B2B. It has been with us in the context of petrol boards, auction rooms and recommended price lists for quite some time, and in fact, will be the topic for debate at a forthcoming roundtable discussion at the OECD.

But the new tools still raise challenges and questions, including the following. First, the Internet is introducing price transparency issues into a whole range of industries where it had never really been an issue before and requiring regulators to focus their thinking on these issues more keenly than ever before. For example, B2B marketplaces are developing in diverse industries such as office supplies, chemicals, media advertising, pharmaceuticals, and aviation, not just Airline Computer Reservation Systems (CRS) and petrol boards. Second, as with any new tool, it is necessary to distinguish the reality from the hype, in terms of what the technology can deliver, the magnitude of efficiency gains, the difficulties involved in making firm's internal IT systems compatible with trading hubs, and whether the same degree of price transparency was already available in that market. Third, whether certain arrangements which do raise competition issues should be allowed on public benefit grounds (in countries which allow anticompetitive arrangements if they have sufficient public benefit), particularly if the overriding benefits cannot be achieved any other way. For example, it may be that some B2B hubs will only develop if they have the equity backing of market participants. That is, because these ventures are risky, it may be that industry participants are the only ones willing to invest in establishing an ehub

because they are the only ones who can actually guarantee any throughput.

Consumer Issues

In looking at the opportunities and risks of the Internet, it is also important not to ignore the role of the consumer. In particular, there are some very substantial new issues about consumer protection in electronic commerce which require consideration by policy makers. The Internet as a tool for enabling new entry , and smaller businesses to reach more customers and facilitate more cross border transactions is only effective if it accepted by consumers. Therefore, I think that this is an area that deserves some attention in the context of overall competition policy.

On the positive side, the development of online trading can give consumers greater choice of domestic and international suppliers, potentially a greater diversity of products due to "virtual" and almost costless floor space, and the ability to scope out more information particularly price information about products.

The downside is that shopping on the Internet is not as costless as we would have hoped, both in terms of search costs and the integrity of e-commerce transactions.

The Internet is becoming so large that businesses may find it difficult to obtain equal access to customers. The domain name system provides an inbuilt advantage to existing businesses, because in most cases, a customer can type in a known brand name in order to locate a product. But an unknown business has to rely on search engines, portal services, or expensive advertising campaigns in order to be seen. Already, existing brand and goodwill have an advantage in obtaining a prominent position on a portal or search engine, as the service may wish to be associated with known, reputable businesses.

Inexperienced e-retailers, unscrupulous traders using the medium to revamp scams and pyramid selling schemes, and consumer nervousness about use and disclosure of personal information on the Internet have also contributed to consumer disillusion. In Australia, Internet-related complaints received by the Australian Competition and Consumer Commission (ACCC) have risen from negligible in 1997 to about 5,000 complaints per annum in 2000. Some of the key areas of concern are:

- ? Scams (eg technology scams such as page jacking and modem jacking);
- ? False and misleading conduct by suppliers (eg health claims re miracle cures);
- ? Non-delivery or failure to deliver within a reasonable time period (eg auction sites); and
- ? Advertising and claims about ISP services

Recent surveys indicate that the major concerns for consumers about shopping on the Internet include high shipping costs and fears about security of personal information and credit card details. Consumers International surveys indicate that globally, non-delivery, late delivery or incorrect deliveries are a major problem.

The recent International Marketing Supervision Network (IMSN) Sweep Day on compliance with the *OECD Guidelines for Consumer Protection in the Context of Electronic Commerce* also showed that there is still room for improvement, particularly in the level of disclosure of returns, exchanges and refunds, and privacy policies. For example, the overall results indicated that 55% of sites surveyed provided a policy on returns, exchanges and refunds (and 54% allowed for returns, exchanges and refunds), and 42% had a privacy policy of some kind.

In many cases, it appears that problems have arisen due to the fact that many "start-up" Internet businesses did not fully appreciate the level of demand and did not have the procedures and physical infrastructure in place to fulfil orders made on the Internet. Many did not appreciate the information disclosure requirements necessary in an online environment. For example, the size and position of disclaimers may be relevant, as well as "how many clicks" it takes to get to a disclaimer policy.

All of these things undermine consumer confidence in e-commerce. This in itself is a risk for competition, as consumers will tend to gravitate towards Internet sites provided by established businesses that they know they can deal with offline in case anything goes wrong.

It is in businesses' own interest to take action to protect the reputation of trading on the Internet, for example by implementing self regulatory initiatives such as adoption of the *OECD Guidelines for Consumer Protection in the Context of Electronic Commerce*, codes of conduct and Certification Schemes or trustmarks.

At the same time, caution needs to be taken in relying too heavily on industry Codes of Practice or Certification Schemes. First, the proliferation of such schemes in itself may create confusion. Second, consumers need to fully understand the limitations of such programs particularly jurisdictional limits and limited liability clauses. For example, consumers need to know whether a Code scheme which involves a dispute resolution process is limited to dispute resolution within the jurisdiction where the Code has been developed or if it applies in cross jurisdiction matters. Also, consumers need to know whether there are any relevant limitations on liability for goods over or under a certain purchase price. Third, can Codes facilitate collusion or inhibit innovation?

Such measures need to be underpinned by effective consumer protection laws. Some of the key issues to be faced include clarifying applicable law for transactions, investigation powers, information sharing, and enforcement of decisions where perpetrators are located in other jurisdictions.

Increasingly, regulators need to coordinate their activities in order to protect consumers. In some cases, it may be that an enforcement agency in one jurisdiction receives one complaint, but does not realise that there are thousands more complaints about the same trader globally. Coordination is necessary in order to understand the extent of damage. Also, owners of websites in one jurisdiction will, in many cases, be targeting consumers in another jurisdiction. In most cases, it will be the agency where consumers are located that is most concerned in stopping the conduct. To do so, it may require the assistance of

other agencies in order to obtain evidence and to enforce decisions.

Participation by regulators in international forums such as OECD, APEC, WTO, ISCCO and IMSN is necessary in order to facilitate global awareness and understanding of the issues, as well as pooling our resources to find appropriate solutions. Another element is participation in joint compliance activities such as the IMSN Sweep Days which demonstrate to business that agencies are taking an increasingly global approach to monitoring compliance. The recent launch of econsumer.gov which enables consumers to file online complaints about cross border transactions and obtain information about consumer protection laws in other jurisdictions, as well as providing agencies with global complaints and trends information should also facilitate a higher degree of cooperation and coordination.

The development of bilateral and multilateral treaties and agreements between Governments and Agencies is a further element in facilitating cooperation. The ACCC has been one of the leaders in the area. For example, the ACCC and the FTC recently entered into an arrangement to enhance cooperation on consumer protection matters. This involves notification of enforcement activities which might affect the Agencies' mutual interests, assistance in information gathering and coordinating law enforcement activities, and exchange of information. A second agreement permits the ACCC to participate in the FTC's Consumer Sentinel system, a database of consumer complaint data which is already used by over 250 law enforcement agencies.

Conclusion

In summary, what we are seeing is that as the Internet matures, our thinking about what the opportunities and risks are for competition is also developing. The Internet may be used in diverse applications from enhancing a firm's internal efficiency to creating new distribution channels, new forms of joint activities between competitors such as B2B exchanges, and totally new businesses such as Yahoo and Amazon. The threat of new entry may give rise to anti-competitive responses from traditional players. The use of e-commerce applications such as B2B exchanges may enable market participants to enhance or sustain market power. On the other hand, if properly structured, exchanges may provide greater opportunities for competition.

These dilemmas are not really new or surprising. Most competitive tools and efficiency enhancing mechanisms carry a competitive sting. Methods exist for balancing these interests within competition laws. For example, in Australia, the authorisation process enables the ACCC to approve arrangements where the public benefit outweighs competitive detriment. The challenge here is to ensure that in a developing environment, we ensure that we have sufficient information regarding the efficiencies and potential competitive dangers in order to balance competing interests.

Another key element is to ensure that consumer protection laws and our approach to compliance and self regulatory schemes helps to grow consumer confidence, promotes the use of the Internet to enable better informed consumers, efficient

and competitive markets.

To finish, I would like to emphasise that one of the opportunities for both business and regulators is that it is really making us all focus very hard on what we do and how we can do it better. The Internet enables almost instantaneous information flow. This means that many firms are looking at their information systems and thinking about how they can use the Internet to make business more efficient internally and reach more people. It also means that regulators need to revisit some of the more challenging aspects of competition policy outlined above and ensure that their investigatory response and evidence gathering mechanisms are best practice and utilise the Internet as an effective strategic tool in compliance and enforcement activities.