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Quality considerations in the zero-price economy – Note by Japan

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More documentation related to this discussion can be found at:

www.oecd.org/daf/competition/quality-considerations-in-the-zero-price-economy.htm

Please contact Mr. Antonio Capobianco if you have any questions about this document
[E-mail: Antonio.Capobianco@oecd.org]

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Japan

1. Introduction

1. In Japan, recently, there have been several cases that JFTC has addressed taking quality considerations in digital zero-price markets.

2. Meanwhile, in 2016, JFTC formed the “Study Group on Data and Competition Policy” (hereinafter referred to as “Study Group”) , which consisted of various range of experts such as not just competition law professors and lawyers but also cybernetics academics, at Competition Policy Research Centre (hereinafter referred to as “CPRC”)[1], in order to clarify issues like what kind of data collection, hoarding or utilization would be anticompetitive in our competition law (the Antimonopoly Act; (hereinafter referred to as “AMA”) or how we should analyse the cases in this field. The Study Group published the Report in June 2017, which covered a basic and holistic approach regarding how to define relevant market, how to analyse anti-competitive effect in zero-price markets under the AMA.

3. Although there might be a room for development of methods and theories for quality considerations, an existing framework of the AMA and JFTC’s current approach would basically be applicable to zero-price markets, in light of the Report and the previous cases.

4. This contribution paper shows some introductory concepts regarding how we should analyse business activities in zero-price markets in accordance with the AMA shown in the Report (section 2), and explains actual quality considerations in relevant cases by JFTC (section 3).

2. Report of the Study Group

2.1. Quality competition and market definition in zero-price markets

5. The Report points out that most of so-called digital platform businesses would create multi-sided markets (a market in which a firm acts as a platform and sells different products or services to different groups of consumers, while the demand from one group of customer depends on the demand from the other group(s)), where they provide free services such as social media with consumers and compete on a dimension of non-price element, i.e. quality of the services. The Report also mentions that the market where free services transactions are taken place can be defined as zero-price markets:

6. “Competition is normally based not only on price, but also on product quality, quantity, the customers and sales channel involved in transactions, the equipment used to supply goods, and various other competitive tools. The same is true for competition among

[1] CPRC was established in June 2003 by JFTC, with an aim of strengthening theoretical and empirical foundations for the enforcement of the AMA and for planning, policy-making and evaluation of competition policy, from medium- and long-term perspective. CPRC has been conducting research activities and organising seminars in collaboration with competition law and economic experts.

digital platform businesses and also for competition between digital platform business and other type of businesses. So, in case that digital platform businesses provide products free of charge, competition between digital platforms will take place based on factors such as product quality (e.g. product details and level of protection of personal information)", and "therefore, if there is a possibility that this competition is impeded, it is sometimes appropriate to regard the place of the competition as a '(relevant) market' that the regulation of AMA can be applied. In such cases, the place where you can trade 'free' services provided with no monetary payments, could be defined as a market comprising multi-side markets, or put another way, as a free-of-charge market".

2.2. Approach for market definition in zero-price markets

7. In defining a zero-price market, SSNIP test, which is used to decide substitutability for buyers by taking into account the degree of buyers' diversion of purchase in response to an increase in the "price" of a product, is considered inapplicable. On the other hand, it is considered possible to assess substitutability for buyers from the viewpoint of [1] whether the product is used (or it could be used) for the same purpose, and [2] buyers' recognition, preference and behaviour. These indicators are already adopted in JFTC's guidelines for merger review, "Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination", which means that, JFTC can apply an existing framework of merger regulation even to cases in zero-price markets.

8. Precisely, by surveying consumers to find out usage of the service subject to investigation or review, buyers' recognition, preference and behaviour concerning the service (e.g. what kind of other services consumers consider as alternatives and what kind of standard they apply to choose the services), it should often be possible to clarify the degree of substitutability for buyers objectively.

9. Although "Small but Significant and Non-transitory Decrease in Quality" (SSNDQ) test or "Small but Significant and Non-transitory Increase in Costs" (SSNIC) test are suggested as alternatives to SSNIP test in the Report, there are some challenges in using these tests, such as how to define "quality" or "cost" (non-monetary costs such as consumers' attention and privacy) and, if ever, how to quantify them. The report therefore concludes that these tests would probably be difficult to apply in practice (In fact, there has been no case where JFTC applied these tests.).

2.3. Analysis of anti-competitive effect in zero-price markets

10. The Report also indicates that reduction of service quality in zero-price markets can be seen as a sign of competition restriction, by saying that "for digital platforms providing "free" services such as social media, the level of privacy protection can constitute an important competitive tool. In such cases, the level of protection can be regarded as an element of product quality, and a reduction in the level of protection as a result of restriction could be assessed as having an effect in reducing competition".

3. Merger case related to zero-price markets (Yahoo/Ikyu (2015))

11. This section introduces a merger case related to zero-price markets by JFTC; Yahoo Japan Corporation (hereinafter referred to as "Yahoo"), which runs online reservation services for travel and restaurant on its website, planned to acquire all shares of Ikyu

Corporation, which runs the same businesses as Yahoo. In this case, JFTC defined a multi-sided market including a zero-price market, and also calculated market shares in consideration of non-price competition, that is, quality competition.

12. Both of the merging companies run online reservation services for [1] travel and [2] restaurant. To be more precise, through their reservation websites, they provide hotel businesses (including inn business and air transport services. The same shall apply hereinafter.) and restaurants with services which enable them to attract consumers, accept and manage reservations. Also, they provide consumers with services which enable them to obtain information on hotels and restaurants and make reservations.

13. They are so-called “platforms”, and the markets of “online reservation services” for travel and restaurant are regarded as multi-sided markets, which are composed of two services for two different types of users; one is for hotel businesses and restaurants, the other is for consumers.

14. Also, they receive a certain proportion of the values of closed contracts as fees from hotel businesses and restaurants, whereas consumers can use the online reservation websites for free; it means that one-side of the market is a zero-price market. In addition, consumers who made reservations through their online websites are awarded points worth a certain proportion of the values of closed contracts.

3.1. Online travel reservation service

15. JFTC defined the relevant market in this case as the “online travel reservation service”, which was different from the service provided by brick-and-mortar agencies, i.e. offline travel reservation service, for the following reasons: firstly, these two services are different for both customers and hotel businesses in the necessity of internet environment and thus there is no demand-side substitutability between these two services. Secondly, supply-side substitutability is deemed to be limited because online travel reservation services need to establish a system for reservation websites and develop a maintenance and management system for it while brick-and-mortar travel agencies need to develop branch facilities and relevant personnel system.

16. In this case, JFTC took into consideration the characteristics of zero-price markets in calculation of market shares, as well as in market definition. That is to say, JFTC calculated the market shares of these two companies in the “online travel reservation service” market, which includes a zero-price service, on the basis of transaction volume through their websites. One of the reasons is that [1] the revenues of “online travel reservation service” are commission derived from transactions between hotel businesses and consumers through their websites. The other two reasons are related to their means of competition; in particular, [2] they compete with each other for hotel businesses in terms of the number of the customers and the volume of transaction through their websites, and [3] for consumers, they compete in terms of the number of hotel businesses on their websites, and by awarding their consumers with points according to the transaction volume. JFTC therefore considered that the market share based on the transaction volume shows their competitive positions in both of the two different services for hotel businesses and consumers in the “online travel reservation service” market. It can be said that JFTC calculated their market shares based on the characteristics of zero-price markets in this case.

3.2. Online restaurant reservation service

17. In calculating the market shares in the "online restaurant reservation service", JFTC based on the number of customers referred through their websites, for the same reasons as the calculation in "online travel reservation service"; this can also be regarded as a consideration of the characteristics of zero-price markets.

4. Others (DeNA, 2011)

18. This section touches upon the AMA violation case in a social game industry, which has often attracted users by offering various digital zero-price services, although the JFTC's case decision did not explicitly mention quality consideration in free service.

19. This case is where DeNA Co., Ltd. (hereinafter referred to as "DeNA"), which operates social game distributing service, interfered with transactions between its competitor and social game developers (hereinafter referred to as "developers").

20. Social game distributing companies (hereinafter referred to as "distributers") including DeNA provide users with services which enable them to play social games on the websites. Although users can play these games for free, they can and often tend to purchase virtual goods within the games which give them an advantage in gameplay. Distributers and developers share in revenues from the sales of those virtual goods.

21. Also, distributers provide developers with services for free which allow them to offer their games to users through the distributers' websites which also show search results of provided games and advertising banners. Developers need to make their games ranked high in the search results or posted on high-profile advertising spots to attract users to their games.

22. In this case, DeNA pressured developers not to provide their social games through its competitor's websites, by removing the website links of the games the developers provided through DeNA's website, if the developers continue to provide their games through the competitor's website. Removing the game links interferes with new user acquisition by the developers.

23. Developers generally earn revenues from the purchase of virtual goods by existing users keeping playing their games. That is to say, interference with new user acquisition does not necessarily mean that they can no longer gain incomes from their games. However, they still need to acquire new users continuously in order to compensate for the decline in revenues which stems from the defection of existing users. It is therefore crucial for developers to make their games available on distributers' websites in order to attract and gain new users on a continuing basis. In this respect, DeNA had a high share in the sales of social games and many developers' revenues depended on the sales through the DeNA's website, leading more than half of the developers to terminate transactions with the competitor. JFTC took those characteristics of the social game industry into account in this case resolution.

5. Summary

24. As the Report describe in section 2 mentioned, the existing framework of the AMA accepts quality consideration in market definition and analysis of anti-competitive effect in

zero-price markets; in other words, the existing framework of the AMA is applicable even to cases in zero-price markets. In fact, JFTC has taken into account the quality of zero-price services in its actual case investigations.