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Five myths about the dearth of competition in presence of "dominant firms": The Microsoft example *

Anti-trust bodies impose fines or regularly penalise successful companies holding significant market shares in the name of an "abuse of dominant position." Instead of favouring competition, such interventions are based upon myths, decrease market rivalry and distort in fine the market process. The Microsoft case is a good example of the pernicious role played by these myths in real-life competition.

A situation where one or few companies hold significant market shares – even if there are no legal obstacles for new competitors to join the fray – is considered systematically with suspicion, and as anti-competitive, by bureaucratic anti-trust bodies, like the Directorate General for Competition (DG Comp) of the European Commission.

But competition, as Friedrich Hayek – a Nobel Prize-winning economist – explained, is a process of rivalry through which individuals and firms compete with each other and through which prices, consumer needs, best technologies, business practices and innovations, are ultimately discovered on the market[1].

Some market players indeed end up performing better than others in satisfying customers: accordingly they gain greater market shares in a specific niche(s) of it. If they are alert to the ever-evolving market situation (market shares and market niches can easily change, for example), they can maintain or even improve their position – judged then as "dominant" – vis-à-vis competitors who can lose ground or be eventually pressed to exit the market. Several pretexts may be put forward to justify anti-trust interventions against "dominant" companies.

Myth 1: End consumers have no genuine choice because the "dominant firm" is supposed to have coerced the market to such an extent that there are no major vendors offering alternative products.

The fact for example that it is difficult to find major vendors shipping an operating system other than Microsoft's Windows would tend to confirm this view.

Even if presumably approximately 90% of computers in the world are equipped with Windows, the relevant point is that there is no legal disposition forbidding vendors from shipping alternative operating systems.

If most of the vendors ship computers running on Windows, it is because they anticipate – all factors taken into account – that it is what consumers want. And, it is ultimately because the offers made by vendors generally meet the needs of consumers that some of them eventually enjoy a significant market share and become major vendors. Not the other way round. When it is no longer the case, consumers do not hesitate to shift to other, established or new, vendors who provide more innovative or cheaper systems than Windows.

Competitive pressure and rivalry coming from potential entrants and possible alternative products are also a continual check on established "dominant" firms. Although merely a potential constraint, this is

* The idea about the possible myths in this study comes from a Letter sent to the IEM by Con Zymaris, CEO Cybersource, Director of Open Source Industry Australia and Convenor of Open Source Victoria-Australia following the publication of IEM's article on Microsoft entitled "The Real Enemy" in the *Financial Post*, April 11, 2007. IEM's formal reply to the Letter is available at: http://www.institutmolinari.org/editos/20070420.pdf.
1. See Friedrich von Hayek, "Competition as a discovery procedure," 1968, p. 13, available at: http://www.mises.org/journals/qjae/pdf/qjae5_3_3.pdf.

just as real a threat to Microsoft and its vendors as the existence of direct competitors. For instance, what would prevent Intel, the number one maker of microprocessors providing for 80% of the world 'market,' from competing against Microsoft in the field of operating systems?

Contrary to what one may be inclined to think initially, this sort of new 'competition' may already be starting to emerge. For example, Red Hat – a company offering Linux operating system plus assistance – and Intel have announced that they are combining their efforts to help the latter's reseller partners achieve "rapid entry into the expanding Linux marketplace with Red Hat's comprehensive portfolio of solutions and new ways to provide their customers with more value"[2].

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Competition actually plays across all sectors and may come not only from within a more or less narrowly defined one, but also from firms - whether "dominant" or not – active elsewhere, in a completely different sector of the economy. In this context, antitrust authorities like the DG Comp – with their tendency to punish companies overwhelmingly favoured by consumers – may paradoxically stifle competition. Their policy can only induce Intel – or others – to hold back on moves to promote projects that fully challenge Microsoft's "quasi-monopoly". Is the commission not already eyeing on Intel because of another presumed "abuse of dominant position" with its 80% world market share in processors?[3]

Myth 2: Dominant companies like Microsoft abuse their market position in one niche to attack and kill competition in other niches of the market and thus become a monopoly.

In this vein, Microsoft has been accused in the US and the EU of abusing its position in the market for operating systems to attack other software niches.

“The relevant point is not what the market shares of each company were in the immediate past, but whether or not, there are legal barriers forbidding the entry in the sub-sector at issue.”

But the fact that a company is "attacking" other niches – and even being condemned under anti-trust legislations – is not the one that is relevant *per se*. The crux of the matter is to know whether such a move hampers competition or not.

Even if it may constitute a threat to old players, a new player in reality increases competitive pressure – instead of diminishing it – for the benefit of consumers in the sectors or sub-sectors in question. It puts additional pressure on already established players – which explains why they may not like it – in the same way as Intel is becoming involved with attacking the niche of operating systems and thus challenging by the same token Microsoft's position.

It is ultimately up to consumers to decide if such business decisions to enter new niches serve them better or not, by making an overall comparison between new products and existing alternatives. The fact that a new competitor is already well established and successful in another niche of the market or not, is thus irrelevant.

Under free competition, what matters is that there are no legal barriers to entry for any firm. Businesses shouldn't be forbidden to come and compete in the market niche of their choice. Microsoft may thus even decide some day to build its own computer from scratch, and thereby become the exclusive vendor selling machines running Windows on them. Would this instance of vertical integration completely abolish competition in all computer-related niches "attacked" by Microsoft? Of course not, it will still be in competition with other fully-integrated computers like Apple, running on existing operating systems.

But what if Microsoft becomes the only computer provider in the world after having allegedly pressed all existing competitors to exit the 'market'? Would competition then be destroyed?

There is no economic reason in itself why the most effective structure in some sector of the economy wouldn't be a unique producer – the one chosen by consumers – providing a specific good. The unique provider still must fear though potential entrance of new players if profits are too high or if consumers are not served in the best possible manner.

In the absence of legal barriers to entry for new players, a so-called "monopoly" is always subject to competitive pressure coming from other sectors of the economy. If it remains the only producer, it's because it alone is able to provide the best value to consumers.

2. See the press release dated March 19, 2007, available at: http://www.redhat.com/about/news/prarchive/2007/intel.html.
3. See Cecile Philippe, “AMD-Intel: Are price cuts anticompetitive?”, *Wall Street Journal*, March, 1 2007. A version of it is available at: http://www.institutmolinari.org/editos/20070328.htm.

Myth 3: Software 'market' is anti-competitive because consumers are not able to choose any PC and acquire a PC without incurring the cost of Windows' operating system. They should be able to ask and obtain from hardware vendors to provide Linux or any other operating system pre-installed.

While it is indeed possible to put together one's own computer, or have an independent professional do so, and equip it free of charge with the Linux operating system, one may ask why consumers have to contort themselves in such a manner.

A situation implying that there would supposedly be better or cheaper offers than already existing ones, provides, if true, a profit-making opportunity and potential new value to consumers. And entrepreneurs are ceaselessly alert to, and acting upon, such profit opportunities.

"Under free competition, businesses – whatever their market share may be – shouldn't be forbidden to come and compete in the market niche of their choice for the benefit of consumers."

But bringing products to the market and commercialising them entail costs and consume valuable resources in terms of time, advertising, storage and selling space, etc. The fact that all possible and imaginable offers are not available on the market – precisely because there are no potential consumers for them and there is no economic justification for bringing them to the market – doesn't mean at all that it is an anti-competitive market. It is not because the end consumer should "contort" him-/herself trying to buy a new Toyota without engine motor or brakes that competition among car makers is indeed somehow precluded.

If one is genuinely convinced that consumers should be able to choose "any" PC – especially computers "without" having to pay the cost of Windows – and that there is eventually a real demand for that, there is an obvious market solution. He/she should find like-minded associates or investors and found a company doing exactly that and making a profit out of it.

But to reveal valuable, such an offer will have to pass the market test and the consumers' verdict instead of relying on weaker competitive pressure from established players through anti-trust legislation. On the contrary, anti-trust intervention distorts competition by helping artificially offers which add no value to consumers. For example, the European Commission imposed on Microsoft a compulsory sale of Windows operating system without its multimedia software Media Player which turned out to be a commercial failure. Such offers wouldn't otherwise pass the market test and thus are a mere waste of resources.

Myth 4: Source information and interoperability protocols are sometimes shared within 'network' community. When dominant players like Microsoft withhold such interoperability protocols from others, they are acting anti-competitively. They should be forced to disclose such information to competitors in order to restore free competition.

Because of the existence of voluntary disclosure ('open source') of some information in the 'network' milieu, one might be tempted – but wrongly so – to generalize and to conclude that companies should automatically disclose their information.

Coerced transactions stemming from decisions of bureaucratic bodies to reveal information to one's own competitors cannot though in any way be justified on market principles. Free markets rest indeed upon voluntary exchanges and free negotiation of prices. If a company chooses not to reveal such information ('closed source'), it is still acting in conformity with these market principles, even if it is a company which holds a significant market share.

As one Australian specialist stated himself, 'open source' seems to have several advantages for consumers who don't have to pay to get software, as well as for creator companies themselves in terms for example of saving their time in developing new software.

But 'open source' business model may also present some drawbacks, such as problems with "generating revenue to ensure core source coders continue their work, ego battles, and the possibility of fragmentation of standards and protocols"[4]. These reasons, among others, certainly explain why we have to pay for some software while others are available for free.

It's not up to bureaucratic bodies to decree which business model is the best, but up to each company to decide voluntarily to open or to keep closed their information. Ultimately it is up to consumers again (and to vendors who are prospecting the market relentlessly) to sanction which products suit their needs lesser or better.

Myth 5: Dominant companies confiscate customers' purchasing power because there is not strong competition, the implication being that one

4. See Con Zymeris (CEO Cybersource, Director of Open Source Industry Australia), "Shoulders of Giants – A Paper on the Inevitability of Open Source Dominance," available at: http://www.cyber.com.au/users/conz/shoulders.html.

could have obtained the same products or services cheaper if there was a more even distribution of market shares among a greater number of players.

For example there is a study relying on a hypothetical estimation and comparison with the hardware market pretending that Microsoft would "extract" an additional AU$10 billion per year at least from consumers globally than it would if there was strong competition in the software market[5].

Such extrapolations and comparisons of profit margins with the hardware market are however senseless. Profit margins depend on risks and other factors specific to each sector and different from one sector to another. If there is really higher margins in some niche of the market, investors and entrepreneurs will not hesitate to quit other less profitable sectors of the economy and enter the field.

But the main flaw in such studies lies in them leading us to believe that strong competition is impossible when there are few players and when one company holds a significant market share.

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However, for existing and potential competitors as well as for consumers, the relevant point is not what the market shares of each company were in the immediate past, but whether or not, there are legal barriers forbidding the entry in the sub-sector at issue.

But the absence of such barriers doesn't provide indeed automatically a new competitor with distributors, purchasers, clients and easy profits. It requires investment and risk-undertaking in the short as well as in the long run. One shouldn't take them as granted and conclude too easily about the existence of abnormal profits.

The only way of knowing whether an abnormal profit opportunity is genuine or completely illusory (i.e., the presumed annual amount of AU$10 billion), is to effectively enter the field, convince vendors and consumers of the superiority of one's products, instead of calling for intervention from anti-trust bureaucracies.

Conclusion

A situation with one or few successful companies holding significant market shares is conform to free competition and market principles.

Existent competitors as well as potential competitors are seeking the slightest opportunity to attract customers and better serve them. But in order to really provide valuable solutions, such competitors need to pass through the market test instead of looking for help from public authorities.

Anti-trust regulation thus serves to artificially protect some competitors, but it does not promote competition in and of itself. When there are no legal barriers to entry, consumers can stand up on their own and choose the companies that best meet their needs.

"Dominant" companies are constantly subjected to the consumers' verdict and must continuously win their confidence. Free competition needs to be protected, not against dominant companies, but rather from the policies implemented by anti-trust authorities and from those firms seeking the latter's intervention in the market place.

5. See Steven D'Aprano, Arik Gershoni and Con Zymaris, "The Cost of Software Monopoly: How Australian Consumers Lose," 2005, at: http://www.cybersource.com.au/press/the_cost_of_software_monopoly.pdf.

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