

ANDROID, IOS AND MARKET POWER - WHAT DOES MOBILE PLATFORM COMPETITION REALLY LOOK



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I. INTRODUCTION

The European Commission's competition investigation into Google's Android mobile operating system ("OS")² has unsurprisingly raised a lot of attention and commentary. So far most comments focused on the "abuse part" of that investigation. The key question there is whether certain provisions in the Mobile Application Distribution Agreement ("MADA"), relating to the bundling of Google apps and the anti-fragmentation agreement ("AFA"), constitute an abuse under Article 102 TFEU. In fact, the Computer and Communications Industry Association ("CCIA") has addressed a letter to Commissioner Vestager explaining why the MADA and the AFA are key to the functioning of the Android ecosystem, spurring innovation and competition.³

While the issue of "abuse" is arguably the more interesting part in most Article 102 cases, I believe that the finding of a dominant position is worth a broader discussion in the Android investigation. That is because it reveals a lot on how the Commission views the competitive dynamics in the mobile OS space. This contribution will discuss this issue and will also explain how large market share is not a reliable proxy for market power.

II. TAKING ACCOUNT OF THE "APPLE FACTOR"

Most readers will know that conceptually, a finding of dominance involves a two-stage assessment. First, one has to define the relevant market. While that definition can involve complex economic assessments, it is essentially a matter of substitutability. Where goods or services can be regarded as substitutes or interchangeable by the consumer, they are within the same product market. Second, competition authorities look at whether a given company has a "dominant position" on the relevant market. For economists, companies with a dominant position are companies that have substantial market power. In the often recurring words of the Court of Justice of the EU ("CJEU"), a dominant position:

relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers. (*United Brands v Commission*, para. 65)⁴

Importantly, the Commission explains in its Guidance on Article 102 Enforcement Priorities⁵ that the notion of "independence" is "related to the degree of competitive constraint exerted on the undertaking in question" and where competitive constraints are ineffective, the "undertaking's decisions are largely insensitive to the actions and reactions of competitors, customers and, ultimately, consumers." (para. 10)

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2 Press Release from April 20, 2016, available at: http://europa.eu/rapid/press-release_IP-16-1492_en.htm.

3 Letter from August 18, 2016, available at: http://www.ccia.net/wp-content/uploads/2016/09/CCIA-Letter-on-Android-Investigation_August-2016.pdf.

4 Case 27/76 *United Brands v. Commission*. Judgement of the Court of February 14, 1978.

5 Communication (2009/C 45/02). Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings.

With this in mind, let's turn to the ongoing Android investigation. To most people, competition experts and non-experts alike, one aspect of the Commission's investigation stands out: the market definition. When the Commission announced the Statement of Objections⁶ ("SO") it sent to Google, it held that the company has a market share of more than 90 percent in the market for licensable smart mobile operating systems. The word "licensable" is key because it means that Apple's iOS which powers all iPhones and iPads is outside the scope of the relevant market. So are iPhones really not competing with Android-powered smartphones? (Leaving aside the question of whether tablets should be included in the market definition for now).

One can argue the answer to this question depends on perspective. If you're an original equipment manufacturer ("OEM"), like LG or Samsung, iOS is not an option for you, indeed. Apple does not license iOS, leaving OEMs with the possibility of either licensing from a mobile OS provider or developing their own OS. OEMs are also free to develop a "forked" OS based on the Android open source code. From the perspective of app developers and consumers, however, the answer to the question above would be dramatically different.

Without the need to dive into a complex econometric analysis, it is fair to say that in the eye of consumers, iPhones and Android-based smartphones are pretty interchangeable, particularly as regards the higher-end Android phones that have started to compete in the price range of the top iPhone versions. Today consumers can seamlessly switch from OS to OS – Apple even developed an app allowing consumers to easily move from Android to iOS.⁷ That may be one of the reasons why Apple has repeatedly stressed the increased number of "movers" coming from Android in its earnings calls. At the end of 2015, Tim Cook said that 30 percent of customers who recently bought an iPhone switched from an Android mobile device.⁸ Furthermore, competition between Android and iOS is set to increase among mid-range smartphones as Apple continues to sell its entry-level iPhone SE as well as iPhone versions right below the newest one. Consumers will continue to look for the best mobile experience even if that entails a change of the OS.

It is also fair to say that in the eye of developers, iOS and Android compete for their app development efforts. While Android powers the biggest volume of smartphones, iOS has proved to be by far the most lucrative OS. Data recently released by App Annie shows that in Q2 2016, the worldwide app revenue generated by Apple's App Store was twice as high as the revenue generated by Google Play – even though Google Play had twice as many worldwide app downloads as the App Store.⁹ Interestingly, the data also showed that when compared to Q1, the revenue gap in favor of the App Store has increased (and in fact by 10 percentage points), indicating that iOS is becoming even more important for app developers. The recent dispute between Spotify and Apple confirms this and shows who the real power player in the mobile sphere is.¹⁰ Without going into the details of this fight, suffice to say that iOS Spotify subscribers are extremely important because they generate most of Spotify's mobile revenue. Importantly, what is true for Spotify is also true for many other apps.

Going back to the Android investigation, it seems illogical to leave out what I will call the "Apple factor," i.e. the presence of a clearly weighty company in the mobile space despite its lower share in mobile OSs.

III. COMPETITION BETWEEN MULTI-SIDED MOBILE ECOSYSTEMS

Competition in the mobile sphere is better described as competition between competing ecosystems— of course, today the two main ecosystems are iOS and Android but in fast-moving technology markets one should never neglect competition, particularly when exerted by a company as sophisticated and well-resourced as Microsoft. If you like, you can replace the word "ecosystem"

6 See Press Release from April 20, 2016, available at: http://europa.eu/rapid/press-release_IP-16-1492_en.htm.

7 See: <http://www.apple.com/iphone/switch-to-iphone/>.

8 Woollaston, V. (October 28, 2015). The decline of Android? Record number of users are abandoning mobile software in favour of Apple. Available at: <http://www.dailymail.co.uk/sciencetech/article-3293254/The-decline-Android-Record-number-users-abandoning-mobile-software-favour-Apple.html>.

9 App Annie. (2016). Q2 2016 Index. Available at: <https://www.appannie.com/insights/market-data/app-annie-index-market-q2-2016/>.

10 See e.g. Webb, A. Spotify's Apple Dispute Reveals Uneasy Dependence on App Stores. Published July 1, 2016 at: <https://www.bloomberg.com/news/articles/2016-07-01/spotify-s-apple-dispute-reveals-uneasy-dependence-on-app-stores>.

with the trendier word “platform” or even “multi-sided platform.” In fact, the multi-sidedness of a platform like a mobile OS is key to understanding the dynamics of competition in this market. For any mobile OS platform, ranging from Apple’s closed platform to Android’s open business model, the ability to keep the various sides of the platform happy is key. Arguably the three most important sides in the mobile OS market are consumers, app developers and content providers. Keeping all of them happy in a balanced way is no easy task. In light of the numbers above, Apple clearly excels at keeping consumers and app developers happy. Some commentators even refer to an “iOS bias”¹¹ to explain developers’ preference for trying new features with their iOS apps before launching them later on Android.

To define a market as narrow as “licensable mobile OS” essentially means that there must be a separate market for “non-licensable mobile OS” and that companies active in these two markets do not compete. In light of the “Apple factor,” that is more than just counterintuitive. What does not feel right from a pure consumer or app developer view has also been indirectly rebutted by the Australian Competition and Consumer Commission (“ACCC”).¹² In a request made by some of Australia’s leading banks, the competition authority was asked to grant authorization to the banks which would allow them to collectively bargain with Apple in respect of access to the iPhone’s embedded Near-field Communication (“NFC”) controller as well as the ability to pass through Apply Pay fees to bank cardholders. In essence, the banks’ ultimate goal was to provide their own digital wallets with embedded NFC on Apple devices without relying on Apple Pay for mobile payment processing and to make sure Apple would not apply any unreasonable terms and conditions to the distribution of the banks’ digital wallets through the App Store.

While this proceeding has many interesting angles, the ACCC has recently denied authorization for a variety of reasons, including a concern that the proposed conduct could lead to a distortion of competition between mobile OSs. That is because it could lead to an alteration of the integrated iOS experience which is an “important point of product differentiation that Android and other platform providers compete against” (p. vi). The fact that iOS and Android compete with each other could hardly be expressed more explicitly in the ACCC’s observation that:

As software platforms, both Apple’s iOS operating system and Google’s Android operating system are driven by the goal of attracting more users, developers and (for Android) handset manufacturers. There is often strong competition for market share, which tends to be fluid and subject to rapid change. (Emphasis added, para. 93).

IV. BACK TO BASICS: DOMINANCE ONLY IF THERE IS “ECONOMIC INDEPENDENCE”

But of course in the context of the Android investigation one can say that market definition does not matter much because even if one includes iOS into the equation, Android’s share in mobile device shipment will still be around 80 percent which would not dramatically change a finding of dominance.

Well, that would be true if we stubbornly stick to market share as the most important indicator of dominance. However, let’s look back at the key ingredient of a dominance finding: independence. Dominant companies can act independently of competitors, customers and consumers because they are not constrained by the market. It’s essentially an economic situation which allows you to be completely numb and unresponsive to market forces. It allows you to profitably raise price, limit output, suppress innovation, reduce the variety or quality of goods or services and deprive consumers of choice. In light of Apple taking the lion’s share of profits in the mobile economy, how likely is Google’s ability to totally neglect the Apple ecosystem, the demands of app developers and the wishes of Android users? In a multi-sided market setting, one unhappy side will very quickly translate into other sides becoming unhappy, straining the whole ecosystem and pushing consumers towards the competing ecosystem. And that is not to mention that the overall flexibility of the Android ecosystem diminishes Google’s ability to exert control over the final Android experience users get on their mobile devices.

¹¹ See Parker, M. Which mobile operating system is best? Android vs iOS vs Windows 10 Mobile. Published February 16, 2016 at: <http://www.trustedreviews.com/opinions/which-mobile-operating-system-is-best>.

¹² Australian Competition and Consumer Commission. Draft Determination from November 29, 2016. Bendigo and Adelaide Bank & Ors – Authorisation – A91546 & A91547. Available at: <http://registers.accc.gov.au/content/index.phtml/itemId/1197444/fromItemId/278039/display/acccDecision>.

It is worthwhile to highlight that while the “Apple factor” is probably the single most important reason not allowing Google to act independently and ignore the wishes of its various platform constituencies, both Google and Apple cannot ignore dynamics of global mobile economy markets. The ACCC, in the proceeding mentioned above, raised this point quite convincingly in saying that “[d]espite Apple and Google currently holding strong global positions in the market for smartphone operating systems, it is a highly dynamic market marked by the frequent emergence of new players and rapid shifts in market share” (para. 94). It bolstered this point by adding that:

Whilst the ACCC accepts that there are some barriers to switching between devices or operating systems, the dynamic global market for smartphone operating systems is characterized by high levels of innovation, fluctuating market shares, and entry and exit. (para. 250).

Frankly, that does not sound like a market that is constrained by the abusive behavior of a dominant company.

While the true degree of Google’s economic and competitive independence is key to the Android case, let me just mention a few words on market shares in dynamic online platform markets. The European Commission summed up that matter in its *Microsoft/Skype* decision¹³ quite nicely, even if primarily related to consumer communications services:

Market shares only provide a limited indication of competitive strength in the consumer communications services markets. [C]onsumer communications services are a nascent and dynamic sector and market shares can change quickly within a short period of time. Furthermore, almost all communications services are offered free of charge. (para. 78).

In reference to this paragraph, the Commission went on to stress that “market shares are not the best proxy to evaluate the market power of providers of consumer communications services and they only give a preliminary indication of the competitive situation in these dynamic markets” (para. 99).

If one were to replace the words “consumer communications services” with the words “mobile operating systems” in that sentence, it would still make a lot of sense.

V. CONCLUDING REMARKS

The relevance of the Android investigation goes far beyond the alleged anti-competitive conduct Google is accused of. Despite being in its infancy, this case is set to say a lot about how the Commission intends to enforce competition rules in dynamic, multi-sided platform settings. In the mobile economy, it is inconceivable how one would apply competition rules without regard to the “Apple factor.” Apple’s fully integrated iOS experience is a clear competitive constraint on Android raising the stakes for Google to keep its mobile OS as integrated and attractive as possible. This, coupled with the overall flexibility Android leaves to third parties like OEMs and mobile operators, makes a finding of dominant position, i.e. a situation of economic independence, highly questionable.

13 Commission Decision in Case COMP/M.6281 *Microsoft/Skype*. (October 7, 2011). Available at: http://ec.europa.eu/competition/mergers/cases/decisions/m6281_924_2.pdf.

