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# Multimedia, Vertical Concentration, and the Free Market System

The "World of Consumer Electronics" fair from August 26th to September 3rd in Berlin made manifest that the demarcation lines between computers, telephones and televisions are becoming increasingly fuzzier. At the root of this phenomenon is a development which is often described by the catchword "multimedia": information, communication and entertainment needs will in future no longer be satisfied separately. The consumer will develop his/her demand for specific audiovisual and communication services on corresponding services markets, which will no longer be characterized by monopolistic structures but by competition between independent suppliers. This will be possible because these services will in future be able to utilize the same transmission paths, the so-called electronic "superhighways". The digitalisation of the transfer of information implies the multiplication of transfer capacity, which is virtually the same thing as the multiplication of the supply of services. But the Berlin consumer electronics fair was not the only event which was responsible for the fact that the word "multimedia" has dominated the headlines of the economic press recently. Other reasons are to be found in the misgivings felt in connection, firstly, with the introduction of the PC operating system Windows 95 with its integrated online service, and secondly, with the large mergers in the American media sector: Walt Disney and Capital Cities (ABC), Westinghouse and CBS, and Time Warner and Turner Broadcasting System (CNN).

Although at first glance Microsoft's new version of Windows has little in common with the mergers of the giants in the US film and television sector, looked at from the point of view of the safeguarding of competition they show clear parallels. In the final analysis, both Microsoft and the merging enterprises are reacting to the growing together of branches which were previously largely separate, namely the information and the communication industries, and – in the audiovisual sector – programme production and programme marketing. Just as these branches have become ever more strongly integrated through their use of the same data networks and the same final products, the corresponding strategy is to arm for the multimedia future by means of vertical integration upstream or downstream into other stages of production. Microsoft, which with DOS and Windows dominates the market for operating software for PCs, is entering through internal growth into telecommunications via its global online service. Walt Disney and Time Warner, which until now have been mainly programme producers, are attempting via the external "tailoring" of the largest media concerns in the world, to combine market control in entertainment software with control over distributional channels.

Independently of the question as to whether the chosen strategies will prove successful from the point of view of the individual firm, it must be asked whether the resulting concentrations can be tolerated from the point of view of the economy as a whole. After all, in this case the branches involved are such that concentration processes involve the danger that pluralism and diversity of opinion may be threatened, and they therefore deserve particular attention. These concentration processes are, furthermore, not a purely American

phenomenon. Firstly, many of the markets involved are international and events on them can therefore have global repercussions, and secondly, the experiences of the European Commission indicate that the concentration processes also affect European firms. The analysis of the case practice of the European Merger Control Regulation shows that the telecommunications sector is among those with the highest share of total mergers. The number of mergers in the audiovisual sector, which has increased markedly since the end of 1994, further shows that European media enterprises see their future in subscriber television and value added networks services.

However, concentration or size as such is not necessarily damaging to the consumer. Nor do the powerful business managers of the modern multimedia industry such as Bill Gates or Ted Turner necessarily threaten entrepreneurial freedom on the developing services markets. On the contrary, vertical integration processes in particular can under certain conditions be explained by overall economic cost advantages. Ronald Coase already pointed out in the 1930s that it was not only internal coordination within firms that caused costs but also coordination on the market via the price mechanism. The integration process can be an ex-post indicator of cost savings due to internal coordination if it makes apparent that the marginal costs of hierarchical coordination at a certain stage of production are less than the marginal costs of market coordination. In the field of the digital processing of signals economists find a whole number of arguments in favour of high concentration on the corresponding input markets. Among these are, for example, network externalities, which lead to the fact that the benefit provided to the consumer by a link to a communication network is so much the greater, the larger the number of other participants. On the other hand, for these high-tech industries economies of scale in the form of high irreversible R&D expenditures, which imply corresponding barriers to market entry, are often characteristic. In addition, the necessary compatibility of product systems and standards means that so-called "first movers" have a greater room for manoeuvre.

In reality, however, it is problematical to interpret vertical integration as an indication of the coordination form with the lowest costs. Not only real cost savings are in fact aimed at through the organisational form but also other objectives, particularly market control advantages. Thus, for example, in the case of Windows 95's online service the Antitrust Division expressed its suspicion that Microsoft was misusing its dominant position in the market for operating systems vis-à-vis other suppliers of online services. But is this suspicion enough to justify the intervention of the competition authorities in view of the fact that the "child's play" communication with the dominant PC user interface without doubt represents immense progress on the way to the informational society?

In telecommunications, in data processing and in the media sector, a rapid technological transformation can be observed. The innovations resulting from this, however, undermine market power. Competitive pressure on innovative markets does not arise from price reductions or from improved services by competitors. Dominant enterprises are disciplined here by new products and processes which replace the old systems and standards. Does this mean that Microsoft's dominant position and the media giants which have developed artificially are no longer a threat? Not at all, for vigilance in the interest of competition continues to be necessary. Innovation as a means of competitive discipline can only function as long as the opportunities for innovation are not themselves monopolised. For the developing multimedia sector, therefore, above all control over the distribution channels must continue to be limited. Only then can competition also develop on the downstream services markets. For the assessment of economic control on the services markets it is decisive whether substitution competition with market outsiders can be maintained. A concentration process is unacceptable, such as the one which is possibly beginning in the USA, which leads to a cross-market dominance of the entire sector, a sector whose function for the economy as a whole is irreplaceable. In this case the functioning of the economy would be disturbed to such a degree that the market economy system itself would be threatened.

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