Policies to Improve Monopolistic/Oligopolistic Market Structure

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I. The Concept of Dominance

Dominance is the most critical concept in competition analysis and application of competition policy. Dominance refers to the degree of influence a firm enjoys within a particular market, and this ability to influence can potentially lead to anti-competitive activities and effects. Dominance do not exist in a vacuum – it depends on the characteristics of the particular market (or in the competition analysis parlance, the relevant market), which makes it necessary for us to examine and monitor the structure of markets.

Although dominance is the central concept in competition analysis, it is not a well-defined concept. Nor is it easily measured. And there are differences between the economic meaning of dominance and legal meaning of dominance under different competition laws.

1. Economic Definition of Market Power and Monopolistic Power

Under perfect competition, there are many firms, their actions do not affect each other, and anonymous forces of supply and demand determine prices. No firm has the power to influence or control prices; therefore firms produce at marginal cost and there is not excess profit. Consumers are served at the lowest price that can be sustained by given supply and demand, and technological constraints (ie, marginal cost). Economic resources are efficiently used. There is no room for anti-trust regulation.

Under monopoly, there is only one firm in the market, and thus the monopolist has the power to raise prices by reducing supply. At given cost, the monopolist can raise prices and still make a profit, without losing market share to a competitor. This ability to raise price above marginal cost is the commonly accepted economic definition of monopoly power. Under monopoly, production is cut back and consumers are served at higher prices than if there was perfect competition; there is inefficient use of economic resources, adverse effects to the consumer, and thus, there is every reason for anti-trust regulation.

Thus, from the economic perspective, the main problems related with increased market
power are: economic inefficiency and adverse effects on consumers.¹

In the real world, the prevailing market structure would lie somewhere in between (ie, oligopoly), with the degree of market power increasing from the perfect competition - end to the monopoly-end of the spectrum. This is often measured by the difference between the price and marginal cost.

However, there are other factors, which affect the structure of the market, and market power. For example, ease of entry, the potential for entry, technological factors, imports, availability of substitutes, the number and size of competitors, the shape of the demand curve (ie, how sensitive the consumer is with respect to change in prices).

With due considerations to these factors, the crucial role of competition authorities is to determine whether there is substantial degree of dominance and market power in a particular market; whether there is exercise of such dominance to maintain that power (eg. abuse of dominance); or whether firms attempt to acquire that power in collaboration (collusion, mergers).

2. Legal Concept of Dominance

Economic concepts rarely match what can be measurable or observable in the real world. Eg, marginal cost, and therefore market power, is not easily computed with ordinary accounting measures. Most commonly, competition authorities use a proxy to estimate market power. Since there is a rough matching between market power and market structure, competition authorities often look at the market structure; ie, the size or the degree of dominance of a firm or group of firms in relationship to some well defined market.²

Thus, a firm which hold a dominant position in a well defined market, has a substantial

¹ Different countries have put varying degree of significance on these factors, over other factors held to be important (eg, fairness, protection of small business, impact on economic power etc). Note, in the US, with one of the oldest competition laws, competition policy in the 1950s and 1960s was applied to protect the “viability of small and middle-sized business, to preserve the freedom of action of independent business people, and to disperse economic and political power.” Emphasis on efficiency only started in the 1970, under the influence of the Chicago school.

² Defining the relevant market is therefore critical in assessing competitive effect of dominance in most jurisdictions. This is largely a technical matter, depending on each case, and will not be discussed further in this paper.
amount of market power, and thus the ability to behave substantially independently of its competitors. Dominance is usually measured by market share or concentration. Different legal systems interpret the concept somewhat differently. Below, this paper looks at how the term is interpreted in US, EU in turn, and then look at the Korean case in more detail.

1) US (Section 2 of the Sherman Act) (Janow 1996).

Illegal monopolisation involves two elements: (1) the possession of monopoly power in the relevant market, (2) the wilful acquisition or maintenance of that power, as distinguished from “growth or development as a consequence of a superior product, business acumen, or historic accident.”

Index or screen of market power is market share. A 90% market share has been deemed sufficient to support an inference of monopoly power, and courts have rarely found such power when the market share was below 70%. A market share below 40-50% virtually precludes a finding of dominance. The market share benchmark is used in light of other various competitive pressures at work in the market. US law is relatively permissive towards the unilateral conduct of even those firms having substantial market power.

Liability in the under the Clayton Act (…) , for some conduct such as exclusive dealing, tying or discrimination, dominance can be established at much lower market share levels and lesser degree of market power.

Examples of areas of application of competition law under the provision prohibiting monopolisation are access to essential facility, refusals to deal, exclusive dealings, tying.

2) EU (Article 86 of Treaty of Rome) (OECD 2000)

Dominance is defined as position of economic strength, which enables a firm to prevent effective competition being maintained on the relevant market by affording it the power to behave appreciably independent of its competitors.

This concept is a broader one compared to the US concept. The emphasis of the law itself is on dominant position, rather than more theoretical concept of monopoly power
as in the Sherman Act. The former therefore has led to more behavioural remedies while the latter tends to rely more on economic or market analysis.

Jurisprudence in the EU has found dominance at much lower levels than in the US. Market share exceeding 65% makes presumption of dominance almost irrefutable. For market share in the 40-45% range, dominance is presumed, but can be refuted if there is another equivalent firm in the market. Dominance has been found even at 20-40%, but rarely below 25%, and never below 10%.

3) Korea

The Korean competition law (Monopoly Regulation and Fair Trade Act: MRFTA, hereafter) espouses both the concept of dominance and market power. The provision prohibiting abuse of dominant power (Article 3), the concept is close to the European. A market-dominant enterprise is an enterprise and which holds market dominance to determine, maintain, or alter price, volume, quality and other terms of trade either on its own or in concert with other enterprises in a given area of trade. In other parts of MRFTA, concept closer to market power is used. For example, an action of a firm is judged to be anti-competitive if it “substantially restricts competition in a given area of trade (Lee et al 1995).

The Korean law is also concerned about economic power arising from concentration of ownership. A unique aspect of the Korean law is its two-pronged approach to the problem of dominance – it has general prohibition against abuse of dominance by market-dominant firms, and provisions directly regulating the behaviour of chaebols (or large business groups, according to MRFTA parlance).

In determining market-dominance, market share, the existence and scope of entry barriers, and the relative size of competing enterprises shall be taken into consideration. An enterprise whose annual turnover or purchase amount in relevant area of trade is less than one billion won shall be exempted (Article 2.7: Definitions).

However, any enterprise whose market share in a relevant area of trade that meets the following criteria are \textit{presumed} to be market-dominant (Article 4):

1. market share of one enterprise is more than fifty percent.
2. combined market share of less than three enterprises is above seventy-five
percent (excluding) any enterprise with market share of less than ten percent)

Acts of abuse of dominance is given by a non-exhaustive list under Article 3.2, which is structurally similar to the EU provision: unreasonably fixing, maintaining or changing prices; unreasonably adjusting supply; unreasonably hindering business activities of other enterprises, including new entry; engaging in unreasonable transaction to eliminate competitors or harm the interests of consumers. That is, the MRFTA prohibits not only predatory or exclusionary conduct but also excessive pricing or output restrictions, which is again, similar to EU provisions.

Provisions pertaining to the regulation of chaebols.

I. Nature of Dominance in Korea: Empirical Investigation

1. Degree of Market Concentration and Market Power

In general, the Korean market has been heavily concentrated. The top three firms accounted for more than half of the sales in 76 percent of the markets and 9 percent of the markets were monopolies in 1994 (World Bank 1999: 67-69). Further, compared to other OECD countries, degree of price mark up seems higher, although one is cautioned against direct comparisons, due to difference in calculating techniques (see Table 1).

However, over time, the level of concentration has abated. Top three firm concentration was on average 0.49 during the 1990s, with small variation from year to year (see Table 2), compared to the average of 0.593 during the 1980s. This is suspected to have gone up again since 1999, due to consolidation resulting from many bankruptcies and mergers.

There are large sectoral variations, ranging from the heavily concentrated petroleum and fertilizer (with average CR3 of 0.789 and 0.758 respectively) to the competitive textiles and other industries including furniture, toys and publishing (with average CR3 of 0.273

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3 Further, this figure should not be directly compared to the price cost margin in Table 2.
percent and 0.302 percent, respectively) as Figure 1 shows.

Price cost margin shows a similar trend. Although it increases slightly between 1993 and 1995, it falls thereafter, especially in 1997 (see Table 1 and Figure 2). Again, sectoral variation is wide. Price cost margin is largest in the pharmaceuticals, whereas it is lowest in petroleum.

2. The Relationship between Concentration and Market Power

Numerous studies have shown positive correlation to exist between concentration (concentration ratio) and market power (most often, price cost margin), independent of various controlling variables such as economies of scale, product diversification, barriers to entry, and access to specific assets such as technology etc. Literature is large for developed countries. Examples of Korean studies are Lee (1977), Lee, Shujiro and Choi (1998), Lee (1985), Choi (1986), and Yun and Lee (2001). Some details from Yun and Lee (2001)’s study. See Tables 3 and 4.

3. Aggregate Concentration: Proportion of Chaebol in the Korean Economy

Generally high level of aggregate concentration and chaebol dominance in the Korean economy. Chaebols encompass practically all major private firms in Korea, with three quarters of top 100 firms belong to top 30 chaebols. Top 30 chaebols operate in 18.5 of 60 business categories, showing the high level of diversification of these large business groups. Proportion of top 30 in the Korean economy in 1995 was 44.6% on asset basis, and 45.8% on sales basis (see Table 5).

Including 9 SOEs in the top 30, the proportions become 55.9% and 49.5%, respectively. Chaebols are also leading firms in major markets. Tables 6 shows that the chaebols are strongly correlated to market concentration measured by CR3 and HHI. Further, through cross share holdings, founder and their families have been able to acquire managerial rights throughout the subsidiaries with little actual investment. Chaebols are therefore, a central source of dominance in the Korean economy, in all aspects of concentration measures. Further, Table 6B shows that concentration measures are

\[ \text{Four categories of concentration: aggregate concentration (size measure: share of asset, sales or employment), conglomerate concentration (degree of diversification), market concentration (market} \]
strongly correlated to inefficiency (measured by the deadweight loss under monopoly price mark up), indicating that concentration due to chaebols have contributed significantly to inefficiency in the Korean economy.

An international comparison, however, shows that the degree of aggregate concentration is not so spectacular in Korea, though, again, should be cautious in directly comparing across countries.

II. Implementation of the MRFTA: Some Cases

1. Abuse of Dominance
2. Chaebol Regulation

Corrective orders issued for abuse of dominance seems to be considerably less than that under regulatory provisions against abusive acts by chaebols. This shows the that the Korean competition policy is mainly concerned with aggregate concentration, leading to emphasis on chaebol regulation.

III. M&A and Corporate Restructuring

1. Trend in M&A in Korea (See Table 7A, 7B, 7C)

M&A shows consistent increase since 1997 to 2000. Telecommunications sector saw the greatest rise in M&A during recent years. Year 2000 shows a rise in M&A between different sectors (combination), while a decrease in horizontal mergers, which has the worse competitive impact. This is partly explained by large off line firms entering IT industries through acquisition. In general, combination mergers take up the greatest proportion of mergers. Further, M&A through stock acquisition or joint setting up of new establishments take up major proportion of M&A than direct mergers and acquisition of business lines.

share), and ownership concentration (control of managerial rights; corporate governance issues). It is important to note that different categories of concentration do not always move in the same direction. Diversification can increase conglomerate concentration, but may lower market concentration in specific markets. Further, aggregate or ownership concentration, which has been the cornerstone of chaebol regulation under the MRFTA, need not always mean market concentration, although empirical studies show high correlation between the two.
M&A by top 30 large business groups have also increased substantially in 2000, especially with non-affiliates. The out of group M&A, consisting of 59.5% of total M&A of top 30 groups, increased to 71.7% in 2000. This indicates that the chaebols have, in the main, completed internal restructuring and are seeking to diversify into new promising sectors, such as the IT sector.

Cross border M&A was only allowed in 1997. Table 6 shows that in 1997, only 4.5 percent (19 cases) of total M&As were cross border. This increased rapidly to 27.2 percent (132 cases) and 30.2 percent (168 cases) in 1998 and 1999 respectively. Asset and business acquisitions formed 10.5 percent of each in 1997. This increased significantly to 29.5 percent and 22 percent respectively in 1998 and 36.3 percent and 29.2 percent respectively in 1999. On the other hand, establishment of new firms through mergers decreased from 68.4 percent in 1997 to 39.4 percent and 22 percent in 1998 and 1999 respectively. The trend is reversed in 2000, indicating that there was less number of firms on sale, and reflecting the general downturn in FDI.

2. Merger Analysis and Review Procedure in Korea

Mergers are regulated by Article 7 and 12 of the Monopoly Regulation and Fair Trade Act (MRFTA). Article 7 prohibits mergers that substantially restrain competition in the relevant market. The prohibition covers purchase of shares, mergers and acquisitions, joint establishment of a new company and interlocking directors. A merger is presumed to substantially restrain competition in the relevant market according to the following two criteria [MRFTA Law No. 6371, last amended January 2001. MRFTA Enforcement Decree No. 17176, last amended March 2001].

(1) Market share criteria: Combined share of merging firms is the largest in the relevant market and;
   a) combined share of the merging firms meets either one of the criteria of a dominant enterprise;"
   b) the ratio of the market share of the second largest competitor to the combined market share of the merging parties exceeds 25%.
(2) Consideration of SMEs: The merger involves a large company (with sales or assets of over two trillion won) leading to a share of more than 5% in a market where small and medium enterprises constitute 2/3 of the market.
In addition, possibilities for new entry, import competition, collusion among and with non-merging firms, and availability of substitutes are considered in the competition analysis.

There is an exemption provision designed to allow mergers with large efficiency effects or mergers involving failing firms. The efficiencies arising from the merger must be specific to that merger, and the benefits from increased efficiencies must be greater than the harmful effects of restraint of competition due to the merger. However, benefits from increased efficiencies are interpreted broadly, including not only firm-level efficiencies in production, sales and R&D but also contributions to national or public welfare (e.g., employment creation, support for local economy or related industries, environmental protection and provision of essential goods). The failing firm defence applies when the failing firm's assets are unlikely to be utilised without the merger and less anti-competitive mergers are unlikely.

Article 12 deals with notification. Any merger involving a company with assets or sales (including those of its subsidiaries) over 100 billion won must notify the Korea Fair Trade Commission within 30 days of transaction. The merging parties can opt to request KFTC review before the completion of the transaction, however. In this case, the KFTC must deliver its decision within 30 days, with the possibility of extension for 60 days. For large firms with sales or asset over two trillion won must notify the KFTC before the transaction is completed and must not consummate the merger within 30 days of notification. That is, pre-merger notification is mandatory for large firms but optional for others. Through a recent amendment, notification obligation is made not to apply when other central government ministry has already consulted with the KFTC about the merger.

Jurisprudence in this area is not large. Between 1981 and 2000, there were 11 corrective orders only. Some cases are explored below, first with respect to post-crisis restructuring, and then the IT sector, where prominent M&A has recently taken place (see Table 8).

3. Some recent review cases
1) The role of M&A in Corporate Restructuring: Big Deals

“Big Deals” are business swaps (involving both divestiture and M&A among chaebols) initiated by the government to facilitate corporate restructuring after the crisis. Major rationale behind this initiative is based on the presumption that there was excess capacity (ie, “excessive competition”) in the light of recession. Industries subject to big deals were semiconductors, automobiles, petroleum and petroleum refining, aeronautics, railroad-trains, electricity generation, engines for ships, automobiles and electric equipments. Of these, semiconductors, aeronautics (consortium of 3 chaebols), railroad trains, petroleum refining, electricity generation, and engines for ships have been successful deals.

Immediate questions that follow in evaluating Big Deals:

- Was there indeed excess capacity? Lee (2000)’s estimation shows that indeed there was excess capacity, especially in automobiles, aeronautics, and trains, and to a certain extent, electric goods (utilisation rate below 75% or 80%; usually normal capacity utilisation in manufacturing industry is considered to be 80%, and below 75% is considered to be recessionary).
- But does this warrant government intervention, in general? Excess capacity can either exist because of wrong demand predictions, but also may be used strategically by incumbent firms to deter entry. In the latter, should be subject to competition policy considerations. Lee (2000)’s empirical study shows that in the main, excess capacity in Korea during the years 1988-98 were due to over-optimism in the main, although there is also the indication that incumbents were trying to deter entry. The latter motivation, it is pointed out however, is part of a deliberate move to justify government regulation restricting entry in these industries. Government regulation may have therefore, aggravated entry deterrence and concentration in these sectors Lee 2000).
- Even if there was excess capacity, were some of the M&As warranted? What about anti-competitive effects of these mergers? Merger reviews seems to have been lenient in these cases. Eg automobile sector – could have disallowed merger in the bus sector (see below).
- Lee (2000) recommends recession cartels as an alternative, but this doesn’t seem to be such a good idea. First of all, chaebols, even under high level of concentration were not able achieve coordination. What incentive will they
find just because they are forced to do so? Further, it might create an inertia, with the danger of collusive activities continuing beyond recession. Allowing some firms to fail, early on, may have been a better alternative.

**Review of Hyundai’s Acquisition of Kia**

Market shares post merger made the case subject to merger review (66.3% for sedans, 78.8% for buses, 94.9% for trucks). However, in the sedan and bus market, there were significant competitors in the market. This case is an interesting case because of the application of “failing firm doctrine.” Kia was deemed to be bankrupt and unable to recover by itself. On this basis the merger was approved.

However, this was conditional upon a corrective measure by which the merged entity was forced to keep prices under export prices in the truck segment for three years, from 1999 to 2002, due to establishment of market dominance in this sub-sector, post the merger. In 1999, the merged entity had raised prices of trucks and buses by 3-11%. The KFTC considered this to constitute abuse of dominant position, since the firm did not raise prices in the more competitive market for sedans, nor in foreign markets where they do not hold dominant positions (the firm was consequently fined).

Critique: a proper failing firm doctrine? Ie, was there a less anti-competitive merger as an option? Was price ceiling an appropriate corrective measure for trucks market? Would divestiture have been more effective?

2) **The role of M&A in Corporate Restructuring: Cross-border M&A**

Interestingly, the three orders for corrective measures by the KFTC in 1998 all involved M&As by foreign parties. In the case of P&G’s acquisition of Ssangyong Paper Ltd, the KFTC ruled that the merger would adversely affect competition in the hygienic band market, and ordered the sales of manufacturing facilities and industrial property rights to a third party. When a joint venture of three companies, Hansol Pulp and Paper, Abitibi Consolidated (Canada) and Norske Skog (Norway), acquired Hansol's paper manufacturing business, the KFTC concluded that the acquisition would limit competition. The merging parties were ordered to maintain the market share of the joint venture to be below 50 percent until 2004, when import tariffs on newsprint would be lifted. For Gillette Company's acquisition of Rocket Korea Ltd, the KFTC ruled
that it would limit competition in certain segments of the battery market and ordered
that the product price of the acquired firm should not rise above a certain level for the
next five years (Yun 2000. See Figure 3 ).

The Seminis Case (Yun & Lee 2001).

The vegetable seed industry is a case where acquisition by foreign firms has been
extensive after the crisis. There were 48 major seed producing companies in Korea as
of 1998 and the number of firms increased to 52 by 1999. Besides these, there are
known to be hundreds of very small seed producing companies. Of these, top five
firms were Hungnong, Choong Ang, Dongbu-Hannong Chemicals, Seoul Seed Co., and
Nong-Woo. After the crisis, three of the top five, Hungnong, Choong Ang, and Seoul
Seed Co. have been acquired by foreign multinationals. A non top five firm, Chung-
Won, was also acquired by a foreign firm. Seminis, a top ranking multinational in the
seed industry, acquired Hungnong and Choong Ang in sequence. Seminis, also
established a subsidiary, Seminis Asia Inc., to act as its Asian headquarters.

Under normal circumstances, acquisition of Seminis would have been subject to M&A
regulations under the Monopoly Regulation and Fair Trade Act (MRFTA). However,
until February 1999 amendment when all industries became subject to the Act, the seed
industry was exempt from the law, and was not screened by the KFTC. Even though
the acquisition of remaining shares of Hungnong took place after the amendment, the
KFTC was not notified.

Since the review was not completed by the KFTC, no detailed information exist about
the case. Here, a competitive effect of a merger is attempted, using the usual criteria
under the Korean law. Competition effect is mainly assessed in terms of increased
market share (concentration) and prices. Table 9A shows the changing market shares
of the major seed producers. Hungnong remains as the first ranking firm after the
acquisition, although its market share hardly changed before and after the acquisition.
But its first ranking position, and 30 percent market share does give it a dominant
position in the market, though not reaching the bench mark of 50 percent used to
determine market dominant firms under the MRFTA. When the second ranking
Choong Ang’s market share is considered together, the total market share comes to

5 See Appendix for details on the merger regulations under the MRFTA.
6 Although the KFTC had initially opened an investigation, it had subsequently abandoned the case.
around 45 percent, almost reaching the 50 percent benchmark. Although Hungnong and Choong Ang remain as separate entities, Seminis controls both, and their product portfolios have been restructured so that they can no longer be considered as competitors.

Meanwhile, total market share of top three firms comes to 49-57 percent, and this again is below the threshold adopted by the competition law, and the difference between market shares among the top three are not regarded as sufficiently large to inhibit competition in the market using current competition law guidelines. In the long term however, the possibility of increasing market share or dominance of Seminis can be expected to be very high, when its own imports, operations of Seminis Asia and shares of the two subsidiaries are considered in conjunction.

To examine whether merging firms enjoy super normal profits through price increases post-merger, detailed information on product prices and production cost of relevant firms are required. However, these data are not readily available. The best readily available proxy for seed prices would be prices of vegetables, since prices of vegetables and vegetable seeds are known to move together. Table 9B shows the price changes in radish, cabbage, and chilli, which are the three main products of the acquired firms. Prices for cabbages show a declining trend until 1999, but have increased enormously since 2000. Radish prices show an incremental, though consistently increasing trend since 1998. In the case of chilli, prices have increased substantially in 1999, but has stabilised in 2000, though the decline is small compared to past increase in prices. It seems that then, prices have generally increased post the merger. It is difficult to tell however, whether the increases were specifically due to mergers. Vegetable prices are largely determined by other factors such as weather and seasonal effects, so that such price information does not give sufficient insight for our purposes.

One incident, nevertheless lead us to suspect the increased market power of the merged entity. In July of 1999, the KFTC investigated a resale price maintenance case of Hungnong. Hungnong had unilaterally declared to all its retail outlets that if they sell under a consumer price limit it has set for “Hungnong Chilli,” it would stop its supplies. At the same time, it had reported to its mother company that this has enabled it to maintain the price of a new variety of seeds at a certain level, and that it had withdrawn
its supplies from outlets where its policy had been violated.\textsuperscript{7} It can be concluded from the above discussion that although the combined market share of Seminis and its subsidiaries does not technically reach the 50 percent market share benchmark, Seminis has established effective dominance in the vegetable seed market, and has price setting abilities at least in certain sub-product lines.

Considerations other than market shares (in absolute amount and in comparison to close competitors), and prices in examining competitive effects of mergers are possibility of new entry and competition from abroad. The seed industry in Korea is currently undergoing a consolidation process, and new entry is not expected. However, exports and imports are showing increasing trends and therefore competition from imports is expected to a certain extent. Nevertheless, most of these imports would be coming from multinationals such as Seminis, which has already established production facilities in Korea and therefore this cannot be seen to have real pro-competitive effect.

**Impact of FDI on Competition**

An econometric study finds strong correlation between FDI and concentration for the period 1991-1997. The direct correlation between FDI and price cost margin is dubious, but given that there is strong correlation between concentration and price cost margin, suspect indirect upward influence on price cost margin also. Suggests that multinationals are a potential source of concentration and market power, and competition authorities should make sure that competition law applies to multinationals (which are often elusive of national laws) effectively. Possibly 1997 has a strong influence on this result, when most FDI took the form of M&A, and there was a heavy wave of business failures (see again, Table 3 & 4).

**3) Other cases: Telecommunication**

**SK Telecom’s Acquisition of Shinsegiland Telecom..**

i) The Merger

SK Telecom acquired 51.19% of Shinsegiland Telecom in December 1999, paying cash of 1,874 billion won and 6.5% of newly floated SK Telecom stocks. The merger was

\textsuperscript{7} KFTC decision document, September 1999. Case No. 9907 kyungchok 1010
notified to the KFTC in September 1999. The merger had the support of the MIC, but the KFTC had difficulty in achieving internal consensus to approve the merger due to the highly anti-competitive aspect of the merger. KFTC delayed its decision, requesting further information from the merging parties and the merger received unprecedented media publicity. Ultimately, the KFTC approved the merger on condition, in April 2000.

ii) The KFTC Review

Competitive Analysis

KFTC’s published document shows that the merger was anti-competitive in most aspects of the review criteria explained in section 2. The merging parties would be the largest operator, and their combined market share, based on number of subscribers, sales, and call-time, would all be more than 50% (56.9%, subscriber basis). The merger was between the first and third largest operators, increasing the HHI index from 2,669 to 3,882, testifying to the high level of concentration in this market. KFTC noted that new entry would be impossible in the near future because of the lack of spectrum and the large sunk cost required. Further, because of the 49% ceiling, foreign competition is limited for the time being. KFTC also points out that although there would be little possibility of price collusion since SK Telecom is regulated by MIC, there is possibility of collusion regarding handset subsidies and other aspects which need no prior approval of MIC. Additionally, KFTC argues that Shinsegi should now also come under price regulation, since SKT could use it to increase prices. Moreover, KFTC noted that while price regulation would limit monopolistic price increases, the merging parties would be in a position to delay price cuts and quality improving investments or engage in predatory pricing tactics.

KFTC concluded that anti-competitive effect would also impact on the cellular handset market. Since both the merging parties use cellular technology, the merged entity would have monopsonistic power, negatively affecting the competitive environment in the cellular handset market. In particular, SKT’s procurement from its own handset manufacturing subsidiary, SK Teletech has shown an increasing trend. The merged entity would be able to dictate terms of price and attach restrictive conditions to the

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8 This section relies on KFTC (2000). *Decision No. 2000-76, Case No. 2000guikyul0129.*
<http://www.ftc.go.kr>
transaction that will disadvantage or raise costs of rival operators. For example, SKT could require suppliers to always incorporate new technology on cellular handsets before PCS handsets, thereby encouraging subscribers to join the cellular network.

*Competitive advantage of SKT*

The competitive advantages of SKT are note as follows. It has first mover advantages, having completed depreciation on most of its fixed investment. Further, KFTC notes that cellular technology requires lower (2-3 times less according to ITU’s estimates) investment cost to build transmission bases. SKT is thus the lowest cost operator, recording high level of profit in the period leading up to the merger. Consequently, SKT can also afford large handset subsidies (which has been more effective in winning new subscribers than rate reductions), and advertisement expenditure. Further, SKT has higher quality customers - its customer default rate is the lowest while call time per customer is the longest among operators. SKT’s ability to improve service quality would also be enhanced with the merger which will increase its spectrum usage to 22.5MHz, as oppose to its rival PCS operators which only own 10MHz each. In particular, Shinsegı has a monopoly in servicing the military.

*Network Externality*

In showing pronounced anti-competitive effect of SKT’s enhanced dominance through the merger, KFTC gives specific consideration to network externality. It notes that because bigger networks attract more subscribers, the dominance of the merged entity will become enhanced and sustained. Given the large installed base of SKT, high switching cost (expensive handsets etc), and low demand elasticity in mobile telephony, the merger would give rise to tipping and permanent domination by SKT. KFTC relies upon a survey to support this effect of network externality. A 1999 survey of subscribers showed that 4% of subscribers of SKT, 12% of Shinsegı, 15.3% of KFT, and 21.7% of LGT, and 22.3% of Hansol M.com wished to discontinue services. On the other hand, of those who had discontinued services, 72% wished to re-subscribe with SKT, 5.9% with Shinsegı, 12/6% with KFT, and 4% with Hansol M.com.

*Efficiency Claim and Failing Firm Defense.*

KFTC dismisses the merging party’s efficiency claim and failing firm defense as
insignificant on various reasons. Both the KFTC and the merging parties conservatively estimated cost savings from merging transmission bases and other physical assets of the networks, since the two operators already have a nation-wide coverage. With respect to the argument that duplication is avoided in further investment requirements, KFTC pointed out that strategic alliance or co-operation agreement short of mergers would have been an alternative. As for third generation technology IMT 2000, KFTC held that MIC would determine the number of IMT 2000 licenses so as to avoid duplicate investment.  

KFTC acknowledged the following efficiency claims: 1) overhead cost reduction due to merging regional offices and marketing outlets; 2) possibility of lowered price of handsets due to increased bargaining power of merged entity in the highly concentrated handset market (combined market share of top three firms is 87.6% in 1999), leading to consumer benefits; savings in R&D cost of Shinsegi; and enhancement of international competitiveness increased bargaining power vis-a-vis large foreign operators. KFTC’s estimate of increased efficiency arising from 1)-3) was about 16.3% of that claimed by the merging parties. The fourth, KFTC deemed unquantifiable. Overall, KFTC concluded that the level of increase in efficiencies it could acknowledge was not sufficient to outweigh the anti-competitive effects of the merger.

As for failing firm defence, neither did the KFTC consider Shinsegi to be under competitive pressure to be forced out of the market, nor that its assets would be worthless unless it merged with SKT. Although Shinsegi was insolvent at the time of merger, its financial status was considered to be similar to other PCS operators, while having lower interest burdens than the PCS operators. Moreover, Shinsegi has almost complete nation-wide network, adding to its competitiveness. At the same time, sales of Shinsegi showed high rate of growth, making it likely that Shinsegi would be able to raise funds in the stock market, as it already have done twice in 1999.

**Remedial Measures**

The KFTC, after much hesitation, approved the merger on a conditional basis. KFTC ordered that the merged entity should incrementally lower and maintain its market share to be less than 50% by the end of June 2000. In addition, the volume of cellular

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9 At that time, new licensees for IMT 2000 were not yet determined, and KFTC noted that it was impossible to reasonably estimate investment cost savings of the merger on this front.
handsets it procures from its subsidiary should not be over 1.2 million sets over the next five years (2000 –2005).

iii) Critique

Clearly, the merger gave rise to a single dominant firm. To remedy abuse of dominance, in general, divestment of certain assets and imposition of interconnection provisions would have been more effective than a market share ceiling. EU and US authorities usually prefer structural remedies. In these jurisdictions, mergers in mobile telephony involved divestitures, although in the Vodafone case in EU, interconnection provisions were also required. The KFTC typically adopt behavioral remedy rather than structural remedy. Although the traditional KFTC remedy was either enjoining the merger or requiring de-merger when merger was already consummated, a 1999 amendment gave added discretion to KFTC to impose restrictions on methods or scope of business. After the crisis, the KFTC allowed several large-scale acquisitions. In doing so, the Commission made extensive use of its authority to impose relief measures rather than to block the whole merger. However, in only one case (P&G’s acquisition of Ssangyong Paper) did it order partial divestiture. In the rest, the Commission shows a tendency to regulate, imposing price or market share ceilings.

In the SKT/ST case, it may have been more appropriate to order divestiture of certain assets (eg, some transmission facilities, revocation of frequency rights, Shinsegi Telecom’s monopoly service to the military) to competitors or impose a hold separate rule until a more level playing ground is fostered. A 50% market share ceiling may have adverse effects on prices with concomitant loss of consumer welfare and may make it difficult for SKT to comply when forced to lower prices by regulation.

Likewise, it could have ordered divestiture of the handset-manufacturing subsidiary if concerned about SKT’s ability to leverage between the two markets, instead of imposing a volume ceiling on procurement. Overall, the following criticism can be made of KFTC’s decision. First, the basis on which it decided to allow the merger seems to be weak, the main reason given being enhancement of international competitiveness, the impact of which was not measurable and therefore ambiguous, and probably not sufficiently large to overcome the anti-competitive effects. Second, the relief measures ordered could have been made more effective by fashioning more structural remedies.
On the other hand, it should be acknowledged, that divestiture orders are easier to make in the European or American cases because market overlap in these regions that would create anti-competitive effects were limited to certain areas, and did not involve region-wide or nation-wide dominance. Even so, imposition of fair interconnection provisions would have been preferred to other behavioural remedies.

IV. Lessons from the Korean experience

1. Main concern of Korean competition policy had been aggregate concentration, and therefore the regulation of chaebols. Lower degree of enforcement in abuse of dominance: should this continue when corporate governance related supervisory mechanisms (eg, outside directors, strengthened auditing requirements and minority shareholder rights, increased transparency etc) have been put in place? Should competition policy enforcement focus more on market concentration rather than aggregate concentration from now on?

2. Typical anti-competitive activities that can lead to emergence of dominance, and consequently the possibility of its abuse are cartels and mergers etc. This paper focused on mergers. Some critique on merger analysis:

- Merger analysis has seen great advancement, especially since the 1999 amendment. Efficiency analysis and failing firm doctrine, based on economic criteria have been incorporated. Network externality was considered, and partial divestiture order has been issued in certain cases. Effective application of merger control against multinationals has been undertaken in numerous occasions. Yet room for some critique remain.

- Preference of behavioural remedy over structural ones. This may have the disadvantage of not curing the disease at its source, but only addressing the symptoms, ad hoc, and putting unnecessary burden of continued regulation and monitoring of implementation of corrective measures issued. Arguably however, this may be the preferred alternative when the market is very unstable, eg in dynamic IT industry, where dominant position may be very transient.
- Sliding scale does not seem to have been applied, requiring greater efficiencies or synergies to be created to compensate for according to the degree of the consumer loss or increase price when applying efficiency or failing firm doctrine.

- Although employing entry analysis, relevant market analysis and considering other relevant factors and indices such as HHI, the KFTC still remains very much dependent upon the 50% benchmark rule. Various cases mentioned above shows that dominance in the Korean markets could be established at much lower levels than that.