



eSAPIENCE CENTER FOR COMPETITION POLICY

**CASE NOTE:**

**Competition Policy in Europe: Harming Incentives to Innovate**

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**Competition Policy in Europe: Harming Incentives to Innovate**

by

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The European Court of First Instance, through its decision in *Microsoft v. Commission*, dealt a one-two punch to incentives to innovate. First, by penalizing Microsoft for bundling its Media Player with Windows, the court will make companies reluctant to add innovative features to their products. Second, by sanctioning Microsoft for not disclosing fundamental innovations to its server software to its rivals, the court will make companies think twice before investing in costly research and development (R&D).

The deterrence of innovation does not stop there. The Court's decision also deters innovation by competitors of leading firms. Why invest in costly R&D, when you can get it for free from the leading company in your industry? Simply send the leading company a request for the use of any and all of its innovations, and threaten to complain to the antitrust authorities if there is not full compliance. Since a leading company's failure to supply the innovation is ruled to be an "abuse," companies with smaller market shares will know where to obtain free innovations.

With deterrence of innovation by both large and small companies, firms in these industries will tend to seek other avenues of competition, from high-priced branding strategies to bargain-basement strategies. While these strategies are part of competition, consumers inevitably lose when incentives to innovate are diminished.

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The Court's decision, and that of the Commission, have little connection to events in the market place. There was no showing that consumers were harmed by Microsoft's offering Media Player or by its server software. Rather, Microsoft's products enjoyed consumer support within the EU. The proliferation of competing media players, from Real Player to Apple's iTunes service, clearly demonstrates that Microsoft's Media Player is only one option among many available to consumers. Server software and hardware already work together seamlessly, with practically all users of servers operating in a mixed environment with plenty of interoperability.

The Commission argued that competition policy trumps protections for intellectual property (IP). By eroding the foundations of IP, incentives to innovation in any industry will suffer, not just in computer software. The interoperability side of the case establishes a major precedent that will impact IP protections throughout the EU in many industries.

The decisions of the Court and of the European Commission reflect an underlying fear of global competition within the European Union. Rather than relying on the innovative abilities of companies within the EU, competition policymakers chose instead to penalize a company for its market success. Instead of trusting European companies to develop new technology, EU policy makers chose a protectionist industrial policy. The question is whether the EU wishes to participate in the global marketplace or whether it prefers to erect a fortress of regulations that deter foreign competitors.