e.CA economics
Experts in Competition Analysis

E.CA Economics

Brand reputation, cooperation and intra-platform competition

Berlin, 1 October 2018

E.CA Expert Forum – Parallel Session 1

Rainer Nitsche
www.e-ca.com

Agenda

Agenda

Context

Digital platforms (DPs) are becoming important distribution channels

Still brands restrict distribution to avoid DPs – is this anti- or pro-competitive?

DPs make use of the data of all platform users and they try to integrate market place and retail activities – is this anti- or pro-competitive?

Competition policy seems to move in two directions here:

- Give brands more control over their distribution if justified by the characteristics of the product (e.g. image)
- Constrain brands in their use of information (e.g. "Chinese walls")

This presentation is to zoom into some economic effects that (should) influence a competitive assessment

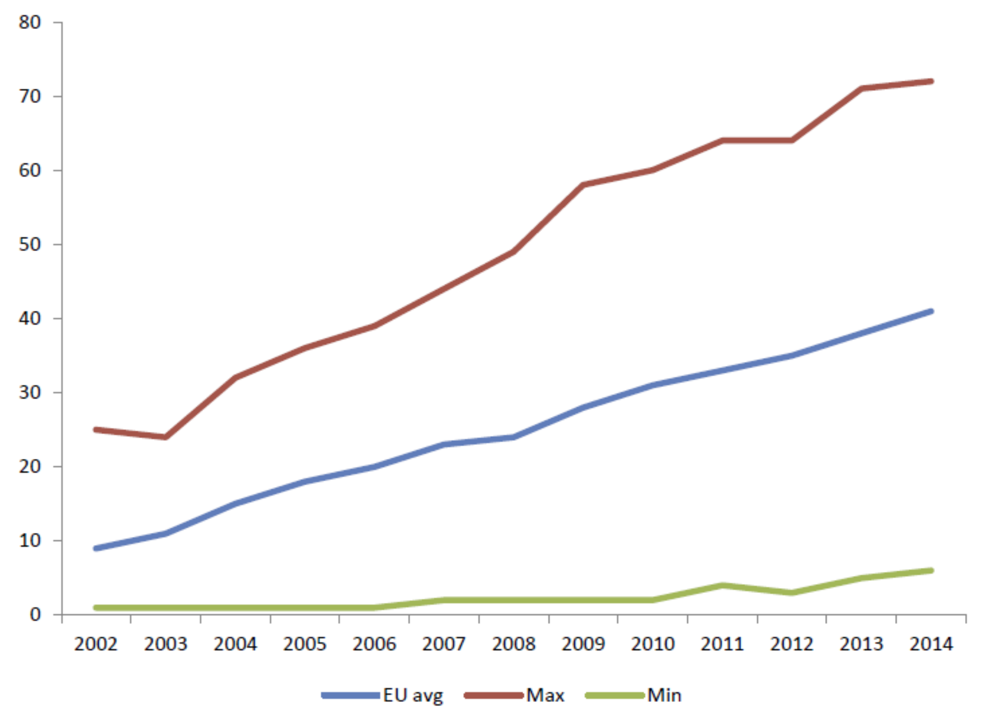
Agenda

Agenda

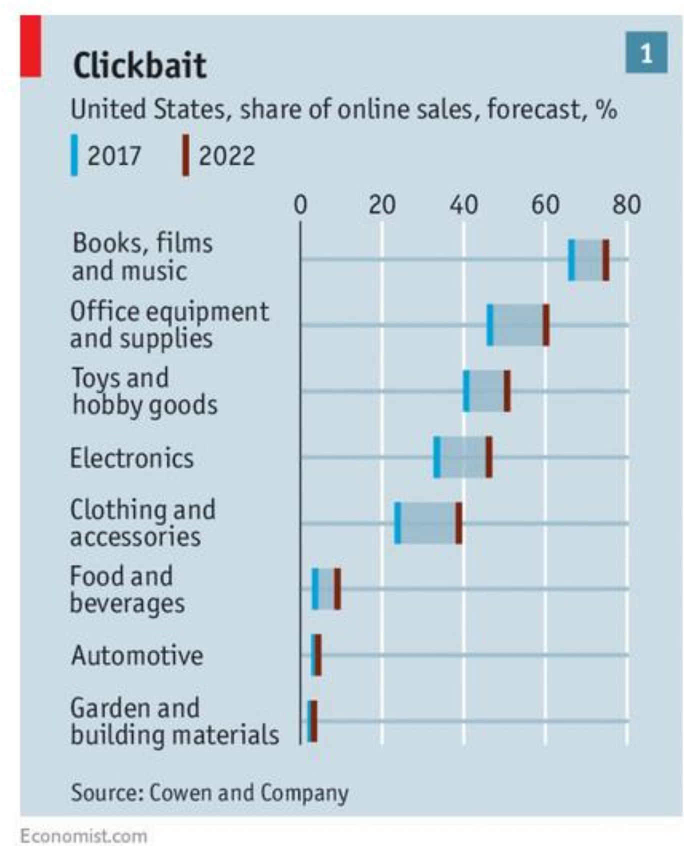
eCA economics

Online distribution and digital platforms are important sales channels

Proportion of population buying online in the EU



Share of online sales in the US



Source: Eurostat. Quoted from Nestor Duch-Brown and Bertin Martens: "The European Digital Single Market: its Role in Economic Activity in the EU", Joint Research Centre of the European Commission, Institute for Prospective Technological Studies, Digital Economy Working Paper 2015/17, JRC 98723. Available at: https://ec.europa.eu/jrc/sites/default/files/JRC98723.pdf.
Note: Refers to individuals aged 16-74 that conducted an online purchase in the last 3 months.

What is special about digital platforms?

The combination of

- Creation of platform value - by bringing two or more user groups together and organizing interaction or transactions (matching, sorting, comparing…)
- Indirect network effects – users on one side benefit from increased participation on the other side
- Non-neutral pricing – the price structure and not just the total fee influences the number of transactions on the platform
- Extensive use of (personal) data – to improve services and make ads more effective

No single point is exclusive

- Non-digital platforms: Think of shopping malls or credit cards or operating systems…
- Other online services: Think of your online bank or your mapping software…

But the combination has important implications for the competitive dynamics

Indirect vs direct network effects

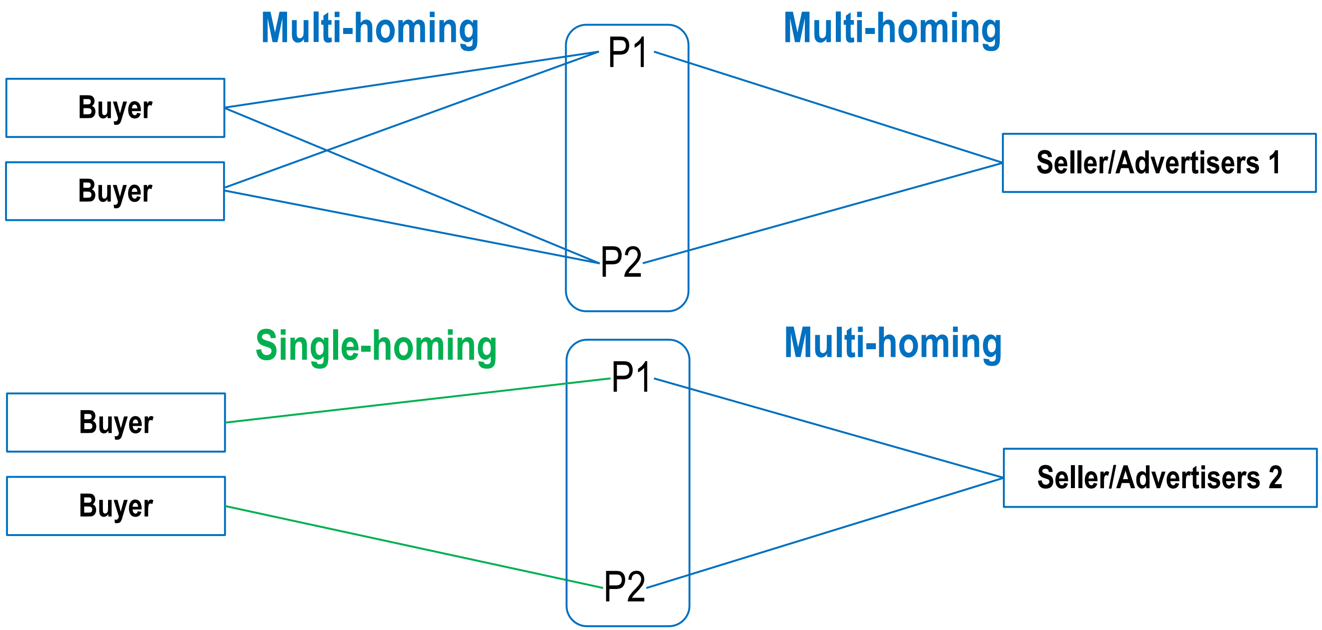
Direct network effects: Utility depends on # users/usage on the same market side

- Positive: More buyers allows better rating
- Negative: More buyers may dilute quality signals for sellers

Indirect network effects: Utility depends on # users/usage on the other market side

- Positive: More buyers make selling more attractive (and vice versa)
- Negative: More ads may distract from content

Multi-homing vs single-homing – who pays more?



Single-homing: Use of one platform for a given purpose

- Implies that platform is a „competitive bottleneck“ for the other market side

Multi-homing: Use of two or more platforms for a given purpose

- Provides options for the other side to reach the multi-homers

Seller/Advertisers 2 pay more

Implications for competition economics

- Huge efficiencies, which are the source of concentration: **difficult to disentangle efficiencies from abuse**
- Very different business models: **difficult to come up with one size fits all rules**
- Constant innovation: **difficult to regulate a moving target**
- Asymmetric information (platform vs user): **choice may not reflect preferences with perfect information**
- Access to users and data: **possibility to leverage power**
- Emphasis on price competition: **eroding margins of brands that rely on their (luxury) image**

Efficiency bias (of this presentation)

There are well established anti-competitive rationales for vertical restraints and horizontal information sharing and agreements

The manufacturer/supplier may want to limit competition with rival manufacturers/suppliers

- RPM or IE may increase transparency across manufacturers and thereby **facilitate collusion**
- Exclusive dealing may **foreclose rivals** by denying access to sufficient sales channels

Which is why this is carefully monitored by competition authorities

In what follows, I will put emphasis on potential pro-competitive effects – this does not mean that the above concerns are not potentially valid

Agenda

Incentives to use a DP

Put yourself into the shoes of an upmarket fashion brand…

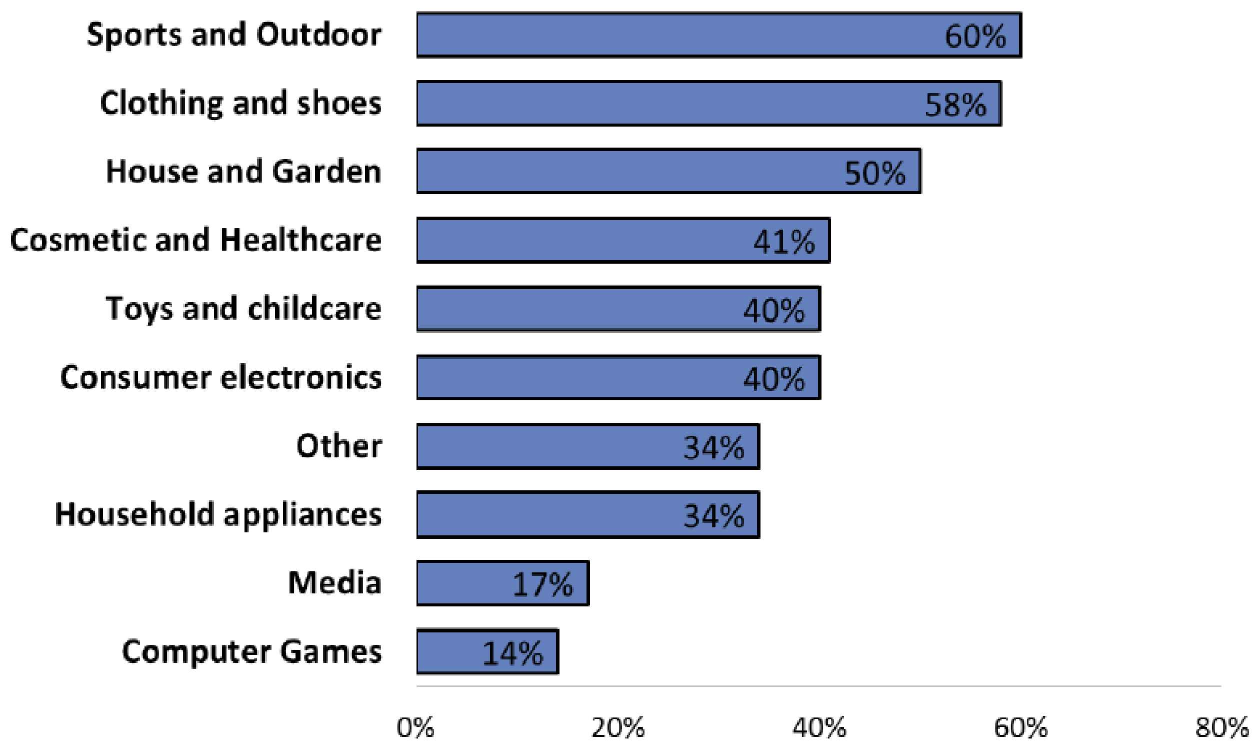
…adding a digital platform as a sales channel will broaden your access to customers

- Reduce search and transaction costs
- Broader access to customers than on your own
- Benefit of platform branding
- Potential to receive payments (for exclusivity) if you join the platform with your strong brand

If brands hesitate to use DPs, they must have a reason…

Level of brands' concerns

Figure B. 61: Proportion of manufacturers in each product category that consider (certain) marketplaces as potentially having an adverse impact[274]



Source: European Commission 2017: Commission Staff Working Document Accompanying the document "Report from the Commission to the Council and the European Parliament. Final report on the E-commerce Sector Inquiry", p. 141

Risks of selling via a digital platform

?

Source: Hagiu and Yoffie 2009

Why are brands hesitating?

1. **Loss of prestigious image?**
   a. Lack of differentiation through showroom
   b. Mix with products with inferior images
   c. Relevance of platform brand

2. **Loss of information and business stealing?**
   a. Backward integration of the platform into your business
   b. Weaken your relationship with the customers
   c. DP takes over part of what makes your brand valuable (trust)

3. **Lower service, pressure on prices?**
   a. Focus on price erodes option to compete on service
   b. Service quality often not visible ex ante

Other reasons

- Plagiarism
- Lack of competence to manage online services
- Etc.

Source: Hagiu and Yoffie 2009

Brands are nervous

Amazon is taking away the power of brand names, throwing another industry into turmoil

Published: July 11, 2017 8:16 a.m. ET

58 Aa

Consumer packaged-goods companies are cutting back on marketing, signaling complacency, analyst says

Amazon and Wal-Mart have been undercutting the prices of big brands.

Big brands may have given into the power of Amazon.com Inc.

Source: http://www.marketwatch.com/story/amazon-is-taking-away-the-power-of-brand-names-throwing-another-industry-into-turmoil-2017-07-10

e.CA economics

Strategic concern: Amazon competes with its own products

Batteries

- 94% of these online battery sales – a $113 million market – are taking place on Amazon.com
- AmazonBasics has one-third of online battery sales
- 93 percent year-over-year growth
- Price competitive product in a largely commoditized market with little brand loyalty

Speakers

- Amazon developed truly innovative products that are redefining the market

Source: https://techcrunch.com/2016/11/03/amazons-private-label-brands-are-killing-it-says-new-report/

Strategic concerns: DPs substitute a brand’s reputation

Online market place for first-hand and second-hand goods of all categories

Started 2001
In 2010 11 Mio registered users, 120 Mio products for sale (ranked higher than Amazon, eBay and Fnac)
Books, CDs, Games, Videos accounted for 80% of the transactions
Pure platform – no reseller
Individual and professional sellers

Carefully designed feedback machanism

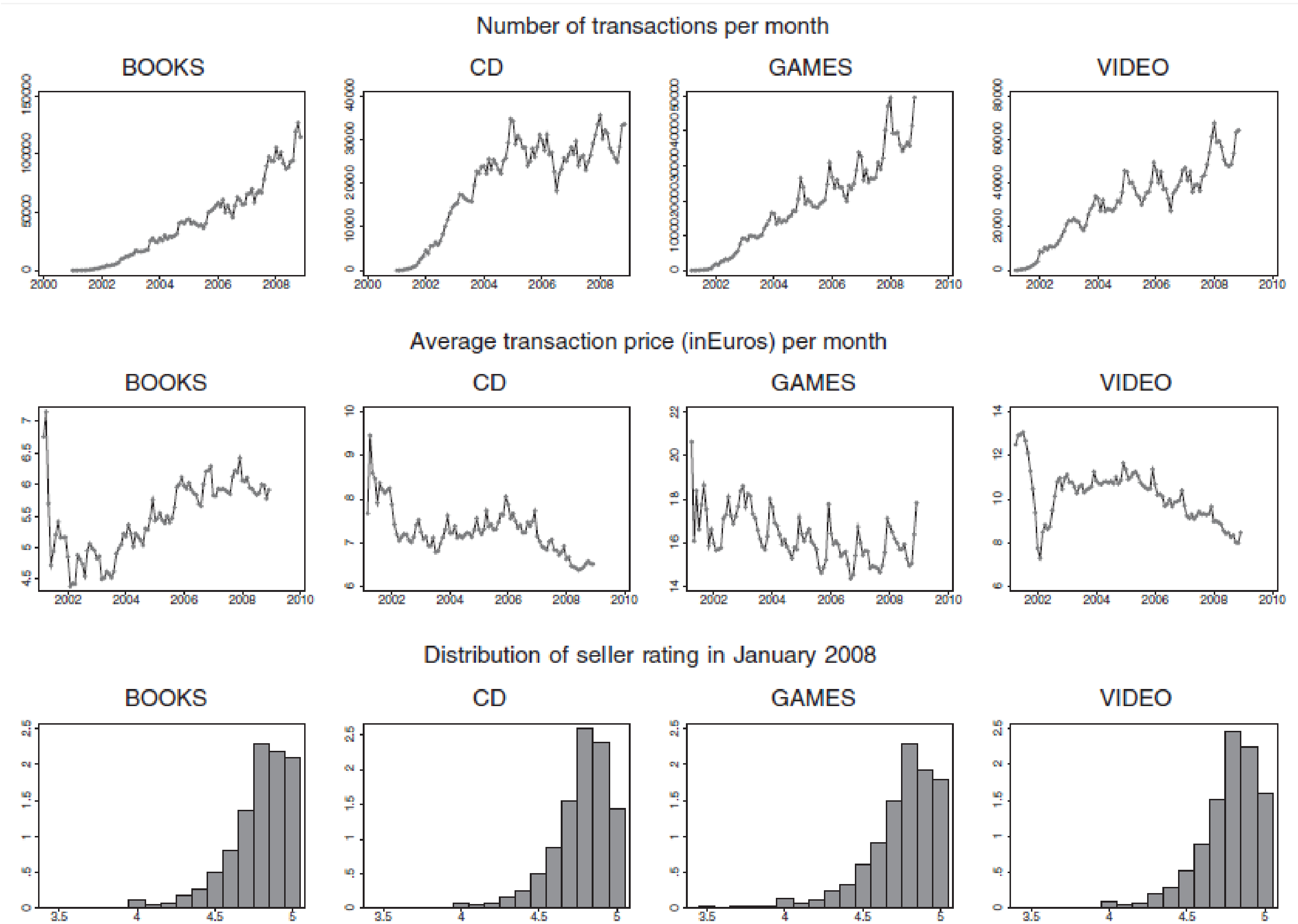
Only buyers provide feedback (no gaming with seller feedback)
Strong incentives: 90% of transactions with feedback
Buyers observe this feedback and the number of transactions by seller (reputation mechanism)
Payment process secured by platform (no buyer moral hazard)
Change of identify of seller difficult: IP-Adress, bank details (increases cost of changing “identity”)
Listings are listed by increasing order of price (which is a given price, no auction)
Platform uses recommended retail price and other information to recommend a selling price to the seller
Ratings per transaction between 1 and 5 (15-20% of feedback ratings below five)

http://www.priceminister.com/

Source: Jolivet, Jullien and Postel-Vinay 2016.

eCA economics

PriceMinister and Reputation: 0.1 rating increase increases price by 13% (games) to 20% (books, CDs and videos)



Source: Jolivet, Jullien and Postel-Vinay 2016, p. 63 and 66.

e.CA economics

The retailer/brand incentive problem

Compared to what brands want, a retailer is likely to have insufficient incentives for demand enhancing activities

- The retailer will have an eye on its margin only, not accounting for the manufacturer/supplier margin
- The retailer competes with rival retailers for the same product (price sensitive marginal customer) while the brand competes against other brands (less price sensitive marginal customers)

This has consequences…

- Too low retailer advertising
- Insufficient effort to present the product well (and find a perfect match)
- No carrying of long-tail products which require high margins (due to fixed retailing costs/opportunity costs of “shelf space”)
- Too small inventories (as the stock-out loss is higher than what the retailer takes into account)
- Too low variety in the portfolio as the retailer also carries rival products and therefore cares less to bring the full portfolio

…which are particularly pronounced if retailers compete on the same digital platform

e.CA economics

Specific issues with online distribution

- More difficult to control the “image” projected by internet outlets – design requirements may conflict with the sales platform
- Large economies of scale of selling many different goods on the same interface – e.g. for many goods the best ordering may be based on the price – for branded or luxury goods that may dilute the brand image
- Very limited sales related advice
- Higher cost of “trying-out” (involves shipment back-and-forth)
- (does all not matter to products where objective characteristics matter)
- High incentive to try in the bricks-and-mortar store and order online
- Despite all this: Individuals who already found their (matching) product may have an interest to buy online

Source: Caffara and Kühn 2008, http://ec.europa.eu/competition/consultations/2008_online_commerce/chanel_report.pdf; https://www.google.de/search?q=showrooming&client=firefox-b&tbm=isch&imgil=9uvG6FkN97qftM%253A%253BCgmV-IMZ29LGOM%253Bhttps%25253A%25252F%25252Fwww.bfscapital.com%25252Fblog%25252Fimpact-of-showrooming-on-retail-businesses%25252F&source=iu&pf=m&fir=9uvG6FkN97qftM%253A%252CCgmV-IMZ29LGOM%252C_&usg=__VKjN0Wcm8AWJtnrfrwLv640VFDU%3D&biw=1058&bih=495&ved=0ahUKEwj2tMGC9-rVAhWNY1AKHYqUCGUQyjcleg&ei=RS-cWbb-Jo3HwQKKqaKoBg#imgrc=9uvG6FkN97qftM:

The response: Selective distribution restraining online sales in practice

- **General limitations**: General "approval" of website or exclusion of certain types like
  - market places
  - price comparison websites
  - Non specialised websites
  - Limitation on keyword-search
- **Product display requirements** like
  - Amongst products with similar reputation
  - Agreed logo/conformity with brands identity rules
  - Dedicated brand area
  - No pop-up window
  - Show representative line of products
- **Service requirements**
  - Speed and reliability of website
  - Call centre
  - Option to open an account
  - Secure payment system
  - Free trial option
- **Transparency requirements**
  - Display available stock
  - Display prices including shipping costs

Source: European Commission 2017: Commission Staff Working Document Accompanying the document "Report from the Commission to the Council and the European Parliament. Final report on the E-commerce Sector Inquiry", p. 79

Legal environment in the European Union before Coty

Limitations on distribution systems must be based on principles (Metro)

- Resellers must be chosen based on objective criteria (applied in non-discriminatory fashion)
- These must be necessary to preserve its quality and proper use

Some court decisions were critical regarding outright prohibitions

- No prohibition of all internet sales (Pierre Fabre, cosmetics)
- No prohibition on the use of brand names (Asics, sports shoes)
- No prohibition on supporting price comparison websites (Asics, sports shoes)

Loss of prestigious image?

Coty has an iconic portfolio of more than 77 brands across fragrances, color cosmetics, hair care, body care and skin care.

Coty (supplier) sought to prohibit **Parfümerie Akzente** (distributor) to distribute products on **Amazon's marketplace**

Source: https://www.coty.com/brands

eCA economics

Coty and third party platforms

CVRIA

Press and Information

Court of Justice of the European Union
PRESS RELEASE No 132/17
Luxembourg, 6 December 2017

Judgment in Case C-230/16
Coty Germany GmbH v Parfümerie Akzente GmbH

A supplier of luxury goods can prohibit its authorised distributors from selling those goods on a third-party internet platform such as Amazon

Such a prohibition is appropriate and does not, in principle, go beyond what is necessary to preserve the luxury image of the goods

Selling on Amazon or Ebay may harm the luxury image

Control over the distribution of the goods is seen as important:

"The internet sale of luxury goods via platforms which do not belong to the selective distribution system for those goods, in the context of which the supplier is unable to check the conditions in which those goods are sold, involves a risk of deterioration of the online presentation of those goods which is liable to harm their luxury image and thus their very character." (Decision, para 49).

Avoiding platforms where goods of all kinds are sold, contributes, according to the court, to the luxury image.

- It also finds that the prohibition does not appear to go beyond what is necessary to achieve the aim of preserving the luxury image: distributors own online shops are an important online distribution channel and they can be used and the Court considers that an authorisation given to authorised distributors to use such platforms subject to their compliance with pre-defined quality conditions cannot be regarded as being as effective as the prohibition (Decision paras 53-56).
- Thus, the court concludes that the prohibition appears to be lawful in relation to Article 101(1) TFEU.

e.CA economics

Potential implications of the Coty judgment from an economic perspective

Judgment clarifies that competition is <u>not</u> limited to price…

- Demand also depends on non-price parameters: use of a restraint may induce retailers to invest more in quality
- This is valued by consumers and may stimulate demand, which may offset negative price effects

… and agreements that enhance non-price competition may well be approved under Article 101(1) as pro-competitive

It is a blow to purely formalistic legal approaches that dismiss limitations of the commercial freedom of one party (here: distributors) as restricting competition by object*

- Prestigious brand image as value for consumers that is worth protecting
- Competition authorities should be prepared to accept restrictions to the online distribution of luxury goods
- Even if such restrictions limit intra-brand competition between distributors and lead to higher price

Future relevance of the judgment will depend critically on two dimensions

- What competition authorities and courts will see as a (prestigious) brand that is worth preserving
- To what extent the competition community will observe the general principles behind the judgment

* At least if it is read together with the preceding opinion of Advocate-General Wahl of 26 July 2017.

For the discussion: is Coty right?

Four fears:

1. Loss of prestigious image?
2. Loss of information and business stealing?
3. Lower service?
4. Pressure on wholesale prices?

Other reasons (not covered)

- Plagiarism
- Lack of competence to manage online services
- Etc.

e.CA economics

Agenda

What does the above imply for digital platform strategies?

Cater for the brands‘ needs

- Select users to ensure an appropriate „environment“
- Establish strict rules to avoid fraud and misrepresentation
- Soften intra-platform price competition but are strict on quality
- Make quality a sorting criterion

Work with brands where they are better suited

- Offer the long-tail
- Offer inventory in out-of-stock situations
- Use their specialised knowledge about their products and demand
- Be clear on your long-run strategy

Vertically integrated DPs

Many DPs have started as (online) retailers in one segment…

- Amazon (books)
- Zalando (shoes)
- Otto (shoes)

…to then broaden the portfolio and add a market place

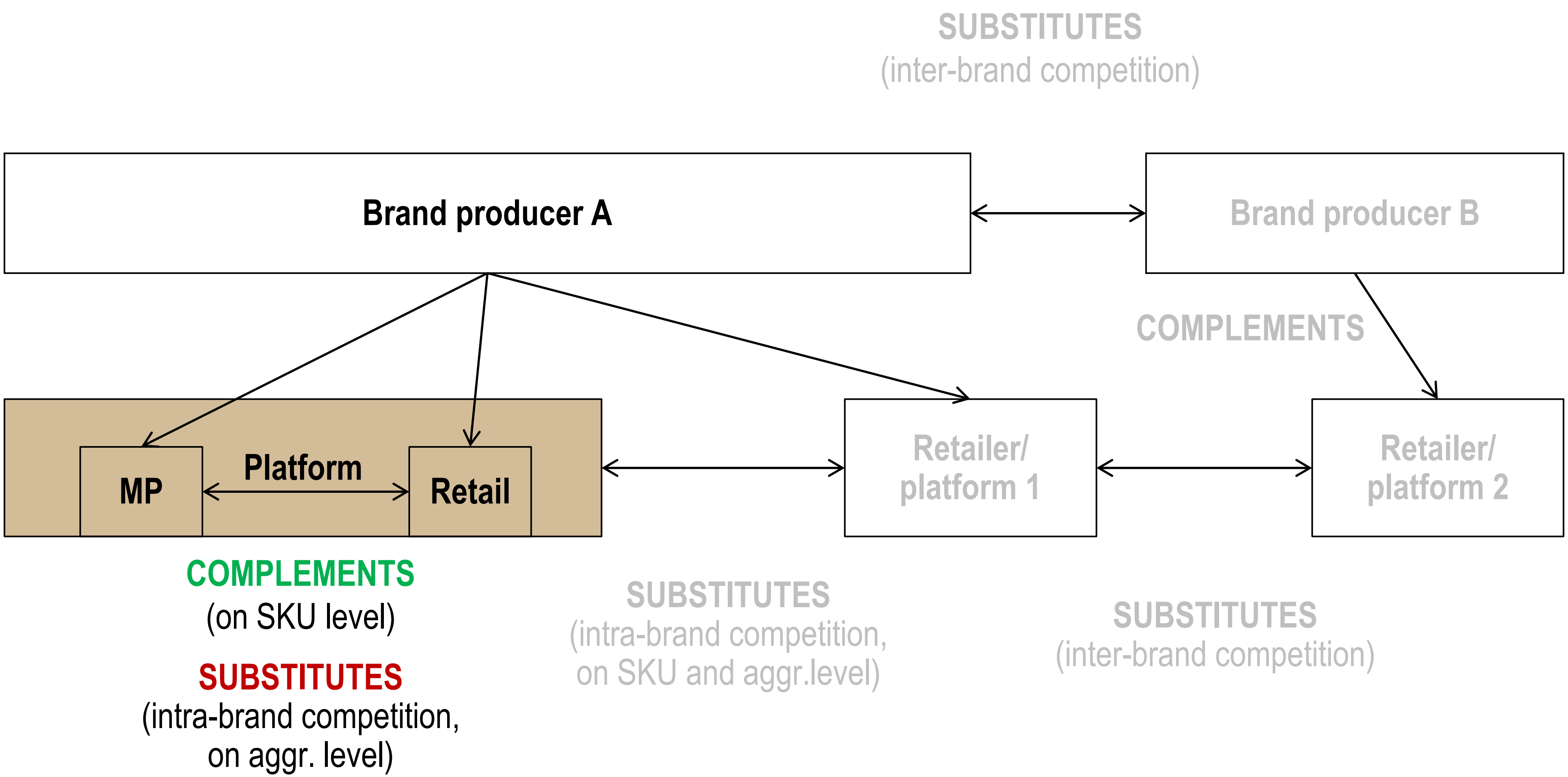
They all operate retail and market place activities alongside

But they still maintain very different business models

- Selection: relevance of other retailers vs brands vs retail activity
- Service performance (breadth of assortment, inventory levels, speed of delivery, store image etc)

eCA economics

A complicated world: Inter- vs. intra-brand competition
Within platform



e.CA economics

Information exchange: the "huge issue" view

European competition authorities have uttered concerns in relation to information sharing between market place and retail activities of platforms – but to date: no detailed theory of harm and not based on analysis

- **FCO**: "*The combination of being a retailer and an infrastructure [provider] at the same time can lead to* ***conflicting interests***"(1)
  - Amazon's "***dual role as a retailer***"*(2)* even with Chinese walls may allow them to gather data from sellers on the market place (i.e. competitors) that it could then use to aid its own sales
  - Klöckner (launching a B2B steel product trading platform): *"[A]n* ***excess of market transparency*** *can make* ***agreements easier*** *or even unnecessary if conclusions can be drawn about the future pricing strategy of individual traders."(3)*
- **EU Commission**: *"[…] the* ***exchange of competitively sensitive data****, such as on prices and sold quantities, between marketplaces and third party sellers or manufacturers with own shops and retailers may lead to* ***competition concerns*** *where the* ***same players are in direct competition*** *for the sale of certain products or services."(4)*
- **German Monopolies Commission**: *"Furthermore, competition problems can arise in e-commerce in cases of* ***vertical integration****, where, for instance, the* ***operator of a platform is also a seller on that platform and thus competes*** *with other sellers on that platform. […] In addition, the platform operator may be able to* ***monitor*** *other dealers' transactions,* ***add high demand, high volume products to his own portfolio****, and potentially even* ***foreclose customer access*** *to other dealers. Furthermore, the platform operator may* ***accumulate additional data****, for example to make more targeted product recommendations and to thereby improve the quality of his own platform and hence his own position in competition with other platforms."(5)*

Source: (1) PaRR (2018), BKartA developing relative market power scenario for Google shopping-type situations (available online at: https://app.parr-global.com/intelligence/view/prime-2616269?src_alert_id=262274). (2) MLex (2017), Amazon's double online role is a 'huge issue,' German antitrust official says (available online at: http://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=887901&siteid=190&rdir=1). (3) FCO (2018), Klöckner allowed to launch digital platform for steel products (available online at: http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2018/28_02_2018_Kloeckner.html). (4) European Commission (2017), Commission staff working document to the final report on the E-commerce Sector Inquiry, para. 651 (available online at: http://ec.europa.eu/competition/antitrust/sector_inquiry_swd_en.pdf). (5) Monopolies Commission (2013), Special Report No 68 on the challenges of digital markets, para. S47.

Proposals for early intervention: lowering the intervention threshold

§ 20 GWB: Prohibited Conduct of **Undertakings with Relative or Superior Market Power**

You shall not impede [your supplier; your customer; your competitor] **in "an unfair manner"** if you have relative market power (supplier/customer) or superior market power (competitor)

Current constraint: only if affected firms are not large – **proposal is to apply § 20 to all firms***

Relative market power: suppliers or customers depend on your services

- in such a way that "sufficient and reasonable possibilities of switching to other undertakings do not exist"
- in Hochzeitsboni Edeka/Plus, this is the **lack of ability to recoup losses with other customers** (BGH)
- Generally: if a high share of supply (22%) of a given supplier is with a customer, the supplier may be dependent
- DP considerations re para 3: superior access to data; special position due to conglomerate activities (p. 55)

What this shows regarding the intervention threshold: (almost) anything goes

- The requirement to show dependence is low
- The criterion is applied to all bilateral relationships

*Schweitzer/Haucap/Kerber/Welker: Modernisierung der Missbrauchsaufsicht für marktmächtige Unternehmen, 29 August 2018.

What if the market place is a complement to the retail activity?

Pro-competitive effects of adding a complementary market place

- Solving the retailer/brand incentive problem
- Broadening of the portfolio (adding choice)
- Increase in availability (adding inventories)
- Increased access for brands

Compared to a counterfactual without a market place, there are usually significant benefits

Competition law should be careful not to deter retailers to add a market place

e.CA economics

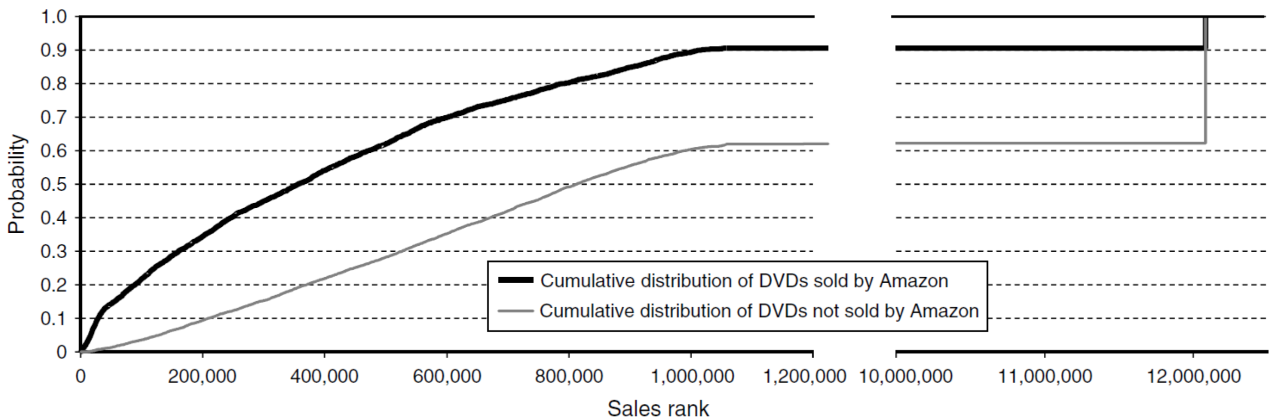
Market place as a complement

Zalando

“[The] most successful setups with brands [are] where we have wholesale as a strong base and the PP ***complementing the assortment both in additional selection and additional availability*** *once wholesale articles are sold out.”**

Amazon**

Figure 1 CDFs of Sales Rank for DVDs Sold by Amazon and Those Not Sold by Amazon



Complementing retail activities with market place activities will improve choice for consumers

Source: *Video by M. Dous, Head of Zalando PP (December 2011), emphasis added; **Hagiu and Wright 2015, p. 197, 198

e.CA economics

How to ensure quality?

Brand/retailer selection to avoid fraud and encourage quality

- The retail platform accepts partners to the market place only according to a set of criteria
- Includes operational and qualitative criteria but also product assortment

Downsorting if underperformance in delivery speed or other quality measures

- The retail platform uses a sorting system determining product placement on the platform
- Underperforming products/brands are downsorted

Uploading restrictions to manage the intensity of intra-platform price competition

- E.g. “One seller per SKU at each point in time”
- The platforms’ own retail is placed before a partner (in case both stock the article)

e.CA economics

Bertrand competition?

Suppose the platform succeeds in ensuring exactly the same service between retail and market place products

- No reputation effects
- No concerns re delivery times, return options etc.

Then competition on the platform for the same item will be only on price

- By assumption you cannot compete on quality
- We are back in the world discussed above: brands will not like this platform

If so, there is no way to maintain high quality and attract brands

It is important to allow different business models including those restricting intra-platform competition

Consider the inventory example

Having an item out of stock creates customer dissatisfaction (and a loss of a potential sale)

- Once you like the product, you want the item…
- …out of stock events are costly

Brands and DP-Retail will have complementary information about demand

- The brand knows sales through other channels
- The DP knows sales of other brands

Having inconsistent pricing can create customer dissatisfaction

- Why should size 36 be priced higher than price 33?
- Why do prices change (once there is a switch)

Not allowing information exchange or coordinated pricing can eliminate pro-competitive effects of market places

Starting points for an economic analysis

An assessment of (likely) effects needs a counterfactual scenario

- What is the relevant counterfactual
- What are the competition concerns compared to the counterfactual?
- What are the pro-competitive (price or non-price) effects compared to the counterfactual?

The assessment must take into account factors that are independent of whether a brand “depends”

- Intensity of competition with other platforms and distribution channels
- The plausibility of concerns given the level of inter-platform competition
- The plausibility of pro-competitive effects of any restriction of intra-platform competition

Agenda

Some relevant questions

The "huge issue" view appears often based on the "fairness principle" – is this the best view?

- Not linked to welfare
- Not linked to the competitive "process"

The relative market power principal may pick up the followers – is this the right target?

- Limits heterogeneity of business models
- May stop a catching up process

Where do efficiencies and the effects on consumers come in?

- What if market places complement retail activities to the benefit of consumers?
- What if market place activities are limited?

Are some concerns not better targeted in other areas of law as they are not due to market power (but asymmetric information)?

For the discussion…

Give brands more freedom to choose their distribution channel (Coty is good)

Let platforms keep their freedom to choose their business model absent a coherent ToH (no general Chinese wall)

Follow on to the panel discussion: should we rely on relative market power/dependence? (Or use existing instruments and think about more general approaches to abuse (data protection, consumer protection, contract law, unfair commercial practices law, regulation)?

- avoid hitting the followers (we all depend on some platforms…)
- avoid criteria that cannot be monitored by the subject of the norm
- avoid criteria that relate to advantage but not to the competitive process and consumer welfare

Thank you!

Dr. Rainer Nitsche

Director
nitsche@e-ca.com
+49 30 212 31-70 20

E.CA Economics

Berlin Office	**Brussels Office**
Schlossplatz 1 **10178 Berlin**	**Avenue Louise 222** **1050 Brussels**
Tel.: +49 30 212 31-7009 **Fax: +49 30 212 31-7099**	**Tel.: +32 2 808-4700** **Fax: +32 2 808-4744**

info@e-ca.com
www.e-ca.com