

Platform MFNs

A discussion of the magnitude of harm, benefits and the effectiveness of potential remedies

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Overview and disclosure

1. Potential benefits from platform MFNs
2. Quantifying the potential harm from platform MFNs
3. Balancing benefit and harm: Remedies

Disclosure:

- Personally worked on a number of MFN cases. Advising a complainant on the Commission Ebooks investigation. Advising a defendant on the Hotels case. Also worked on a number of MFN cases at the OFT.
- Other CRA experts have acted on a number of other MFN related cases, including US cases (of which I have no knowledge).

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1. Potential efficiencies from MFNs



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Potential benefits from platform MFNs (i)

Main concern is potential for platforms to face **free-riding** by sellers or other lower quality platforms.

- Platforms generally undertake **investments to attract buyers** onto the platform.
- However seller has an incentive to find buyers on the platform but then encourage them to transact off of the platform to **avoid the commission**.

Amazon marketplace example:

Hotels example:

- Hotels have a strong incentive to cut out the commission and sell directly.
- Face the same issue with 'low cost' platforms without sophisticated search facilities but with lower commissions

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Potential benefits from platform MFNs (ii)

Free-riding problem arises from two characteristics of most platforms:

1. The platform only charging the buyer or seller when a **transaction** is actually undertaken (not for searching/matching)
2. The ability for customer/seller to **disconnect the search/matching functionality** from transaction functionality.

Thus the platform provides the majority of the value *before* it is reimbursed for providing that value.

Is the solution for platforms to change the business model?

Are MFNs indispensable to prevent free-riding?

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Empirical evidence of free-riding in hotels

Free-riding is a material concern if price differences decrease likelihood of platform receiving booking even though customer searches do not decrease. Thus key hypothesis is:

- *Does MFN non-adherence significantly decrease likelihood a customer books through a platform's site, even though they continue to use the platform's search functionality?*

$$\text{Conversion rate}_{\text{Hotel}=j, \text{Day}=t} = \alpha_0 + \alpha_1 \text{Rate difference}_{jt} + u_{jt}$$

The data for Italian hotels covers the period **January 2013 to November 2014**, for over **13,000 hotels** thus creating a total of more than **2 million hotel-day rate comparisons**

Evidence indicated that an increase in the price differential between hotels resulted in a substantial decline in the conversion rate (holding number of searches constant).

- **Implies that Hotel booking platforms are vulnerable to free-riding**

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Indispensability of potential benefits?

Platforms are **two-sided markets** and therefore want to maximise potential for both sides to meet and make a trade

- **Charging one side** of the platform for access to the platform (i.e. customers) will have a **negative impact on the number of customers**, and therefore a negative impact on the number of transactions.
- However it will also have an impact on the **value of the platform** for sellers, as with less customers, there is a reduction in the likelihood of a match.

Should not be surprising that platforms don't charge either side for access to the platform, and only charge when a successful transaction is made.

- Forcing the platforms to **change their business model** and charge one or both sides to access the platform is likely to result in a **significant reduction in the value of the platform**.

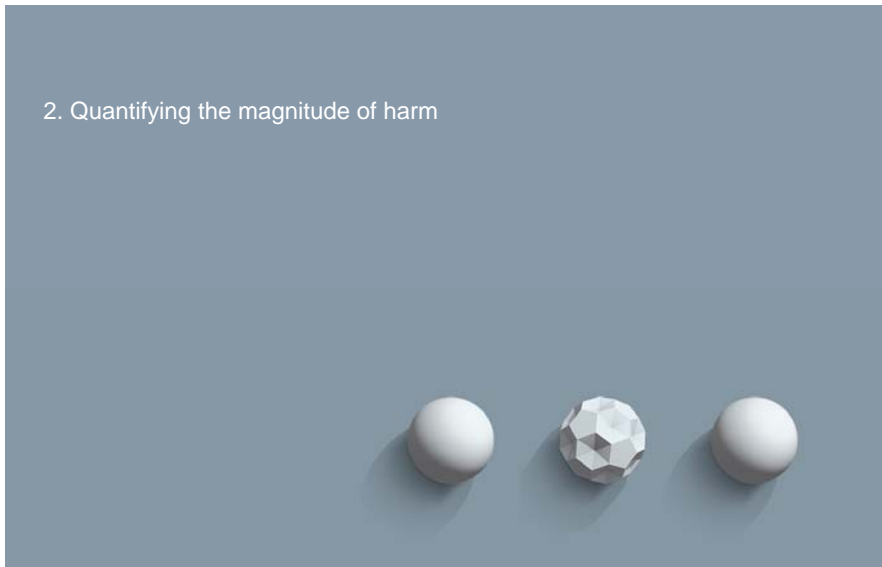
No presumption that free riding prevention (i.e. benefits) can be easily replicated without platform MFN.

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2. Quantifying the magnitude of harm



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Potential theories of harm

Concern that MFNs **soften price competition** between platforms

- MFNs reduce the pass-through rate on platform commissions to hotel price, thus decreasing platform incentives to reduce commissions.
- Also reduces the ability of platforms to differentiate themselves on advertised price and therefore reduces incentive to reduce commissions.

Concern that **MFNs make it harder for entry** by other platforms

- By reducing pass-through rate on platform commissions, MFNs make it harder for 'bare bones' platforms with low commissions to attract customers.
- However MFNs **only make it harder for 'bare bones' entry**, it will actually make it easier for entry by 'full-function' as it eliminates them having to face free-riding.

Magnitude of harm depends on ability to delist

Note that assuming that there is no ability to delist, the more **substitutable** the platforms, the more the MFN will harm competition.

However in reality **sellers can delist from platforms**, either choosing to sell on other platforms without MFNs or sell directly.

- This ability to delist **preserves some degree of competition**.
- If platform A was to offer a lower rate than platform B, then the seller may choose to delist platform B altogether.
- The **more substitutable** the platforms are for end customers, the less customers the seller will lose by delisting a platform, and hence the **greater incentive to delist**.

Thus **threat of delisting** provides a **strong constraint** preventing platform from charging excessive commissions regardless of there being an MFN.

Harm and the degree of platform substitution

Key implication is that **degree of substitution** has several effects

- Incentive for a platform to have an MFN increases with degree of substitution: implies **softening of competition** will have a stronger effect (i.e. move from close to perfect competition to monopoly).
- Incentive for a seller to **accept an MFN decreases** with degree of platform substitution: MFN will have a large impact on its commission which de-listing would free itself from.
- Ability to **impose an MFN** decreases with degree of substitution: more substitution between platforms implies easier to delist for customers.

Implication is that there may only be a **relatively narrow 'band'** of circumstances in which MFN has a **significant harm** if implemented, **and** it is implementable.

- Too much substitution and there is no ability to implement MFNs
- Too little substitution and there is an ability to implement but little harm.

When is delisting likely to be difficult?

Given the importance of delisting in minimising MFNs ability to increase commission's, when is delisting unlikely to be possible?

Ability to de-list is **inversely proportional** to market power of platform

- The more market power the platform has, the less outside option the seller has, and therefore the less ability to de-list.

Market power is thus a key indicator of MFN's ability to harm

- Where a platform has significant market power, the potential to harm is greater, and therefore intervention may be more warranted.
- Where a platform has **limited market power**, there is **limited ability to harm** and potentially a greater risk of free-riding – and therefore intervention is likely to be less warranted.

Suggests block exemption on vertical agreements may well be in the right place

Networks of MFNs?

Market power increases concern for MFNs – however should one be concerned about industries where there are **multiple MFNs** and platforms have **no market power**?

Unlikely to be a concern unless one has evidence of coordination?

- If all platforms have MFNs and none have market power, the **incentive** for one platform **to remove the MFN** will be significant
- Offering MFNs absent market power, in order to increase commission rates is unlikely to be a **competitive equilibrium**.
- Implies some sort of **tacit or explicit coordination is required** (ties into ebooks case).

If there is no evidence of tacit or explicit coordination, one may want to be careful about intervening where there is no market power.

- Note that potential free-riding issue will also be most significant when there are several platforms without market power.

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3. Balancing benefits and harm - Remedies



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Balancing benefits and harm

Balancing act:

- Platform MFNs provide an important ability to **mitigate free-riding** problem – potentially very important on online platforms with increased pricing transparency.
- However Platform MFNs can also **harm consumers by dampening competition** between platforms

Is there a **remedy** that manages to secure the benefits, whilst minimising any potential harm from the MFN?

- **Platform versus seller** MFNs?
- **Wide versus narrow** MFNs?
- MFNs for all parties or only those with **significant market power**?

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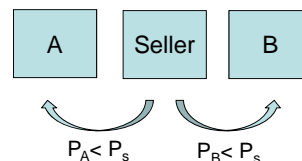
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Remedies: Platform versus Seller MFNs

Authorities have moved towards a platform versus seller MFN distinction:

- MFNs covering **rival platforms** seen to be more harmful.
- MFNs that cover **sellers** are considered less problematic.



Some economic justification in such a treatment:

- Like platform MFNs, **small commission reductions** will have a limited impact on retail prices.
- However unlike platform MFNs large commission reductions will tend towards the sellers deciding to **split pricing**, having a low retail price with the low commission platform and a higher retail price (and own seller price) with the high commission platform (thus satisfying seller MFNs)

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Remedies: Wide versus Narrow MFNs

Various authorities in Hotels cases have also appeared to distinguish between the coverage of the MFN with regard to alternative channels

- **Wide MFNs** that cover all hotel own channels (**including off-line**) are more problematic
- **Narrow MFNs** that only cover hotel's **own on-line channels** are less problematic

Not clear that there is a good rationale for this decision.

- **Contradiction of market definition** in Hotels case and wide/narrow distinction (if off-line channels do not compete with on-line channels, than why should an MFN that covers the off-line channel be problematic?).
- **Wide MFNs** may actually be better than narrow MFNs in that they **increase the incentive for Hotels (sellers) to delist** in response to objectionable commission increase and therefore may provide a stronger constraint on commissions.
- Narrow MFNs may also encourage Hotels to have **higher prices on the on-line** channel to direct customers **to protect its off-line** channel from cannibalisation. Thus potentially benefits offline channel to the detriment of online channel.

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The need for industry wide remedies?

Should authorities also role out MFN remedy to all other players in the market even if they do not have significant market power (i.e. **go below vertical block exemption** threshold?)

- Argued that platform MFNs on smaller player reduces incentive for large player to reduce its commission (even if large player has no MFN)
- Key issue in Hotels case – and also key for national legislation.

Economic rationale for forcing remedies to apply to players without significant market power seems **far from clear**.

- Small platforms have incentive/ability to discount below larger platform – as are no longer constrained and hence compete on price. Thus **incremental reduction in harm** from extending remedy may be small.
- Furthermore **free-riding** may be a particularly important issue for the smaller platforms who are most vulnerable.

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4. Conclusions



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Conclusions

No presumption harm will outweigh benefits

- Platform MFNs have a clear economic rationale in preventing sellers (and other platforms) from **free-riding** on other platforms' investments.
- They also have the ability to **restrict competition** between platforms.
- In **balancing** this benefit and harm there has been too little attention to the ability for **sellers to delist** from platforms.

Current remedies

- Distinction between platform wide and seller wide MFNs seems to be well founded – and may provide the balance desired for dominant companies.
- But limited justification for distinction between online and offline channels, or for remedies to apply to firms without significant market power.
- Particularly worrying trend towards **national legislation** over ruling competition authorities balancing decisions on competition grounds.

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