Autorité de la concurrence

# Two-sided markets : some issues

**Etienne Pfister**
**Chief economist, French Competition Authority,**

# As an introduction

Autorité de la concurrence

- Which specific questions in competition policy are raised wen considering two-sided markets ?

# Taking both sides of the market into account (1) : SSNIP test

Autorité de la concurrence

- The SSNIP test estimates whether an increase in price is profitable to a company :
  - The lost revenues due to an increase in price have to be estimated on both sides of the market
  - Customers lost to rivals are also more damaging than customers who cease to buy or than customers lost to competitors on a one-sided market

- Example : an increase in the price of a newspaper
  - Reduces the number of readers which reduces the attractiveness of the newspaper to announcers
    - The importance of the effect depends on the elasticity of advertising to the number of readers : in the beginning of the decade 2000, TF1 was loosing viewers but this had no impact on advertising
  - Increases the number of readers for competing newspapers which make them more attractive on the advertising market
  - Finally, beware : the platform may adjust its price structure to maximize its revenues
  - Overall, market power may be more difficult to exploit

# Taking both sides of the market into account (2) SSNIP test

Autorité de la concurrence

- SSNIP test are already difficult to implement on one-sided markets, how about two (or more) ?
  - Assess the effects of an increase in price on both sides
  - Consider the effects of two increases in prices

- Note however that the importance of taking both sides of the market into account depends on the relationship between the two markets
  - Increase in advertising prices may entail a reduction in the number of advertisers but this has no impact on viewers or readers (only one positive externality : only the advertising market could be examined)

# Taking both sides of the market into account (3)

Autorité de la concurrence

- Predation cases
  - Charging below-cost prices on one side of the market is not predatory as long as it attracts revenues from the other side of the market
  - In practice, it is only a matter of considering revenues (or combined margins) rather than prices

- One interesting development is that in several cases, some one-sided firms are competing with a platform (sometimes a dominant platform) who can subsidize its prices on side with revenues on the other side of the market
  - For instance, think of Google and geographic search : once there was paid services to drive your car with your map
  - Now, this is free with Google and a smartphone and Google subsidizes the free service with adverts
  - In essence, this issue is not very different from a case where a firm selling a product on a single market is confronted to a competitor selling the same product on different markets
    - Thanks to higher volumes, the multi-market firm can sell its product/service at a lower price than its single-market competitor.

# Eviction abuses in two-sided markets (1)

Autorité de la concurrence

- Competition is fierce before a « critical mass » (« get both sides on board » !!) has been attained :
  - Many services are brought to consumers for free
    - For instance software codes are open so that applications can more easily be written

- This is not to say that no competition problem may exist in this period.
  - Indeed, if a platform-owner is already dominant in another market, it can leverage this dominant position to acquire an advantage in the race to critical mass on the two-sided market
  - For instance, it can tie its platform with its dominant product : hence, the platform gains automatic access to a large number of households
  - Think of Microsoft with its multimedia player

# Eviction abuses in two-sided markets (2)

Autorité de la concurrence

- Once it has acquired a critical mass and some market power, the platform may then use different strategies to protect its market power

- Reduce the ability of consumers to switch platforms on either side of the market
  - Critical mass (or « liquidity ») is a problem for platform : network effects make larger platforms more attractive to the other side of the market (« chicken and egg problem », « get both sides on board » and all the stuff…)

- Strategies
  - Provide a variety of platform specific services to consumers so that they single-home (increase welfare).
  - Use exclusivity clauses to prevent rival platforms from accessing to certain consumers
    - Think of exclusivity contracts between some manufacturers and a platform which prevent rival platform from accessing these manufacturers
  - Reduce interoperability :
    - Indeed, to resolve the « chicken and egg » problem, new entrants could try to use part of the dominant platform in order to have one side of the market already on board
    - Microsoft for instance reduced the interoperability of Windows with exploitation systems for servers : thereby, competitors has difficulties to impose their own products because they would not work with the Windows

# Eviction abuses in two-sided markets (3)

Autorité de la concurrence

- Actually, such strategies may be analyzed through traditionnal tools

- For instance, consider exclusivity clauses : what is the duration ? Is there space for the competing platform to gain access to key consumers (such as notorious trademarks) ?

- The specificity of eviction in two-sided markets is that the effects of such strategies can be more detrimental to competition
  - Loosing on one side of the market entails loosing on the other side of the market

# Competitive bottlenecks and exploitation abuses (1)

Autorité de la concurrence

- On some two-sided markets, consumers on one side of the market may single-home while consumers on the other side multi-home

- This may create competitive bottlenecks where the platform charges high prices to multi-homers (especially if it has sufficient single-homers on board)

- This behaviour has generated much noise about so called « exploitation abuse »
  - Think about mobile application developers and Apple
  - Think about  hotels and the online travel agencies (Booking, Expedia, etc.)
  - In some cases, the revenues made on the multi-homing side will create lower prices for single homing consumers.
  - But not so if prices are not set by the platform or if consumers single-home because they are locked in…

# Competitive bottlenecks and exploitation abuses (2) Travelport/Worldspan (2007)

Autorité de la concurrence

- These merging firms are Global Distribution System (GDS) platforms relating airlines and hotels on one side to travel agents on the other side
- The merger reduced the number of operators from 4 to 3
- Travels agents single-home while airlines multi-home. GDS revenues come from airlines
- GDS revenues depend on the number of reservations made so GDS are searching to have as many travel agents as possible
- Following the merger, would GDS increase price to travel agents ?
  - Travel agents may go to another GDS
  - This entails a reduction in the revenues from airlines as well as less attractivity towards airlines.
  - Standard two-sided reasoning

# Competitive bottlenecks and exploitation abuses (3) Travelport/Worldspan (2007)

Autorité de la concurrence

- However, prices may increase for airlines
  - The merging party now grants access to larger pool of travel agencies
  - Furthermore, airlines do not control the demand on the GDS : they cannot diminish the quantities sold through the merging party in response to a price increase

- Yet, airlines can still « hurt » GDS through other means
  - Withdraw specific content from the GDS (such as lowest fares)
  - Impose surcharges
  - These could cause travel agents to change GDS : then the merging GDS would loose all the reservations associated with a given travel agent
  - But this is only valid if travel agents can indeed change from one GDS to another : this happens to be the case as a large share of travel agents change GDS each year. Furthermore, the merging parties did not appear to be the closest substitutes.

- As a result, the operation was unconditionnally approved by the Commission

# Competitive bottlenecks and exploitation abuses (4) On-line Travel Agencies and MFN clauses

- Similar questions are raised with OTAs.
  - Limited number of OTAs, some of them may be dominant
  - Increasing proportion of hotel reservations made through these intermediaries
  - Consumers tend to single-home while hotels multi-home

- Debate about the « exploitation » of hotels by OTAs
  - Indeed, hotels do not have the same bargaining power than airlines or hotels towards GDS
  - Most-favored nation clause (MFN) prevent the hotels from withdrawing specific content from OTAs or from imposing surcharges. Hence, the end-consumers has little incentive to switch OTAs
  - Hence such MFN clauses limit competition between OTAs as they reduce their incentive to charge low commission rates to hotels

- The question however in the OTAs case is about free-riding
  - Absent most favoured nation clauses, hotels (as well as « low-cost » OTAs) could free-ride on the promotional efforts of their competitors and charge low price to consumers (who have discovered the hotel on the site of an OTA)

# Conclusion

Autorité de la concurrence

- One issue that has not been tackled in my presentation is how different firms can combine themselves to build a platform

- In some cases, building a platform means including restrictions : are these necessary or not ? And how should they be treated by competition law (restriction by object or effect) ?