CMA-CCRP ROUNDTABLE

Competition implications in a digital world

21 January 2016

Xeni Dassiou – CCRP City University London

Preface

- With the hindsight of what other panellists will be covering I will try to provide an economic prologue of the concepts to be covered with a bit of my own thoughts provided too.
- It is very important to have a perspective - I will use for this an article by Stephen Littlechild, and no, it is not his price cup article on the regulation of BT’s profitability.
- Littlechild, S. (1981) "Misleading calculations of the social costs of monopoly power." *Economic Journal*, 91(362): 348-363.

It is important to remind ourselves of counterfactuals

- Littlechild asserts that in some cases it is irrelevant to compare monopoly with perfect competition: in the absence of monopoly (for some time at least), the product is often not provided in the first place, which represents a greater social loss.
- For a new market (including digitals markets in our case) the relevant alternative to the innovator’s action (counterfactual) is no product at all. It would therefore be inappropriate to characterize actions as generating a social loss. On the contrary, his action generates a social gain given by his own entrepreneurial profit plus the consumer surplus, both brand new areas.
- Moreover we need to remind ourselves that perfect price discrimination leads to optimal (welfare maximizing) solutions as it removes the monopolist‘s incentive to restrict output and consumers that would not be served are now served.

What is the definition of a digital market?/1 The old definition

- Article in 1997 by Hal Varian on digital markets:
  - **Defined as all content that can be digitised** (news, music, books, voice, pictures, software, etc.)
- Varian talks about versioning (market segmentation) in the form of "damaged" goods. It allows a firm to easily provide different qualities – versioning by switching off some of the attributes of the full version; only the high value (cream) customers are fully served. But this existed in the "old" world too.
- Yes, a lot of consumer surplus captured by the company along the way but more consumers captured. To calculate whether this is bad or good new we need to determine the counterfactual - remember Littlechild
- Allows monopolist company to capture consumer surplus and avoids defections from wealth customers with high valuations for the good by damaging goods designed to be provided to low valuation (lean wallets) wo valuation customers
- The common characteristic of such markets is that fixed costs can be high but marginal costs of reproduction are very low increasing the incentive to price discriminate and thus increase sales to cover the high upfront fixed costs.
- Some of these were new sectors that did not previously exist - NEW BUSINESS. Hence as Littlechild would argue these markets are brand new consumer surpluses and brand new profits with the counterfactual being zero. The results of the move from an analogue world to a digital world allows for the creation of new markets given the enhanced capabilities.
- This implies a lot of **creative destruction: remember Blockbusters chain? Uber versus taxis? Airbnb versus rooms to let? Emergence of new substitutes many of which in the end creatively destruct the old market altogether**

More recently: Previously offline markets and the digital economy

- Buying and selling on the internet of existing off line markets as for example online sales of physical goods.
- Many offline markets have as a result been hollowed out as resources get pulled into the on lien ones (advertising, marketing and information follow consumers). Off line markets are becoming thin - in both consumers to serve and hence producers interested to serve- or turn into display only markets - we are on an evolution trajectory. Should a regulator second guess the market?
  - How interconnected are online markets to their offline counterparts? Number of participants (producers and consumers) with a dual presence?
  - Complement or a substitute markets. People may browse on a shop and buy electronically or vice versa?
    - Even people that only do online banking highly value the existence of branches!!
  - Market definition issues depending on how the goods on offer are viewed and purchased by the consumers.

Further broadening of the digital world

- Add to the new broader concept of digital markets, the hardware and software with which we access these markets (mobile, tablets, laptops, virtual market places and social network platforms) and you have the digital world with sellers and buyers meeting and trading using digital methods of paying!

On line markets are two way street of information

- More information for the sellers on the buyers and more information for the buyers on the sellers.
- Past purchases provide information on the buyer behaviour and valuation of the good purchased leading to price discrimination and consumer targeting, but also past purchases generate feedback in digital markets (plus forums of discussing all kinds of products).
  - Need to regulate for information to be genuine - without violating privacy - to enhance transparency
  - Smaller firms may find themselves at a disadvantage because they can not as easily collect data hence less ability to poach customers
- **Convergence** by offering bundles such as triple play package
  - Places smaller firms at a disadvantage - barriers to entry
  - **Vulnerable customers tend to buy single product where there is less completion and hence experience rising prices instead of bundles where competition is intense and prices are falling**
  - Thinning of offline markets are these are populated by the vulnerable, digitally cut off/unable customers. Perhaps <u>set social responsibility obligations in the form of old style USOs obligations</u> introduced for providers while simultaneously further thinning of such markets from consumers by state aid introducing blanket coverage of broadband (access) and enabling people to understand and use new technologies (assess and act).
  - Note: thing like our mobiles are bundles too! If bundling is bad then we should not let our mobile serve as alarm clocks, cameras, videos, i-Players, word processors, newspapers, articles, books, GPS navigators etc. because this hurts some other industries.
    - There are no longer mobiles without a camera, the production of alarm clocks has seized: creative destruction at work, although there were serious privacy issues there e.g. photography of or by children at school.
  - Can an offline market be enhanced as a social obligation requirement to offer some of the information and choice available in its online counterpart?

Market failures and behavioural economics

- Market failure is a justification for intervention (asymmetries of information, market power, externalities etc.) and affect the causal link of the three As.
- However if behavioural economics are taken into account then the 3 As of access, assess and act no longer describes a causal link.
  - Behavioural biases are not leading to a market failure (because these are based on human characteristics driving behaviour that people carry with them in all markets and by that logic all markets are "failed".
  - Search does not necessarily lead to switching, nor does switching imply more searching.
  - I do not need to search if am over-confident or have past experiences or I may search but not switch (theory of regret).
  - I may have access to information but do not wish to assess it as I get overwhelmed. Or I have no time to access it (people with children – perhaps targeted reminders to engage at opportune moments may help).
- Digital markets may make people less engaged because they are overwhelmed.
  - Should the regulator intervene? By helping consumers directly? Of by stipulating that firms help people further?

Competition issues

- Distinction between ability and engagement with the market. You may be able but not engaged or your may wish to be engaged but can not.
- Many people have episodes of engagement and you can try to increase their frequency by occasionally prompting them at opportune times.
- Studies suggest <u>disabled</u> people do searching.
- Are <u>rural</u> people more disadvantaged in digital markets than they were in physical markets?
  - If we mean that they have less access than urban people do, this applied before too, and now there is a solution by rolling out rural broadband (sate aid) whereas before there was none. We act as if people were spoiled for choice before - counterfactual again. In fact many people became rural with the advent of digital markets.

My thoughts:

- Consumers not scrolling down the page (Goggle case and dominance)
  - What about consumers that did not “scroll down” the high street because they are disabled, rural, or too poor to afford the bus ride, or too busy/lazy to do so, etc.
  - What about big chains holding premium position and space in the high street?
  - Powerful big chains were always able to grab more of the attention of the consumers as they were ready to spend more to do it and could afford it disproportionately more given non linear pricing by advertisers.
- In the end Google sells market space in its high street.
  - We need more “high streets”, concentrate on barriers to entry!

Market definition

- Product MD: Is the 4G market in the same market as the 3G market? Does broadband compete with mobile internet? High fibre broadband with old connections with less bandwidth ? As quality of service changes, markets separate and became distinct because consumers consider them as different.
- Geographical MD: is the market national, EU or international? It depends how services by different players are viewed by consumers.
  - Transparency (more information than offline by reducing search costs and comparison sites)
  - Use of personal data can be both damaging and of great benefit too (e.g. open data to third parties to make switching easier)
  - Geographical location is of less importance, but not in the case of physical non-durable goods (groceries)
- Should firms be allowed to price discriminate along national borders, especially within the EU?
  - Imposing a same price principle may raise prices in regions offering lower prices rather than lower prices universally; this will lead to welfare loss and will exclude from the market customers with lower willingness and ability too pay
  - Price uniformity is a stage reached through the competitive process not regulated into the market place.
  - Place more emphasis in reducing barriers to entry for new entrants and keep an eye on anticompetitive practices on bundling (but avoid second guessing offerings that may be valued by the customers)
- Privacy, safety and social obligation issues: yes, but is this the remit of an economic regulator?