The Competitive Effects of Across-Platforms Parity Agreements

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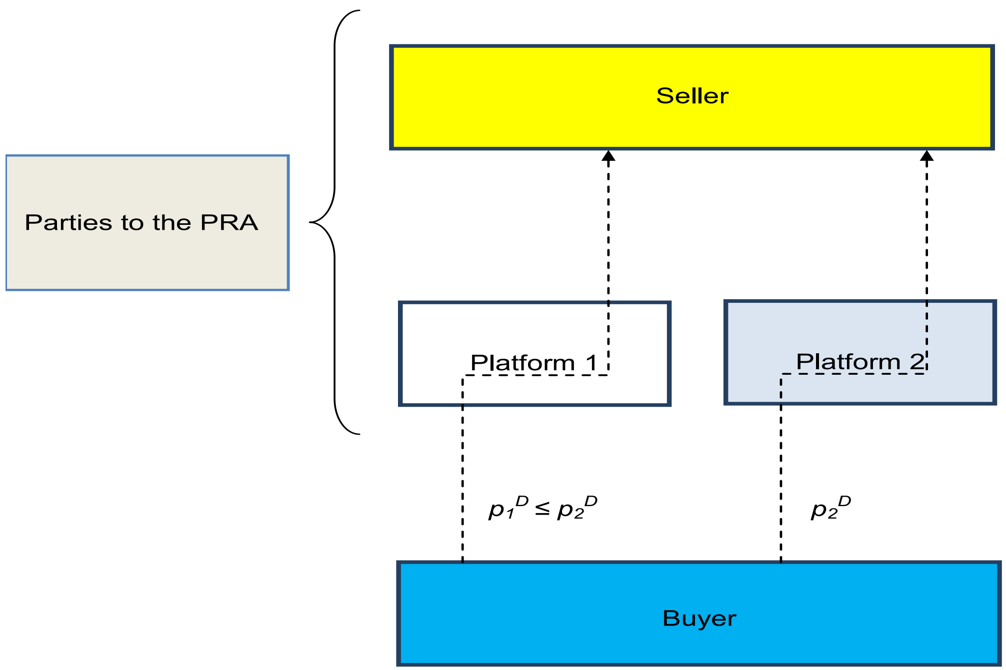
Outline

- Definition
- Insights from other (best) pricing policies
  - Across-customers
  - Across sellers
- Applicable theories of harm
- Efficiency justifications
- Conclusions

APPAs: Definition

Agreement between a seller and an (electronic) trade platform whereby the seller undertakes to charge on that platform a price that is not higher than the price charged on other platforms (including new entrants or its own platform)



A famous interview

Question: "Why would someone buy a book from Apple for $14.99 if the same book was offered for $9.99 from Amazon?"

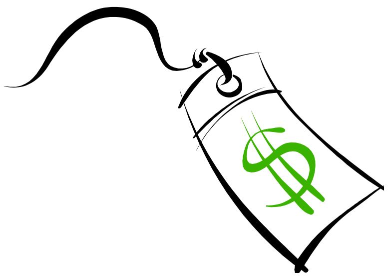
Steve Jobs: "Well, that won't be the case .... The price will be the same"

The contractual obligation to charge the same price on the two platforms was called **MFN**; since then this type of clause is referred to as **retail-MFN**

The price on Apple is a **function** of the price charged on Amazon

Price Relationship Agreements

Price



p^A

Relationship

$p^A = f(p^B, p^C, \ldots)$

Agreement

Where B, C,… are the same product as A or similar competing products

Across-customers price relationship agreements

John

Mario

The price charged by seller A to John is a function of (it is the same as, it is not higher than…) the price charged to Mario

Across-sellers price relationship agreements


A


B


John

The price charged by seller A to John is a function of (it is the same as, it is not higher than…) the price charged by seller B to John

Across-customers and across-sellers: examples

Company X represents and warrants to Company Y that the prices offered to Company Y under this Agreement are no less favourable than the prices offered to any other party purchasing or licensing similar quantities. (***Most Favoured Customer Clause***) (***Across-Customers***)

If you find a lower price on a new, identical item at another store, show us the lower price at the time of the purchase and we will match it on the spot, or show us the lower price within 14 days of your purchase and we will pay you the difference. (***Price Matching Guarantee***) (***Across-Sellers***)

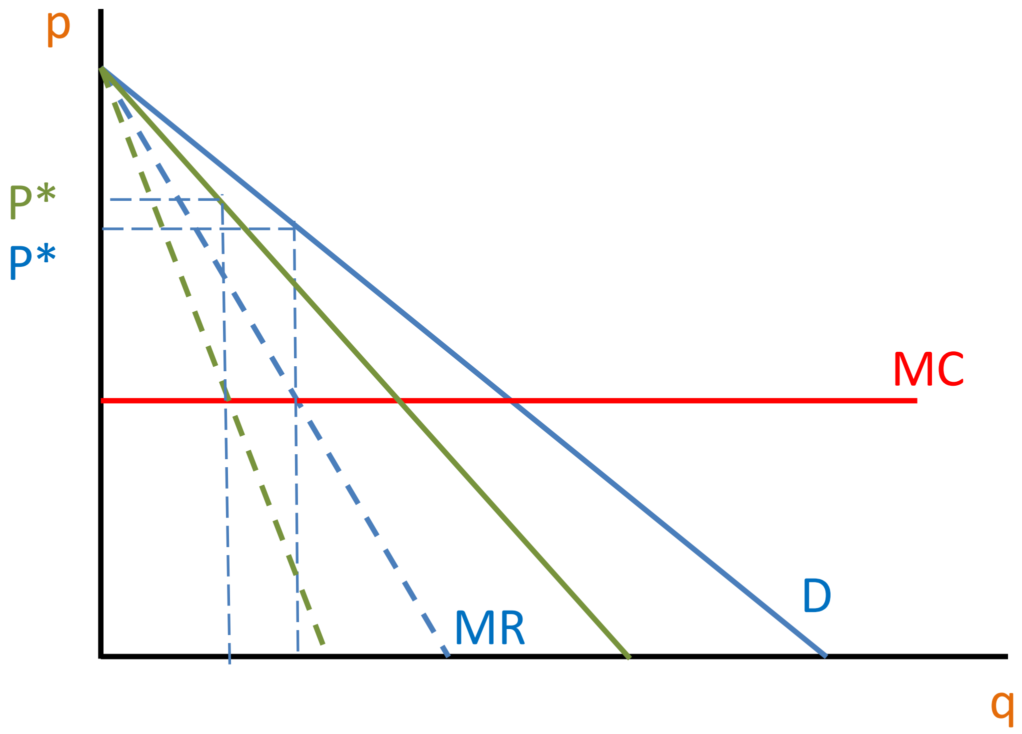
Strategic effects of across-sellers PRAs

- Firm A adopts a price-matching guarantee

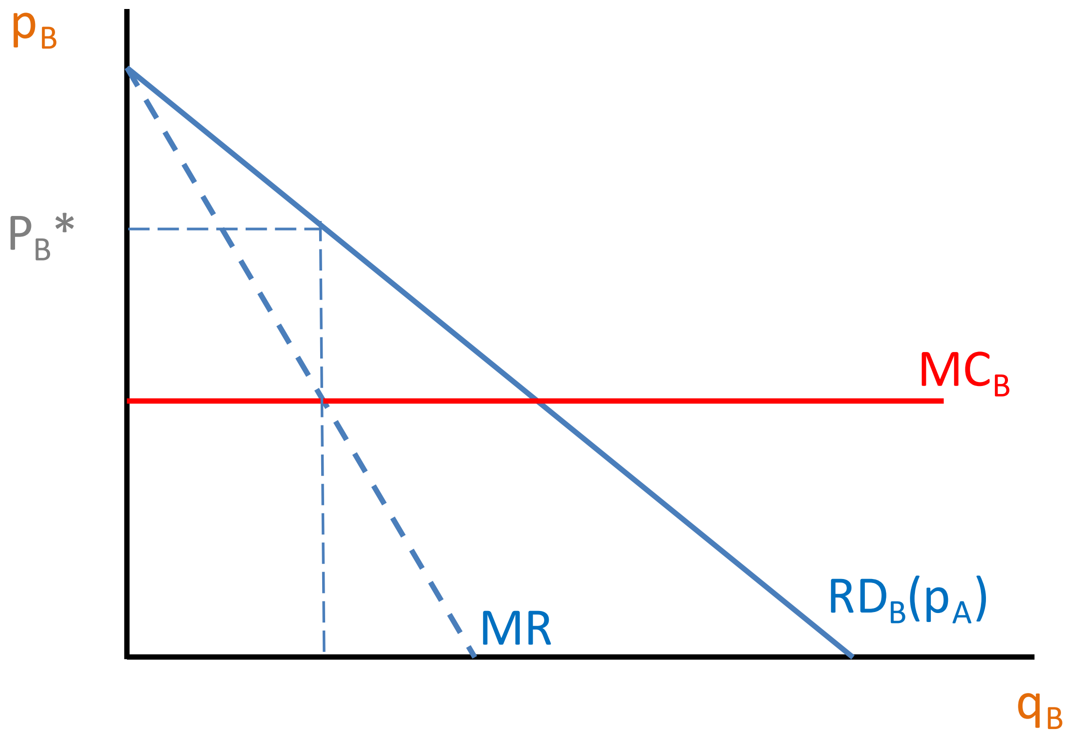
- Three questions:

  1. Does the PMG affect the behavior of A's rivals?
  2. Does the PMG affect A's behavior?
  3. Does the PMG affect consumers' behavior?

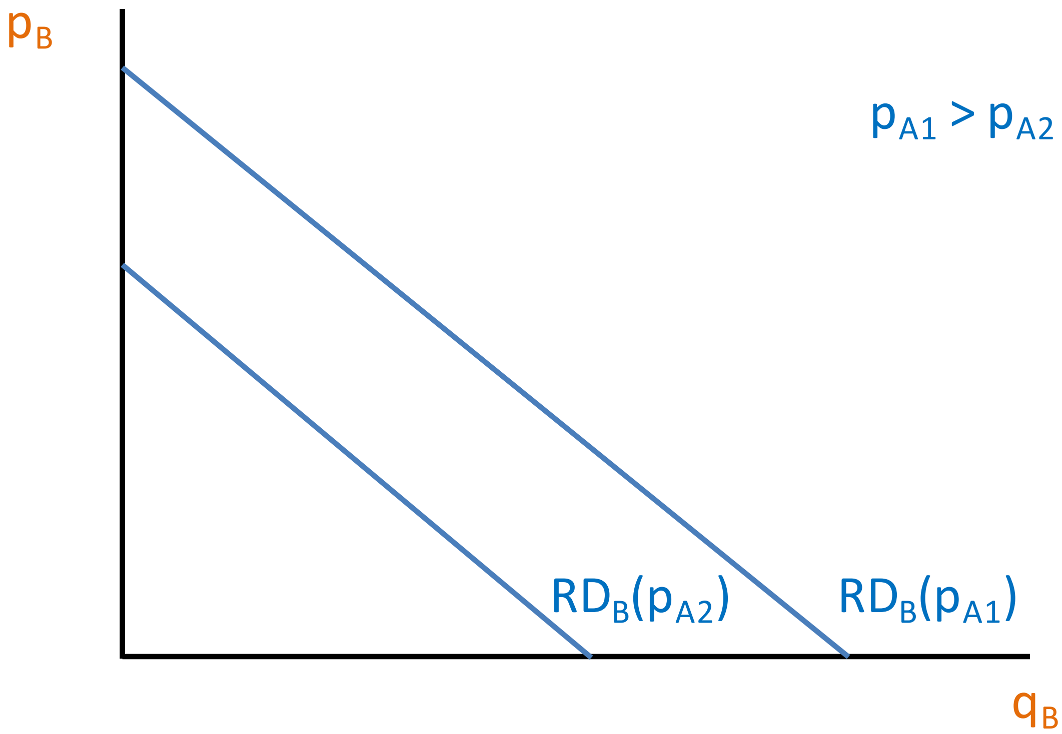
Pricing decision 1: Monopoly



Pricing decision 2: Duopoly – Optimal price



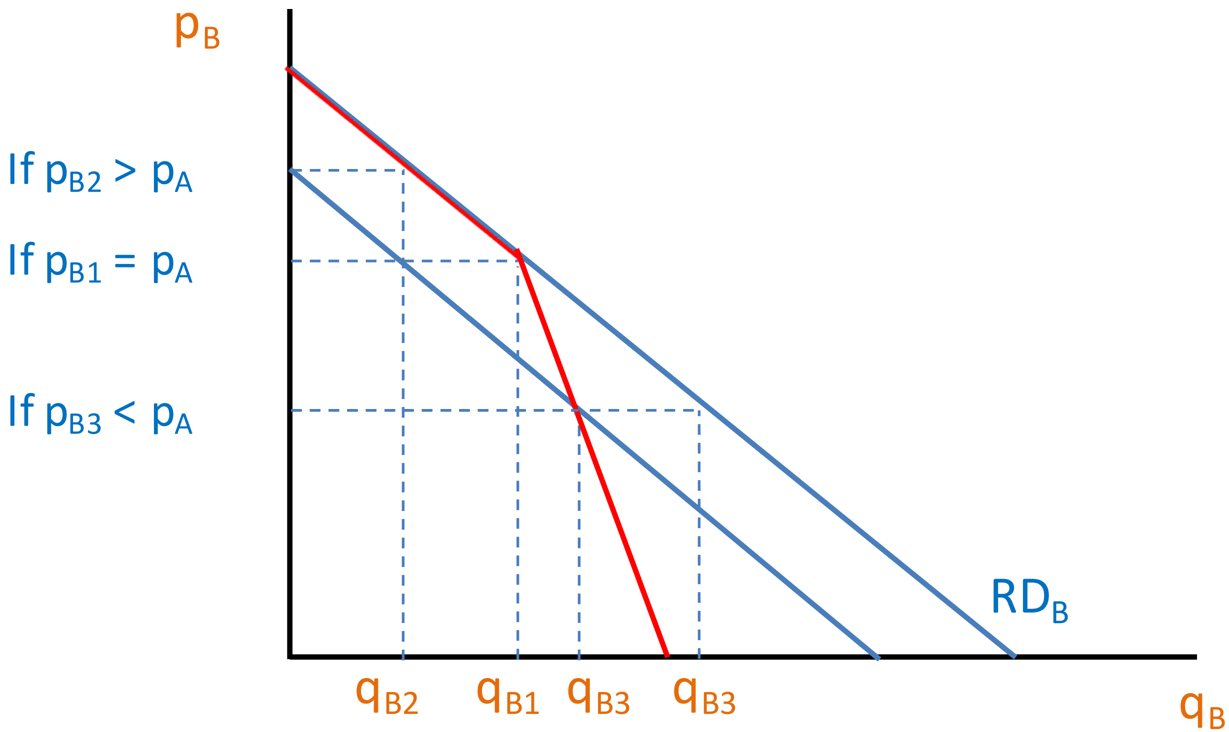
Pricing decision 2: Duopoly – Residual demand curve



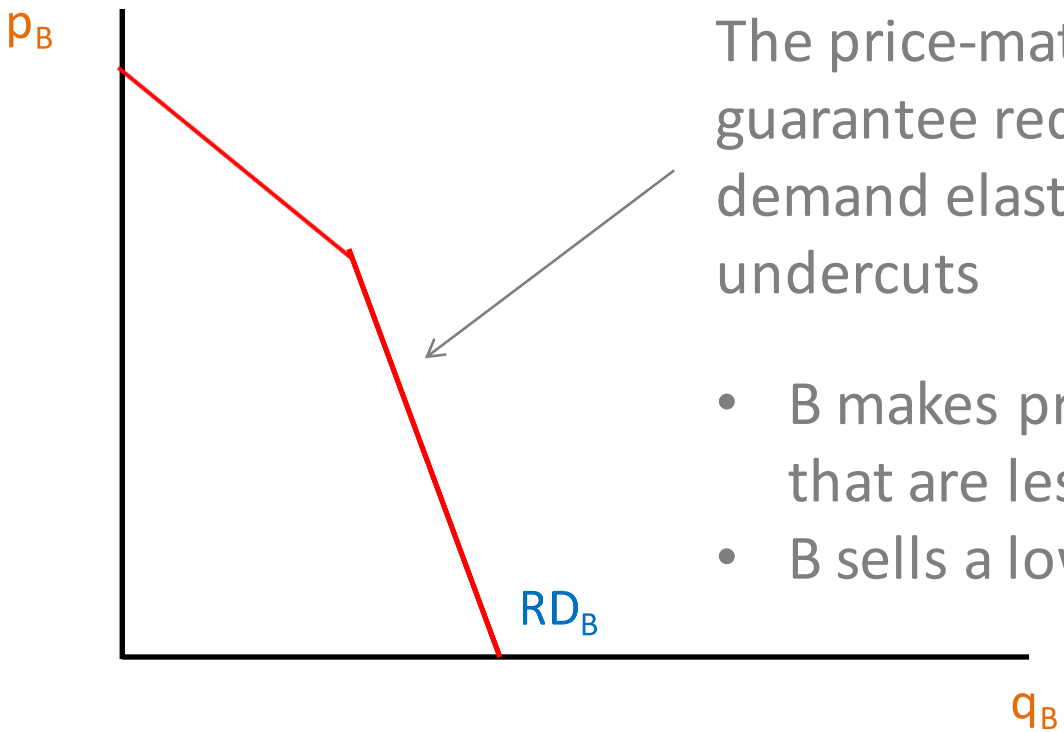
Pricing decision 2: Duopoly with a "price-matching guarantee"

- Suppose firm A sets a price p_A and adopts a price-matching guarantee
- How this strategy affects B's residual demand curve (and therefore its optimal pricing decision)?

Pricing decision 2: Duopoly with a "price-matching guarantee"



Pricing decision 2: Duopoly with a "price-matching guarantee"



The price-matching guarantee reduces B's demand elasticity when B undercuts

- B makes pricing decisions that are less aggressive
- B sells a lower quantity

Across-sellers and APPAs

- Suppose A and B are two platforms and A adopts an APPA
- B's demand depends on the price that sellers set on B
- If B undercuts A (lowers the platform fee) it would obtain a higher demand if sellers passed on the lower fee on B
- An APPA prevents this pass-on
- The APPA reduces B's demand elasticity when B undercuts

APPAs: Theories of harm

- Who are A and B?
  - A and B are two established and similar competitors
    - Softening competition: both firms compete less aggressively
    - The effect is stronger if both A and B adopt the same pricing policy
  - A is the incumbent and B a potential (or a small) rival
    - Foreclosure: insufficient demand to cover entry sunk cost or more limited ability to expand trough aggressive prices

APPAs: A possible efficiency justification?

- Who are A and B?
  - A is a new entrant and B the incumbent
    - Facilitate entry: the APPA prevents B's from fighting entry with an aggressive pricing policy
    - Yet… softening competition: both firms compete less aggressively

Across-sellers: effects on A's behavior

Price delegation

A

B

If B sets a price below A's list price

John pays to A an actual selling price decided by B

Across-sellers: Signalling

- Suppose B is a high-cost firm and A a low-cost firm
- B does not want to delegate its actual selling price to B as this price may be insufficient to cover costs
- A may be willing to (pretend to) delegate its actual selling price to B since B is unable to undercut

- A price-matching guarantee can be used by A as a credible signal that it is a low-cost firm

APPA: Signalling?

- If platform A adopts a parity policy usually it does not delegate its prices
- Signalling theory requires that consumers have the ability to observe the signal (and that comparing prices is costly)
- APPAs are not observed by consumers
- Signalling is an unlikely explanation

Across-sellers: Effects on consumers' behavior

- Consumers are heterogeneous in search costs
- Some (informed) consumers activate the guarantee and pay the low effective price
- Other (uninformed) consumers pay the high listed price

- A may use this buyers' heterogeneity to price discriminate

APPA: Price discrimination?

- If platform A adopts a parity policy it does charge different prices to its sellers
- Price discrimination impossible

APPA: other possible economic justifications

- Protect investments made to develop the platform (esp. ancillary services needed to reduce info asymmetry), very important in two-sided markets

Conclusions

- APPA is not a new practice, but one that may become common in the digital world
- There is no established jurisprudence…
- Nor a developed economic literature
- Some competitive risks are clear, but…
- Efficiency justifications cannot be ruled out