Barcelona School of Economics

Self-preferencing and foreclosure by digital platforms

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Disclosure

- I worked on Google Shopping when I was at the European Commission (2013-2016)
- Other than that, I have not been involved in any of the cases I mention in this presentation
  - ➢ I have limited knowledge of the facts of the cases

Introduction

- Academics, policy-makers, agencies have focused attention on some large digital platforms' practices
- Competition agencies all over the world have opened abuse of dominance investigations
  - EC probably the first one; its cases have shaped the DMA
- Abuse is an area of controversy in general; many are skeptical about abuse by big tech in particular
- Here, I offer a possible anti-competitive rationale for some of these practices

Cases of abuse in digital markets

(Exclusion in vertically-related or complementary markets)

- Reaction to imperfect rents extraction
  - Self-preferencing (and 'refusal to deal'): *Google (G.) Shopping (EU); Amazon Marketplace (EU); ApplePay (EU); G. Privacy Sandbox, G./EnelX (ITA); G. favouring own ad exchange (UK)*
  - Denial of information/data: *G. Privacy Sandbox (UK,US,EC)*
  - Tying and pre-installation: *G. Android (EU, US DoJ)*
  - Anti-steering provisions: *Apple v. Spotify (EU); Apple v. Epic (US)*
- Exclusion of potential competitors (dynamic foreclosure)
  - Degradation of interoperability (and copying): *Facebook (US FTC);*
  - Refusal to supply: *Apple cloud-gaming and web apps (CMA)*
- Raising Rivals' costs
- Denying 'advantages' to rival logistic services: *Amazon Marketplace (ITA)*

Theories of vertical foreclosure

I. Imperfect rents extraction

- Regulated prices
- Opportunism: inability to commit to terms of trade (Hart-Tirole)
- **The platform is constrained by its own business model**
  - **Zero price of access (monetization through advertising)**
  - **Uniform fees and conditions (probably to avoid discrimination and consequences of possible opportunism)**

II. Dynamic vertical foreclosure

- Elimination of potential competitors

III. Raising rivals' costs

Vertical foreclosure: Chicago School's critique

A vertically integrated firm with a dominant position upstream gets all the market's monopoly profits. Excluding an as-efficient downstream rival is unprofitable.

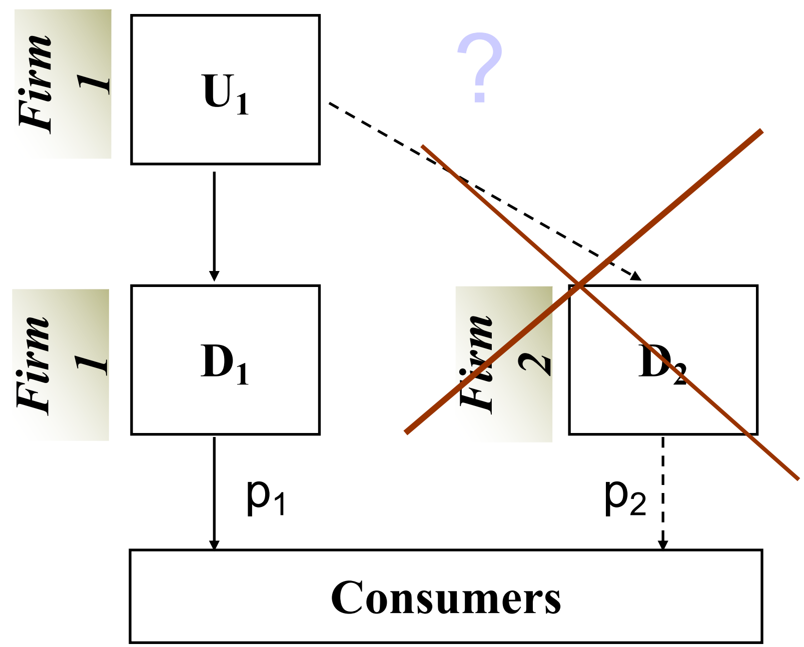
(Ability v. incentive to exclude.)

Exceptions:

- If there are restrictions on access prices, e.g., upstream regulation

But also, more relevant for digitals:

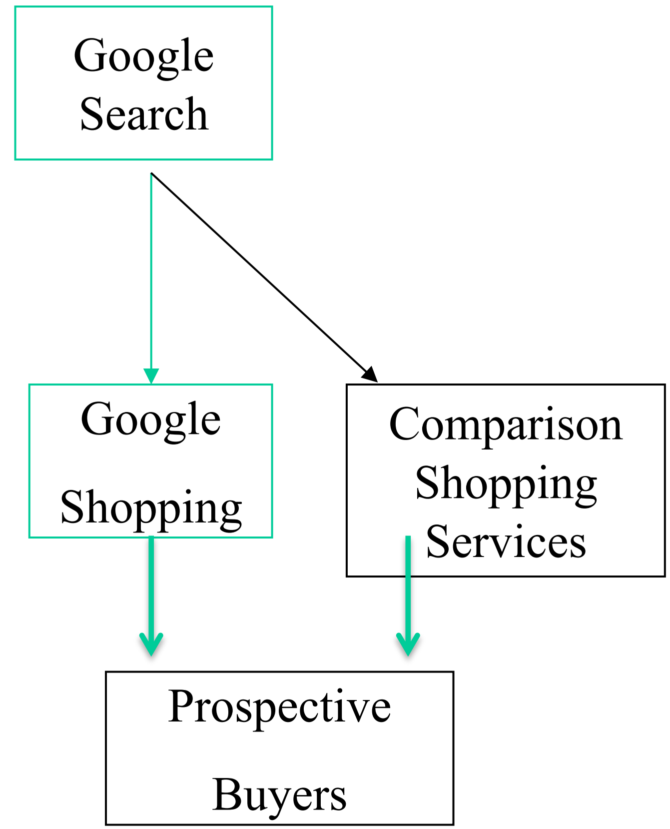
- If the business model foresees zero prices, rents extraction will be limited (*Google Shopping? Google Privacy Sandbox?*)
- Similarly, if a platform hosts many sellers and commits to uniform fees (*Apple v. Spotify?*)



Google Shopping

EC/GC: Google fined for promoting own comparison shopping service (CSS) and demoting rival CSSs from Google Search

- Google was not charging them (or buyers) for being listed in organic search – one monopoly profit theory does not apply!
- Inability to 'monetise' → either directing customers to own shopping service or pushing the sites to buy advertising may have been a way to monetise
- (Risk that users may become loyal to other comparison sites and go directly to them, a possible rationale for exclusion)
- Possible justifications: innovation; Google Search not indispensable



Google Privacy Sandbox

Jan 2020: Chrome to no longer allow websites to use third-party cookies

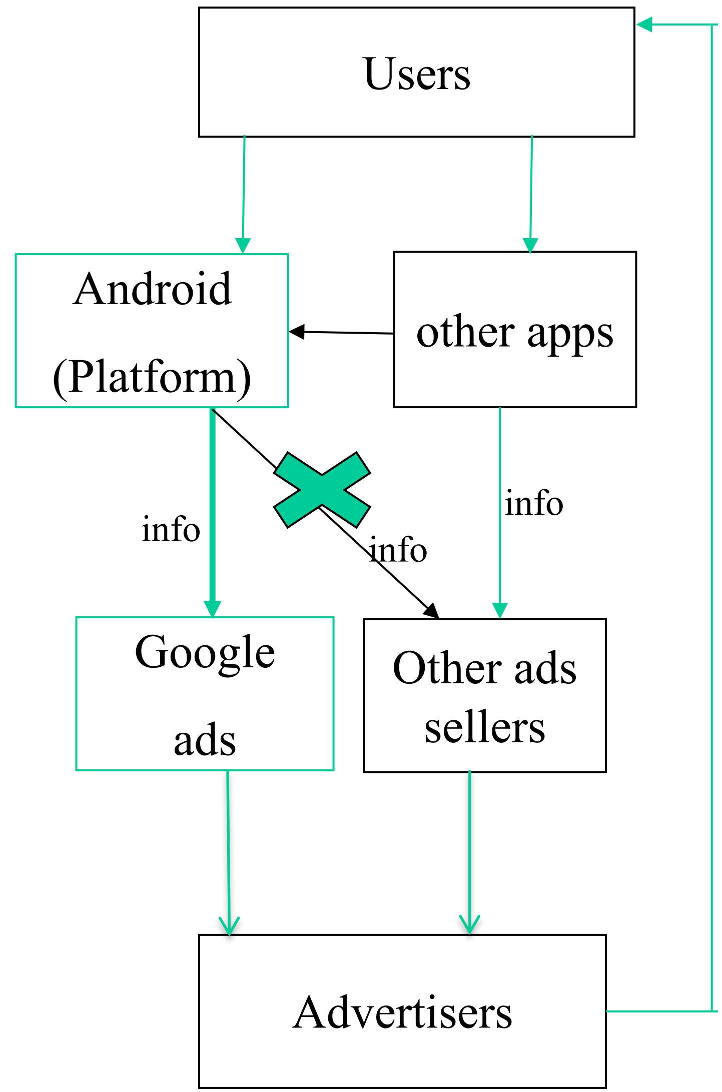
More difficult for advertisers to track users' activities on the web, figure out who each user is, and then serve targeted ads

- Chrome to use algorithms to create a large number of "cohorts," groups of people sharing certain features
- A person's browsing history is kept private, but browser itself looks at history and assigns a user to a cohort
- When a user visits a website, Chrome will tell the site the cohort that individual belongs to.

→ Improve privacy experience for users or entrench Google's dominance in digital ads?

Feb 2022: CMA accepts revised commitments

- Google to restrict data sharing within its ecosystem not to benefit when third-party cookies are removed; no self-preference for its ad services
- Monitoring Trustee to work alongside the CMA to ensure Google complies with its obligations.



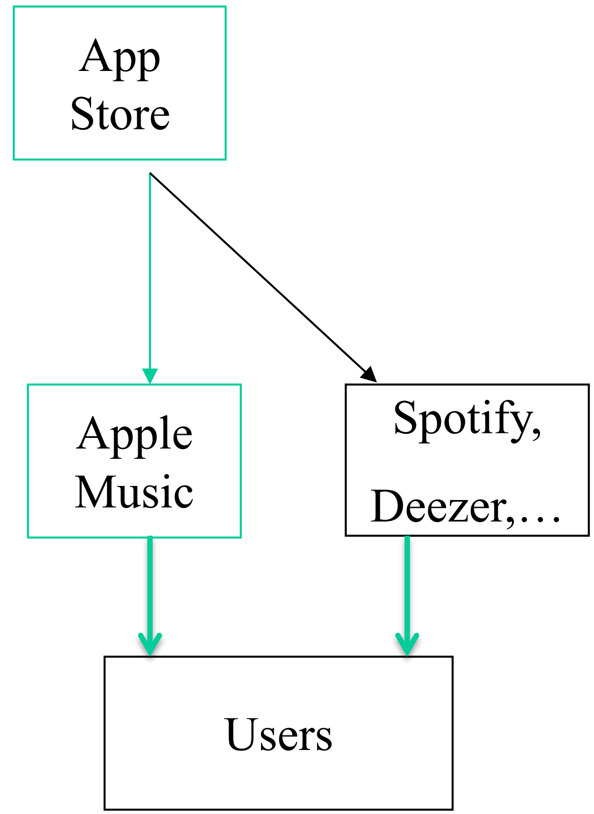
Apple Music

Spotify*: Apple behaves anti-competitively, by:

- Setting a 30% fee for Spotify Premium on App Store; creating problems for upgrades; frequently rejecting its app; changing arbitrarily App Store guidelines; rejecting Spotify app for Apple Watch; preventing it from sending promotional push notifications (Apple Music does)

- In App Store, Spotify Premium raised price from $9.99 to $12.99 (Apple Music: $9.99). 2018: withdrew from it

- EC Statement of Objections in April 2021. Possible abuse of dominant position in the distribution of music streaming apps to owners of Apple devices, for:
- Mandatory use of Apple's own in-app purchase system to buy digital content (30 % commission fee)
- “Anti-steering provisions” preventing app developers from informing iOS users of alternative, cheaper subscriptions available elsewhere.
- → Rivals do not have access to data about clients



* https://www.timetoplayfair.com/timeline

Imperfect rents extraction due to uniform terms

- Users value the system of platform+app(s)
- A platform commits to non-discriminatory terms of access for 3rd party apps (e.g. <u>to avoid opportunistic behaviour</u>)
- The optimal *ad valorem* fee, f, increases with app's demand; but apps have different uncertain demand: f set to max ex ante profit
- The fee creates double marginalisation
- Ex post, the platform would like to raise fee for high-demand apps, but it can't, due to commitment to uniform access terms
- <u>How can the platform extract more rents from high-demand apps?</u>
  - (It would also like to lower fees to low-demand apps; note that platforms typically allow for lower fees if apps have revenues below certain thresholds…)

How to extract more rents

- Degrading interoperability does not help the platform: it decreases the value of the system for users and reduces platform's income
- But suppose the platform can produce an <u>inferior copy</u> of *j*'s app at some cost K; price competition with the original app
- Even if inferior, 'me-too' app can win users because it does not have to pay the royalty fee (self-preferencing?)
- One can show that platform + copy's profits rise (wrt app *j* not being copied) if copycat not 'too inferior' and K low enough
- By degrading interoperability, platform makes more profits: original app less competitive and the copy can set a higher price

Welfare effects

- The platform's copying a 3rd party app is not necessarily bad: prices fall (competition → less double marginalisation)
- However:
  - Copying is wasteful in that it entails a fixed cost
  - There may be a discouraging effect on innovation, if rivals anticipate they are systematically copied whenever they have a successful app
- Degradation of interoperability is always bad: it reduces competition from the 3rd party app, and it increases the price charged by the copycat app, thereby harming consumers.

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II. **Dynamic vertical foreclosure**

- **Elimination of potential competitors**

III. Raising rivals' costs

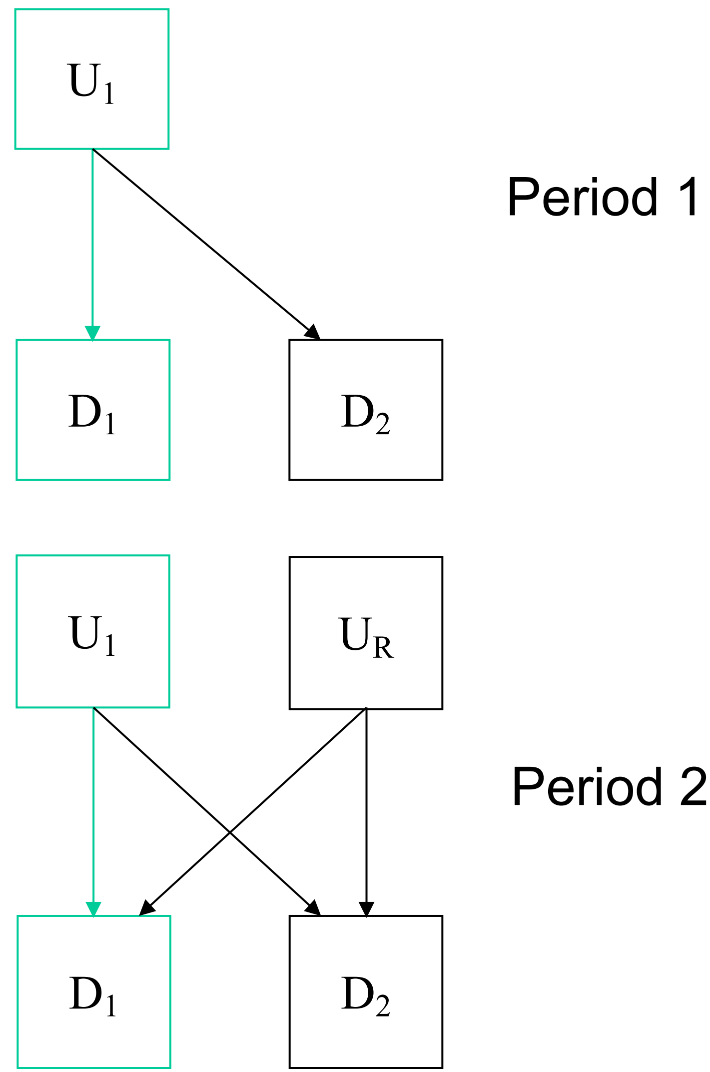
Dynamic vertical foreclosure*

Suppose firm U_R could enter upstream market in the future, but only if D_2 (which could be an affiliate or an independent downstream provider) is successful downstream.

(D_2 does not reach minimum efficient scale by selling only in period 2.)

By denying access to D_2 today, firm U_1/D_1 defends its future upstream monopoly profits

(Similar story as Carlton & Waldman's tying paper inspired to Microsoft case).



*Fumagalli & Motta, "Dynamic vertical foreclosure", *Journal of Law and Economics*, 63(4),November 2020

Facebook: elimination of potential competitors

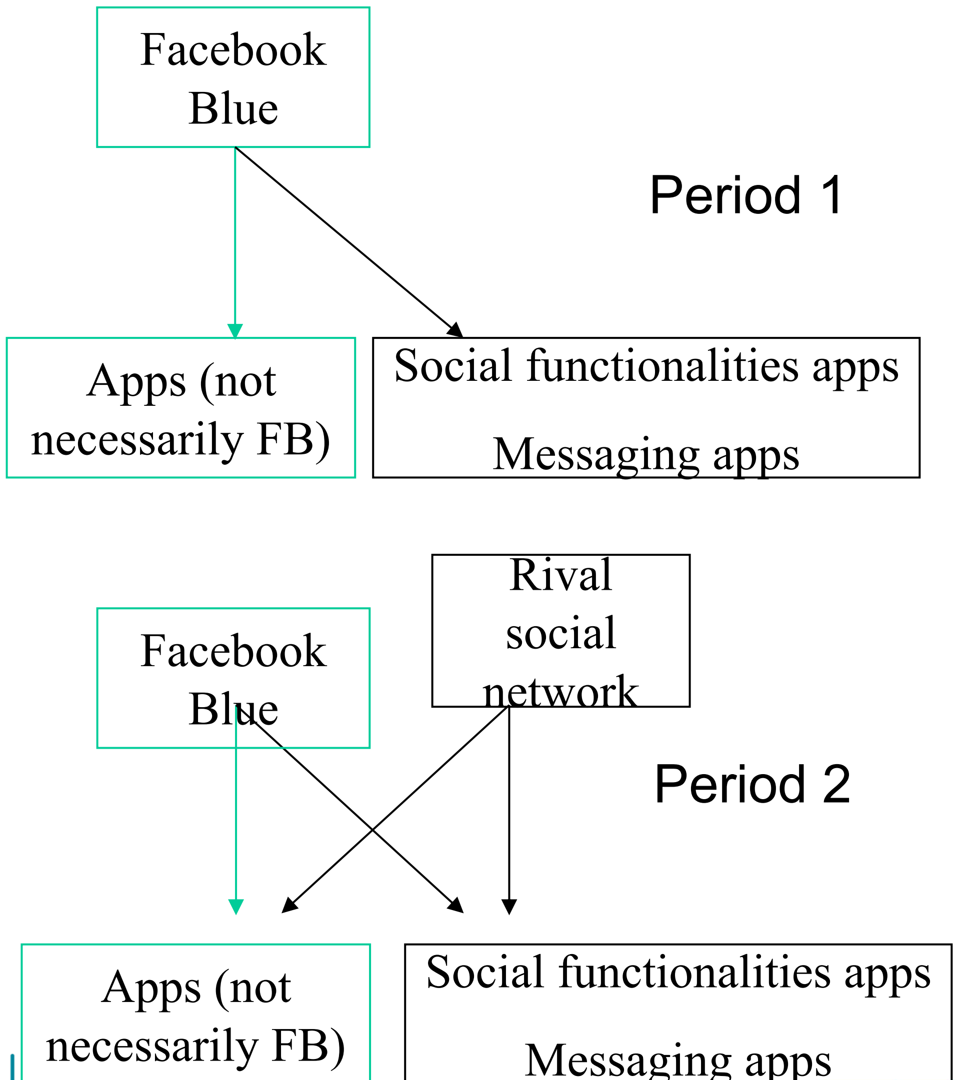
- *To have access to user data and communicate with "Facebook Platform"* (goal: ecosystem of apps and tools interoperating with Facebook Blue), *3rd party apps need APIs*
  - ("Find Friends" and "Open Graph" APIs particularly valuable)
- FTC: *Facebook made them available only on condition that 3rd parties refrain from competing with Facebook's core services* and from connecting with other social networks, thereby deterring growth of potential competitors
- 2013: Facebook bought *Onavo*, a user surveillance company, to better identify possible competitive threats

Enforcement of interoperability conditions

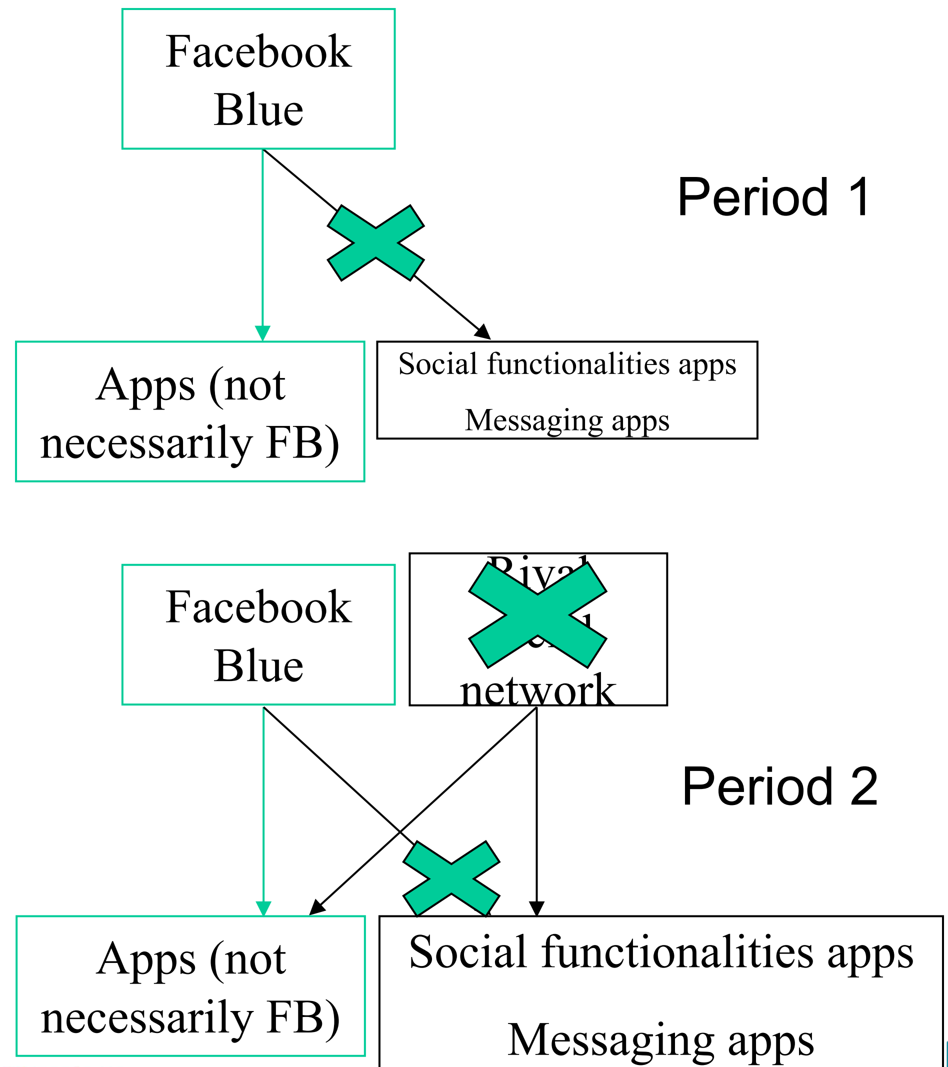
1. Path, a *personal social networking* rival, had access to Facebook terminated, which slowed it down considerably
2. Circle, an app with *local social functionalities* and trying to build a "local social network", had access to APIs withheld (pretending it was for 'spamming' users), with immediate consequences for Circle's growth. Similarly, Vine (an app which made short videos) was cut off by Facebook.
3. 2013: Facebook blocked *mobile messaging apps* from using most relevant APIs

Protection of Facebook Blue's dominance

What Facebook worried about



What Facebook (allegedly) did…



Apple, cloud-gaming apps, and web apps

- CMA considering Market Investigation on mobile browsers and cloud-gaming.
- Apple requires other browsers on its iOS operating system to use Apple's WebKit browser engine ("technology used to transform web page source code into content with which users can engage").
- "Apple's restrictions have effectively blocked cloud gaming services from its app store and hampered the development of web apps through its restrictions on browser engines."
- Cloud gaming "could pose a threat to its App Store business, since it is an alternative way of discovering and distributing games, [and] also reduce the importance of top-end 'high-spec' phones like Apple's."
- Web apps are like native apps but can be accessed via a browser, and need not be tailored to each OS. They could allow users to access content without relying on app stores.

Discussion

- *Short-term costs* (losing revenue from current users) *v. long-term gains* (protecting the platform's monopoly)
- Unlike C&W(2004)/F&M(2020), the *incumbent is not integrated with a complement / downstream; yet it may still have an incentive to exclude (if platform hosts other apps)*

- Copying (+ denial) would increase the incentive to exclude: even an inferior substitute to the rival complement may lower the loss from excluding it

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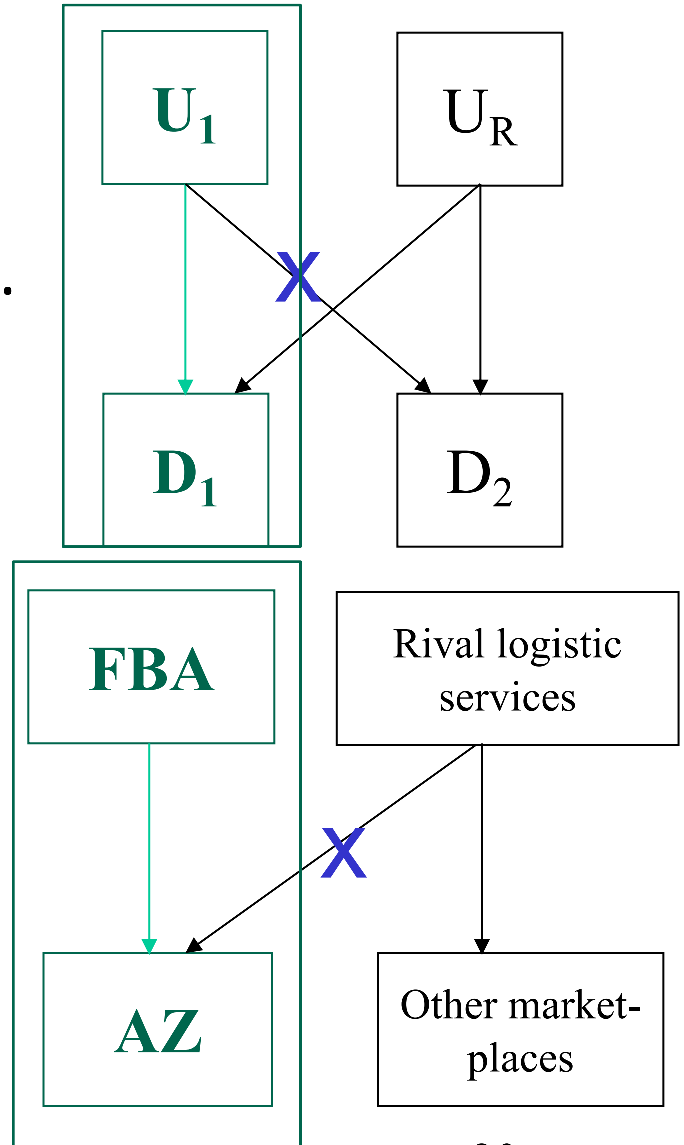
Vertical foreclosure: Raising Rivals' Costs

- Input foreclosure (Ordover et al.): with no input from U_1, downstream rival D_2 will be obliged to buy at a higher price from U_R. Thus, D_1 will enjoy higher prices and profits.
  - Same logic has been extended to partial foreclosure, in models with bargaining over input prices.
- Customer foreclosure: by not buying (or making it less attractive) the input from U_R, D_1 will reduce scale and raise costs for U_R. This in turn will decrease competitiveness for D_2.

➢ Theory of harm for Amazon Logistics, an Italian CA's case



Amazon Logistics, Italy

- AGCM: 3P sellers granted exclusive advantages on AZ's Marketplace only if adopting FBA, thus putting non-FBA 3P sellers at disadvantage → self-preferencing of its own logistic service over competing ones
- Only FBA-sellers get:
  - no "enforcement" of performance metrics
  - eligibility to Prime & access to Prime customers (over 7mio in Italy)
  - higher likelihood of winning the BuyBox (occurring > 75% of total sales) -
  - exclusive access to promotional events - Black Friday, Back to School, Prime Day…
  - preferential access to non-Prime customers - eligible for Free Shipping by AZ
- Logistic services key competitive advantage for Amazon (and ±50% of revenue in Italy)
- By denying scale to rival logistic services, rival marketplaces or direct merchant sales less attractive (handling their orders more costly)

  → dominance (70-75% share) in intermediation services strengthened
- High-quality reputation as efficiency justification? (but why not quality certification?)

Amazon Marketplace: AGCM's Decision

Amazon has abused its dominant position in intermediation services

- Imposition of **€ 1,1 billion fine**

- **Behavioural remedies** in order to restore competitive conditions in the relevant markets:

- Sales benefits and visibility on Amazon.it must be granted to all 3P sellers which are able to comply with fair and non-discriminatory fulfilment standards, in line with the level of service that Amazon intends to guarantee to Prime consumers
- Those standards must be made public
- As of one year from the date of the decision, AZ must refrain from negotiating - on behalf of sellers - rates and other contractual terms concerning the logistics of sellers' orders on Amazon.it with carriers and/or competing logistics operators, outside FBA

Summary

- Antitrust Authorities around the world have been investigating a number of abuse of dominance cases by the large digital platforms
- Here I have focused on self-preferencing and foreclosure cases, and proposed possible theories of harm for some of them
- Well-known and widely accepted theories, just ‘adapted’ to some specificities of the digital sector
  - (But surely some new theories will emerge…)
  - Whether the facts of the case are consistent with them and there exist no objective justifications for these practices is another issue

Thanks for your attention!