

# Common Threads?







# Bundling And Monopoly Leveraging: Implications For Antitrust And Innovation

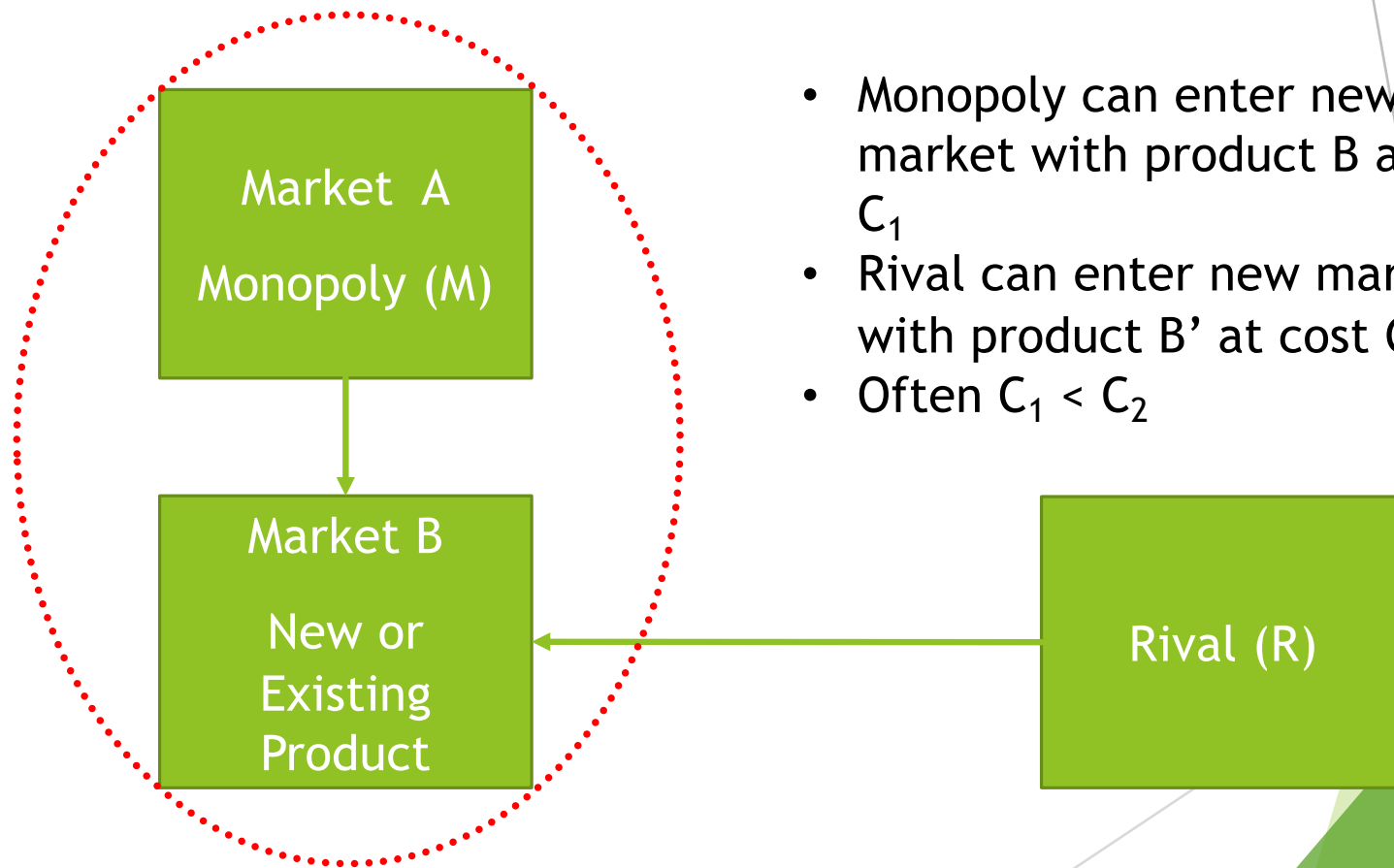
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## A Typical Antitrust Scenario



- Monopoly can enter new market with product B at cost  $C_1$
- Rival can enter new market with product B' at cost  $C_2$
- Often  $C_1 < C_2$

## Why Firms Bundle

1. Economies of scope and scale in supply and demand
2. Reputation and moral hazard for system products
3. Increase the ability of firms with market power to extract profits from customers (price discrimination - match products to willingness to pay)
4. **Deter rivals or make rivals less competitive**

## Why Firms Bundle

Pure bundling: M sells only {A,B}

Mixed bundling: M sells {A,B} and B or A separately

#3 (Price discrimination): Mixed bundling generally dominates pure bundling

#1, #2, #4: Reasons for pure bundling

#1 (scale and scope) and #2 (reputation) are efficiency justifications and potentially pro-competitive

#4 (entry and raising rivals' costs): Potentially anticompetitive

## Is Bundling Worse for R Compared to Separate Products?

Suppose M sells A and B at separate prices

- ▶ If B and B' are not differentiated, aggressive competition can push prices down to marginal production cost and make R earn zero profit
  - ▶ Separate products are no better for R and can be worse
  - ▶ R can have positive profits if B and B' are differentiated

# Case Law

Early US cases don't offer much guidance that is useful for newer cases such as Microsoft - Browser/Media Player, Google Search (Shopping), and Google Android that allege foreclosure from bundling and product design changes

- ▶ Tying cases 🙄
- ▶ IBM Peripherals cases and Berkey Photo v Kodak:
  - ▶ Courts mostly held that the challenged design changes were not anticompetitive if they reduced cost or increased performance
  - ▶ No duty to disclose design changes
  - ▶ Conduct allegedly harmed, but didn't foreclose, competition in these cases



## Microsoft and Google Cases

- ▶ Strategic (business) story
- ▶ Procompetitive story
- ▶ Anticompetitive story



# Microsoft Browser War (and Media Player)

- ▶ M = Microsoft R = Netscape (or Real Networks)
- ▶ A = Operating system
- ▶ B = Browser (Microsoft Explorer (B) or Netscape Navigator (B'))
- ▶ R can compete against the {A,B} bundle (contractual or technological tie) only if it offers a version of B for which:
  - ▶ A significant number of consumers are willing to pay extra for B' compared to B
  - ▶ The demand for B' is sufficient to cover the cost of supplying B'

# Microsoft Browser War (and Media Player)

- ▶ Strategic story
  - ▶ Bundle = “We will cut off their air supply”
- ▶ Procompetitive story
  - ▶ Bundle offers transaction economies in demand and economies of scope in production
- ▶ Anticompetitive story
  - ▶ Browser (B') is a potential substitute for operating system (A)
  - ▶ Bundle {A,B} reduces demand for B'
  - ▶ Lower demand for B' means less innovation by R, which protects the operating system

# Microsoft Browser War (and Media Player)

- ▶ U.S. v Microsoft ultimately decided based on traditional principles of exclusive dealing
  - ▶ In hindsight, a good policy and a good outcome
  - ▶ Even though the case was based on a flawed theory
  - ▶ Antitrust case lowered entry barriers and facilitated innovation for alternative browsers and media players
  - ▶ Did not impede innovation by Microsoft
  - ▶ Remedy called for interoperability commitments that arguably promoted competition and innovation

# Google Search (Shopping)

- ▶ M = Google    R = Comparison shopping website (e.g. Foundem)
- ▶ A = General search engine
- ▶ B = Vertical search engine (Google Shopping (B), Foundem (B'))
- ▶ Google's universal search display (a bundle of A and B) features B prominently
- ▶ {A,B} bundle (universal search) reduces demand for B' (and B) from organic "free" search
- ▶ But R can get on the first search engine results page by bidding for keywords

# Google Search (Shopping)

## ▶ Strategic story

- ▶ Google is in the business of generating advertising revenues
- ▶ Comparison shopping sites such as Foundem collect ad revenues that would otherwise accrue to Google and don't provide much new content for consumers
- ▶ Hence Google chooses to suppress comparison shopping sites in free organic search
- ▶ Google harvests ad revenue with Google Shopping
- ▶ Foundem and others can do the same if they are willing to compete for placement on the search engine results page by bidding for keywords

# Google Search (Shopping)

## ▶ Procompetitive story

- ▶ Consumers like search results that include specialized services such as Google Shopping results
- ▶ Incremental cost of Google Shopping is low, but not zero because Google incurs an opportunity cost of lost advertising revenue
- ▶ Bundling creates investment incentives for Google because investing in specialized search makes general search more attractive, which arguably increases ad revenues from general search

# Google Search (Shopping)

- ▶ Anticompetitive story
  - ▶ Google actively suppressed search results for R while promoting Google Shopping
    - ▶ Google suppressed free search results for comparison shopping services (including Google Shopping)
    - ▶ But search results displayed Google Shopping (a paid service)
  - ▶ Unlike Microsoft, B' is not a competitive threat to A
  - ▶ But conduct possibly harmed consumers by giving preference to an arguably inferior service while excluding others
  - ▶ Google's conduct inconsistent with equal access
    - ▶ An issue in Europe, less so in the US
  - ▶ While bundling may increase Google's investment incentives, it may decrease investment incentives for R and harm innovation generally



## Should Antitrust Policy Force M to Accommodate R in Market B?

- ▶ Complicated effects
  - ▶ Short run effects from bundling/product design depend on many factors
  - ▶ Bundling does not necessarily harm competition or welfare to a greater extent than what would occur if M did not bundle its product offerings
  - ▶ Long term effects are yet more complicated
- ▶ Under the assumption that antitrust authorities have a preference for separate products, what can be done?
  - ▶ Should antitrust authorities force M to accommodate R in market B?

# What Can Antitrust Do To Force M To Accommodate R in Market B?

- ▶ Outlaw bundling (technological tying)
  - ▶ Considered in U.S. v Microsoft; required by EC
  - ▶ Not considered in Google Search (Shopping)
    - ▶ Undermines argument that comparison shopping is a separate market
  - ▶ Complicated effects for competition and welfare
  - ▶ Antitrust historically reluctant to interfere with product design decisions
- ▶ What about bundling that has trivial benefits?
  - ▶ “Product hopping” (not actually bundling, but illustrative)
  - ▶ Problem is that it is hard to predict what is trivial in high tech markets
    - ▶ Integration of the browser and the operating system was once considered a trivial technological tie, but I doubt it would be viewed that way today

# What Can Antitrust Do To Force M To Accommodate R in Market B?

- ▶ Tougher enforcement for exclusionary conduct by M
  - ▶ Perhaps antitrust should be less tolerant of “partial” exclusive dealing (such as exclusive deals with a subset of retailers or deals that do not exclude but raise the cost of selling rival goods or services)
  - ▶ Worked for Microsoft
- ▶ Perhaps condemn some prices above average variable cost
  - ▶ “Limit pricing” excludes entry by R but is not predatory in the classical sense
    - ▶ Limit pricing has positive welfare effects in the short run
      - ▶ Keeps prices low and voids wasteful duplication of entry costs
    - ▶ But limit pricing excludes a rival that could have innovated in the long run
  - ▶ It is easy to envision the potential perverse effects of an approach that forces firms to charge high prices in the absence of clear guidance on how to run it (Tirole, 2005)

# Antitrust Standard for Harm

- ▶ Federal Trade Commission
  - ▶ Concluded that Google had a business justification for its universal display that was not predicated on exclusion of competitors
  - ▶ No conclusion on market definition
- ▶ European Commission
  - ▶ Comparison shopping is a separate market from consumer search
  - ▶ Google's conduct had anticompetitive effects in the market for comparison shopping services
- ▶ Who was right?
  - ▶ EC got a workable remedy?
- ▶ Neither approach is a thorough analysis of welfare effects
- ▶ Is a thorough analysis workable?
- ▶ Long run innovation effects from Google's conduct are unclear
  - ▶ Excluding rivals or raising rival costs may harm innovation by rivals, but so do restrictions on product design and development

## Conclusions?

- ▶ Bundling/tying/product integration effects are complicated in the short run and the long run
- ▶ Alternative of unbundling can be costly and need not promote competition
- ▶ Exclusionary effects can justify heightened antitrust concerns for some industries
- ▶ Highly case specific
- ▶ Some support for interoperability as a pro-competitive remedy