



Briefing Paper

Competition Concerns in Cross-border E-commerce

Implications for Developing Countries

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Summary

This briefing paper summarises a study by CUTS International Geneva on “Competition Concerns in Cross-border E-commerce: Implications for Developing Countries” authored by Philippe Brusick, and presents typical competition related concerns faced by smaller developing countries and LDCs in their integration in global e-commerce. It highlights the challenges that these competition-related concerns lead to for developing country firms, and finally proposes some realistically implementable policy and regulatory responses at national, regional and international levels to assist smaller developing countries and LDCs deal with competition related concerns so as to maximise the benefits of digital economy for them and their trading partners.

Introduction

Digital economy is a major driver of economic growth, and can be a means to achieve development objectives of developing countries and LDCs. At the same time, rapid emergence of digital innovations characterised by big data, artificial intelligence, platform-based business models, multi-sided markets and network effects, present complex competition concerns with both pro-competitive and anti-competitive outcomes.

For example, leading online platform operators are conducting business across multiple product segments and covering several regions of the world. This leads to network effects, whereby larger the platform, higher the value attached to it, wider the range of access and quicker the welfare and development of the economy.

Platform-based Business Models: Types and Overview of Value Chain

While there is no internationally accepted common classification of internet business models, the Mexican competition authority suggests three basic types of platform-based business models¹: (i) Subscription model, in which a supplier offers a service and a group of users pay a subscription to access it; (ii) Advertisement model, where services are offered to consumers free of charge and the platform gets revenue indirectly through advertisements; and (iii) Open Access model, in which the platform functions as a market, connecting suppliers of goods or applications with users who may or may not have to pay for the service provided.

Each of these business models has a specific supply-

distribution or value chain, i.e. the end to end process from where the transaction commences to where it finishes. Some key elements of the value chain include: (i) Supply of goods and services; (ii) Customer demand; (iii) Delivery of physical products; (iv) After-sales Service and Return of Goods.

Developing Countries and the Digital Economy: Pro-competitive Benefits

Among other pro-competitive benefits, the digital economy can support more efficient and cost-reducing distribution in developing countries. Indeed, suppliers may streamline their production-distribution chain, creating direct contact with final customers or through digital platforms, thus eliminating the need for certain types of intermediaries. Increased competition and lowering costs in the supply-distribution chain generally contributes to lowering prices and encouraging innovation.

Of course, online presence also enables reaching wider geographic markets, as a given website can be accessed free-of-charge by customers from all over the world. For consumers, this also means increased choice among more products, as well as better information about their quality and variety.

Digital Economy and Developing Countries: Key Challenges

Internet Connectivity

There are still many developing countries where internet penetration is weak. This along with other issues such as security in online payment systems,

¹ COFECE : COFECE (Mexico) : Rethinking competition in the digital economy <https://www.cofece.mx/wp->

limit suppliers' ability to sell online and consumers' access to e-commerce markets.

Cybersecurity

In smaller developing countries, at the current level of technological infrastructure, regulatory and legal environment across many regions has failed to protect transactions from hackers and cyber-threats.

Customs and taxes

There is uncertainty and lack of awareness of customs and tax rules among consumers and businesses. Tariff and non-tariff measures play out differently in different regions and exporters from smaller developing countries are at a disadvantage as they are aware of the intricacies of trade.

Disruption in the traditional brick-and-mortar commerce

Brick-and-mortar businesses such as travel agencies and retail stores suffer from competition from online platforms.

Barriers to market entry

There are difference in prevalence of these barriers to entry between brick-and-mortar stores and online markets. In e-commerce, the cost of making a new website accessible in a new location are relatively low, but the ability to spread marketing costs over a larger quantity of goods sold remains a constraint for online retailers.

Competition

While the digital markets-powered digital economy may foster competition and innovation through more products and market players, some of its

characteristics can also enhance the risk of certain anticompetitive practices. A typical concern is the prevalence of network effects whereby the size of a platform is a major competitive advantage. Already, established giant e-commerce platforms are starting to enter markets of smaller developing countries by rivalling, taking-over or merging with local firms and nascent platforms. Benefitting from already established reputation, network effects and market power, there is a risk that they quickly acquire dominant power on these markets.

Against this backdrop, this Briefing Paper summarises the main findings of a recent CUTS study², first identifying potential anti-competitive practices in e-commerce, before making srecommendations to addressing them, particularly from the perspective of developing countries and LDCs.

Anti-Competitive Practices: Abuse of Dominance

As in brick-and-mortar markets, dominant firms in e-commerce can engage in unilateral anti-competitive conduct by abusing their dominant position of market power in relevant markets in different ways, e.g. to exclude rivals and to exploit their market power.

In order to analyse the main unilateral practices which may constitute an abuse of dominance on digital markets, it is important to determine how to measure dominance in a given market.

Definition of Relevant Market

The traditional method of defining a relevant

² BRUSICK, P. (2018). Competition Concerns in Cross-border E-Commerce: Implications for Developing Countries. Geneva: CUTS International, Geneva.

market consists of determining first which is the relevant product market, and second, which are its geographical boundaries. Product market definition applies to both goods and services. For many competition authorities, defining the relevant market involves implementing the SSNIP (Small but Significant and Non-transitory Increase in Price) or hypothetical monopolist test. This test involves establishing whether a hypothetical monopolist in a given market could profitably raise prices by small percentage, such as 5% then 10% for a sustained period of time and investigate how consumers would react. With 5% increase, some might shift to another product, say from soft drinks to water bottles, with a price hike of 10% on both, people might switch to beer. Hence, the relevant product market may include beer, water bottles and soft drinks.

However, the SSNIP test has been evolved to test traditional products. They are usually not applicable to dual or multi-sided platforms, such as platforms that link different markets which interact with each other. Competition authorities therefore face challenges in deciding whether to define separate relevant markets on each side of a given platform, or one relevant market comprising all sides of a multi-sided platform.

Determination of Dominance

In general, a wide definition of relevant market will provide an escape route for firms as their share of the market and relative market power is more limited in such case, while a narrow definition of relevant market, closely related to the incumbent firm's activity, will more easily result in determining dominance by a competition authority.

EU Competition law defines dominance as relating to a position of economic strength enjoyed by an undertaking, which enables it to prevent effective

competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers.

In the digital economy, the pace of innovation is such that companies having acquired market power during a given period of time may be completely displaced by others and their disruptive innovations. In assessing market power in e-commerce markets, competition authorities should therefore also consider long-term dynamics of markets in addition to static market share analysis. This would require them to consider potential competition by online rivals which may be defined at present as outside of the relevant market, but which can still impose a competitive constraint on the incumbent as potential entrants.

Examples of Dominance-related Anti-Competitive Practices

Predatory pricing

In traditional brick-and-mortar single-sided markets, as well as online single-sided platforms, pricing below average variable cost is considered predatory pricing, which is outright prohibited in many jurisdictions. In multi-sided online markets, below-cost or zero-pricing on one side of the platform is a common strategy employed by most online firms to attract users on another side of the platform, who in turn are attracted by network effects.

Refusal to deal

Refusal to supply or to purchase is a common business practice, occurring for example in exclusive or selective distribution, whereby some distributors are selected at the exclusion of others, with whom the manufacturer or wholesaler refuses to deal.

Refusal to deal may also occur with respect to essential facilities, where for example, the incumbent telecommunications firm who owns the lines refuses to provide access to its network to newcomers in the market, or at least fix exorbitant interconnection prices. Within e-commerce, refusal to deal might arise with respect to: (i) access to online marketplace under exclusive or selective distribution; (ii) access to physical delivery networks, developed independently by larger e-commerce retailers such as Amazon, which allow lower cost delivery as a result of economies of scale; and (iii) access to big data on consumer habits, generated by large multi-sided platforms, which allows profitable targeting to customers based on their past consumption habits and preferences.

Tying and Bundling

Tying refers to a vertical restraint, whereby the supplier requires the purchaser to purchase additional goods or services, as a precondition to purchase a given product. Bundling occurs where products are sold jointly. “Mixed bundling” is a situation where both bundled and separate items are available, generally with a quantity rebate for bundled products. Tying and bundling are not anti-competitive if the customer can easily switch to a competitor when faced with it. However, if the supplier holds market power or a dominant position, it might not be easy to switch to another supplier. The firm might be using tying and bundling to extend its dominance in one market to another market which would otherwise be competitive.

Excessive pricing and margin squeeze

Dominant firms have the possibility to impose higher than competitive prices on their customers and thus to extract higher revenues from them. In the same way, if an online multi-sided platform is

dominant or has sufficient market power, it can squeeze its independent suppliers who depend on it to access final customers through its retail stores or e-commerce platform by fixing high access prices while imposing low retail prices, thus squeezing their supplier’s margin.

Other Anti-Competitive Practices

The advent of internet shopping platforms allows consumers to quasi-instantly perform ‘window shopping’ worldwide and make informed choices among an endless list of goods and services. In the same way, businesses can also easily and instantly access price/quality information about products by potential competitors. This is further facilitated by price comparison websites. While price transparency is useful and pro-competitive for consumers, it may also serve anti-competitive bias of businesses, increasing potential collusion and facilitating the use of resale price maintenance.

Horizontal Restraints

Hard-core cartels

Horizontal price-fixing, market allocation and bid-rigging cartels are generally considered to be most harmful, and therefore the most strictly sanctioned anti-competitive practice. Uncovering hard-core cartels and collecting required evidence in order to sanction collusion is one of the most challenging tasks of competition authorities. In e-commerce, computer algorithms may serve to facilitate information exchange by monitoring cartel activities. Competition authorities treat algorithms as mere intermediaries to the ‘per se’ illegality of the agreed-upon actions of human agents and direct their enforcement action accordingly.

Hub-and-spoke collusion

The hub-and-spoke cartel is another form of horizontal collusion that may take place through parallel vertical restraints. The collusion is coordinated by e-commerce platforms (acting as the 'hub') which ensure that various suppliers and distributors ('the spokes') follow identical practices in their vertical transactions with their customers. This renders horizontal collusion unnecessary and is more difficult to detect. In order to challenge hub-and-spoke cartels, competition authorities have to uncover sufficient evidence of horizontal coordination by an e-commerce platform arising from the vertical restraints detected in the market.

Tacit collusion

As algorithms increase capacity to collect and analyse large amounts of data in no time, they allow competitors to automatically adjust to price changes and new business strategies, and thus tend to favour parallel behaviour or 'tacit collusion'.

Each firm operating through their pricing algorithm might reach similar pricing conclusions that are not explicitly negotiated among them. However, the fact that each firm is aware of the use of similar pricing algorithm by others that result in tacit collusion could in principle be prosecuted on the basis of anti-competitive intent of the competitors. This would require convincing circumstantial evidence, which is difficult to establish.

Vertical Restraints

Exclusive and selective distribution

Exclusive distribution refers to a vertical arrangement whereby a manufacturer agrees to sell its products exclusively through a single distributor within a given territory. Selective distribution would imply a vertical arrangement whereby a

manufacturer fixes a specific requirement for admission to its distribution network.

With rapid adoption of e-commerce, suppliers have increased the use of selective distribution channels, often including 'internet addendums' for online sales, such as obligations for retailers to maintain approved websites of specified standards and to prohibit certain functionalities, such as price comparison websites.

It is important to note that both exclusive dealing and selective distribution arrangements are perfectly normal business practices which are very commonly found in both offline and online markets. It is only in limited cases, including resale price maintenance and especially when the supplier can be found to abuse a dominant position of market power, that competition authorities may oppose these practices.

Resale price maintenance (RPM)

RPM is a form of vertical restraint whereby manufacturers or wholesalers impose restraints on resale prices or on sales conditions by retailers, something that is frowned upon by competition authorities.

By banning any possibility of discounts by the retailer, RPM constitutes the most evident barriers to intra-brand competition. Indicative price recommendations have albeit been seen as acceptable, so long as there is no attached obligations as such. However, critiques suggest that recommended prices inevitably induce distributors to tacitly align to the recommendations for fear of retaliation, and hence still may limit intra-brand competition in the same way as outright RPM.

In e-commerce, some brands may want to ensure quality brick-and-mortar stores and affiliated specialised services, and hence impose online sales

ban. Businesses may therefore argue that without such downstream restraints such as RPM and online banks, their competitive edge may erode. This would then require evaluation based on rule of reason on a case to case basis, such as in the US.

Dual online/offline pricing policies

The issue of dual pricing whereby a supplier charges different prices for online compared to offline distribution channels can become anti-competitive. While arguably dual pricing might aim at compensating for free-riding, such policies might negate the pro-competitive advantages associated with ecommerce by raising online retailers' cost and dissuading them from using online sales channels.

Price discrimination

A new feature arising from the rapid use of algorithms in e-commerce, is the fact that businesses are now able to get detailed information on the habits and preferences of customers, including their ability to pay. Businesses are thus increasingly able to individualise their pricing policies, capable of fixing different prices for the same products according to individual customer. While price discrimination can be pro-competitive by offering lower prices to less solvent customers, thus increasing overall sales revenues, businesses might do the reverse, by offering lower prices to higher income individuals, depending on the amounts this discount in prices would allow them to reap additional revenues.

Recommendations

In order for policymakers and regulators from small developing countries to be better prepared to address some of the competition-related concerns discussed above, the following policy recommendations can be made:

- Regional Trade Agreements (RTAs), including among developing countries can be employed to develop good practices, rules and collaboration among national competition authorities on competition-related issues in the digital economy.
- Transnational reach of e-commerce platforms would play a crucial role in ensuring growth and market reach. As more advanced developing country markets gradually start to be saturated, e-commerce platforms of developed countries reach less developed and smaller developing countries, in search for future growth. Hence, competition authorities should be equipped to ensure regulation of competition and taking effective remedial action.
- Lack of preparedness of smaller developing countries leaves them unprepared to face challenges posed by the new digital economy. Urgent action is required to be taken to build capacities of their competition authorities in order to tackle the problems.
- It is imperative to understand that competition aspects of e-commerce do not play in isolation. Various others national and regional regulations related to e-commerce affect the anti-competitive behaviour of an entity. For example, taxation law of a state directly affects the revenue stream and disclosure of information by an e-commerce entity. This has immediate effect on competition aspects, such as market dominance, cartelization, or price discrimination. Hence, for Competition Authorities (CAs) to investigate efficiently, they should make coordinated efforts with other regulatory bodies affecting activities of the e-commerce entity.

- Developing countries can come together to formulate guidelines or standards that can be adopted by each state, granting a margin of appreciation to states, according to their development needs. This could take shape in the form of Code of Good Practices. UNCTAD is working in this direction with its ‘Intergovernmental Group of Experts on E-commerce and the Digital Economy’.
- There is an urgent need for more information-sharing and collaboration among CAs while preparing the ground for a possible multilateral instrument in this respect. Indeed, the lack of consensus on competition enforcement in e-commerce potentially leaves room for anticompetitive cases to be treated differently by different jurisdictions.
- One of the most important highlights of this CUTS study is to upscale capacity building in smaller developing countries. A non-negligible number of developing and LDCs do not have such laws, or their laws and enforcement are inactive. Smaller developing states need to be guided by trial and error of developed countries, but also keep close contact with developing countries having more experience in competition field. Relevant international organisations and development partners should also prioritise targeted capacity building assistance to CAs of smaller developing countries and LDCs.
- For potential e-commerce exporters from smaller developing countries, there is a need for consensus-building and coordinated action first at national and regional levels, and preferably at multilateral level. Civil society institutions active in promoting competition law and policy in developing countries (like CUTS) should be supported to organise training and capacity building programmes in the field of competition in the digital economy.



CUTS International, Geneva

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