

# Oligopolies

Damien Neven, Chief Economist\*  
DG COMP, European Commission

\*The views expressed are those of the authors and do not necessarily reflect those of DG COMP or the European Commission

# Introduction



- n Oligopolies extract market power
  - In the presence of capacity constraints and significant market shares
  - When firms control a sufficiently large number of close substitutes (mind the gap)
  - When firms coordinate their behaviour through repeated interactions
- n Networks of contracts
  - Prices contingent on those of competitors
  - Roaming
  - Distribution of online music
  - Information exchange

# Contingent prices



- n Price matching clauses
- n Commitment to sell all products at the lowest price that a consumer can find in competing outlets
- n In the context of coordination
  - Enhance detection
  - Commitment to respond aggressively
  - But contracts needs to be widespread
  - Typically found in retail sectors (coordination unlikely ?)
- n Price discrimination
  - Active buyers use it to obtain rebates
  - Passive buyers pay high prices
  - Not widely used...

# Contingent prices



- n Signalling to uninformed consumers
  - By low cost retailers
  - High cost would not do it as it would induce the informed consumers to obtain the prices of low cost retailers
- n Most favoured customer (commitment to reimburse current purchasers if the price falls)
- n Makes deviation more costly (low prices apply to past buyers)
- n But it is not clear that firms would want to adopt it ex ante
- n Meet or release clauses
  - Reduces the incentive to cheat : customers attracted during a deviation will be able to obtain low prices during the punishment phase
- n Overall : probably only a relatively minor + factor in the context of coordination

# Roaming



- n Provision of mobile services to foreign operators
- n Perception that both wholesale and retail price are high
- n In the early days : no traffic direction techniques
- n Each host network is « an essential facility »
- n With traffic direction techniques, local hosts could compete
- n But initially did not..

# Roaming



- n High prices can be sustained by a network of contracts such that
  - Contracts are bilateral
  - Operators commit to offer the same contract to all foreign hosts
- n In equilibrium, all contracts feature high wholesale prices
- n High costs are supported by high revenues in the other direction
- n And largely passed on to the final consumers
- n Prices started to fall when some operators acquired foreign networks

# Roaming



- n Do we have the appropriate instruments ?
- n Contracts have a vertical dimension but it is not the only essential feature that allow for the extraction of market power
- n Collective dominance under Art 82 (the web of contracts is a « structural link »)
- n Under Art 81 ?
  - With a collective dimension but outside the framework of coordination
  - With both horizontal and vertical components

# Distribution of on line music



- n iTunes is a common (distribution) agent for all majors (60 – 70 %)
- n Common agents affect the incentive to undercut rivals
  - Principals fix the final price
  - The agent has a franchise contract; get all revenues in exchange for a fixed fee
  - Consider a contract by one firm; collusive price and a fixed fee (corresponding half the monopoly profit)
  - Incentive for its competitor : undercut ? It will reduce the profit of the agent – and the agent's profit is effectively his own profit through the fixed fee. Best reply is the monopoly price

# Distribution of on line music



- n Agent effectively suffers the external effect associated with competition
- n Works if prices and contracts are set at the same time ; which is the case for on line distribution of music
- n iTunes gets the full benefit of its effort, in terms of higher sales of a complement (i pods)
- n Rents are extracted by the majors
- n Competition between multiple common agents ?
- n Application to joint ventures

# Information exchange



- n A number of recent cases in members states
- n Palaces Parisiens
  - Information exchange prohibited almost per se
  - Exchange of information on occupancy rates and average price per room
- n Iama (Italy)
  - Database of public information on insurance contracts
  - Distinction between data in the public domain which known or unknown
  - Available to consumers, large number of companies
- n Fedicine (Spain)
- n Private schools (UK)
  - Details of current fee levels and future plans
  - In time for the annual round of price fixing What is the "right" MIF, in the presence of platform competition ?
- n Supermarkets (Norway)
  - Exchange of very detailed prices weekly
  - With a 5-8 days delay

# Information exchange



- n Ex ante to establish a focal point
  - But transparency can be useful for buyers
- n Ex post to monitor deviations
- n But an exchange of information is a commitment to renegotiate
  - which makes deviation more attractive in the first place
- n And current information can also be used to improve the design of deviation strategies (old data may be more harmful)
- n In the absence of coordination, incentive to share information is unclear (improves the design of strategies but also those of competitors)
- n Information exchanges are probably often harmless but yield little benefit
  - Only as part of wider "coordination" case ?
  - Exceptionally ex ante ?

# Conclusion



- n Networks of contracts
- n Central coordination
- n Signalling in auctions