

Price Coherence in Online Platforms – Impact and Responses

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Online platforms often assist consumers in finding goods and services, and sometimes add trust or reputation features that facilitate commerce, but the costs of these platforms are frequently concealed. In particular, consumers often find that the posted price for a purchase through a platform is the same as the price if purchased directly from a seller. This is not mere happenstance—often, platforms explicitly require sellers to sell through the platform at the seller’s lowest available price, even if the seller pays the platform’s significant fees to be included. In joint research, we have examined the problems that these requirements can create.

Consider buyer incentives when fees are structured in this way. Ordinarily, a buyer would compare the benefit of a service (here, the platform’s intermediation service) to the cost (i.e., its price), and the buyer would only buy the service if its benefit exceeds its cost. But here, the cost is paid by the seller. So, a buyer compares the benefit to zero. Platforms almost always provide positive benefits to buyers, so a buyer usually finds it advantageous to buy through a platform. Nonetheless, the benefit to the buyer may be small relative to the fee the platform charges the seller. One natural result is overuse of platforms: transactions flow through the platform although (considering the true costs and benefits) this practice is inefficient. If the cost were truly borne solely by the seller, buyers might not care—but, in practice, sellers increase their prices to cover intermediation expenses. Then all buyers end up paying higher prices, whether they buy directly or via an intermediary.

One need not look far for evidence of these distortions. Airlines often pay \$3 per segment for the services of an online travel agency. Buyers may find it convenient to buy through Expedia, but if they had to pay \$12 extra to do so, it seems many would buy direct instead. Similar problems arise in hotel booking, payment cards, various types of insurance and financial services, and more.

In our paper “Price Coherence and Excessive Intermediation” (Quarterly Journal of Economics 130 no. 3 (2015), pages 1283-1328), we provide a formal economic model of markets with this structure. We begin by showing how the rational actions of each party create an inefficient equilibrium. We then demonstrate that competition between intermediaries does not fix the problem; to the contrary, it intensifies the distortions and widens the circumstances in which these problems occur.

It follows that rules that prevent sellers from offering lower prices on one platform than another are the most problematic. Such rules distort competition between platforms without clear offsetting benefits.

Effects are less clear-cut for rules that prevent sellers from offering lower prices directly compared to prices on platforms. Platforms sometimes justify these rules by noting the problem of showrooming, the

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possibility that buyers would find the best deal using a platform, then switch to a direct purchase to enjoy lower prices or avoid platforms fees. Showrooming could prevent platforms from charging fees, possibly resulting in platforms not being viable. Moreover, if platform competition was effective, competition among platforms would prevent platforms from charging excessive fees to sellers, and prohibitions on discounts for direct purchases then would not raise competitive concerns.

On the other hand, if platform competition is not effective, direct purchases may be the mechanism that can best discipline a platform's fees. Moreover, the prospect of direct purchases need not lead to platforms shutting down. If a platform can provide buyers with sufficient benefits from completing transactions, the platform can charge fees to cover its costs. Even if buyers pay those fees directly, or even if sellers pass on those fees through higher prices when buyers purchase on the platform, buyers will be willing to pay those fees in order to get the platform's benefit. Moreover, the Internet allows platforms to operate at surprisingly low cost, and to cover their costs through other revenue sources such as advertising or ancillary services. In addition, if showrooming proved to be a major problem, platforms could use an alternative model to avoid the problem, such as charging only listing fees (as opposed to fees per conversion), so that sellers have no reason to steer business towards direct sales. On the whole, our instinct is that most platforms could and would continue to operate even if they could not prohibit sellers from offering lower prices for direct purchases. We note, for example, that Amazon lifted its best-price requirements on sellers on its U.K. website, but still seems to be operating effectively there. Likewise, online travel agencies (Expedia, etc.) continued to attract customers even when they charged booking fees, often of \$7 or more, for each ticket, whereas airlines' own sites charged no such fees. On the whole, then, our instinct is that prohibitions on discounts for direct purchase also tend to be harmful on net.

Our paper discusses a variety of possible policy responses to the problems outlined above. Let us offer a general suggestion here: Competition regulators should look critically at platforms which impose price coherence rules, be they called "most favored nation," "price parity," "guaranteed lowest price," or otherwise. Where such restrictions (and their de facto equivalents) discourage consumers from choosing cheaper platforms or migrating to direct purchases, these restrictions likely distort market outcomes and reduce welfare. Of course regulators will also need to look carefully at any offsetting benefits of platforms that are made possible because of these restrictions, such as assisting buyers in identifying sellers, facilitating price comparison, or adding important information or reputation services. Our sense is that in many circumstances, these offsetting benefits can be obtained without platforms restricting sellers' ability to lower their prices when they face lower costs.