

Position paper on CMA Digital Market Taskforce

Executive summary

The UK Competition and Markets Authority (“**CMA**”) seeks views from stakeholders on what kind of intervention, if any, is necessary to protect and promote competition and innovation in digital markets. This paper sets out Booking.com’s position on the proposed ex-ante regulation for gatekeeper platforms that has been proposed in various jurisdictions in one form or another (e.g. a code of conduct). We recognize that there are instances where ex-post competition law enforcement alone is insufficient in ensuring effective competition. This is the case when competition enforcement would take too long and there is a material risk that a market will be harmed irreparably in the meantime or when a market exhibits certain structural features (e.g. high barriers to entry) that make it incontestable for the foreseeable future. We support ex-ante regulation to complement competition law in these instances.

It is important to recognize that, unlike sectoral regulation, ex-ante gatekeeper platform regulations potentially need to be suitable to a wide range of sectors with different technologies, demand patterns and industry dynamics. This sets it apart from, for example, the telecommunications code, where the underlying technology is shared by all firms and fundamental features of the competitive environment are well understood. In contrast, within the so-called “digital economy” one finds vastly different business models, value chains, and incentive structures. For this reason, there always needs to be a thorough market analysis to decide if there is indeed a need for ex-ante regulation, if a company qualifies as a gatekeeper, and what remedies would be suitable and proportionate to address any potential competitive concerns. In this submission we focus on what we believe should be the features of a possible gatekeeper regulation. However, we also believe that the identified shortcomings of the existing competition law framework do not just apply to digital markets. We therefore favor a more broadly applicable and flexible ex-ante regulation tool. We also advocate that countries, in particular those in Europe, should closely cooperate to ensure a uniform approach towards ex-ante regulation.

I. The benefits of digital markets

The growth of the so-called “digital economy” has unleashed a wave of innovation and contributed to growth and economic dynamism. The total value creation enabled by the digital economy is impossible to precisely quantify and not captured by traditional GDP calculations, but in particular the consumer surplus created by access to information, increased choice, and lower prices for consumers are of enormous significance.

However, the reduction in distribution costs is also creating new challenges for consumers as their choice of transaction partners multiplies. Digital platforms are addressing exactly this problem, thereby reducing friction, search costs, and creating value for consumers. As Nobel Prize laureate Jean Tirole notes:

“The most significant transaction costs are no longer transportation costs, but rather assessing what is on offer and choosing who to do business with, along with the signalling costs. Our almost infinite sources of information, and the limited time we have to process and understand them, put intermediaries and platforms that help us find these partners at the heart of the economic process.”

Booking.com is a prime example. Spotting the enormous frictions inherent in traditional accommodation search and booking, Booking created a platform that helps users search, compare, and book their preferred accommodation, whilst giving accommodation providers an easy way to multiply their consumer reach, allowing them to increase utilization and improve the match between the accommodations product offering and customer preferences.

A study by Oxford Economics shows that the increase in transparency and the reduction in search costs that Online Travel Agencies (OTA) such as Booking.com bring to the UK market generated more than 13 million additional overnight bookings and impacted GDP by around 2,8 billion Euros in 2019. The study also illustrates the improved reach of accommodations, in particular for small and medium sized establishments: while 40 percent of the overall market is served by independent properties, the share of OTA bookings going to independent accommodations is 74 percent. Consumers also benefit substantially: the induced price reduction due to the increase in competition that OTAs bring to the market is on average 9 percent.

These benefits are widely recognized, including by our accommodation partners. According to a survey among SME hotels conducted on behalf of the EU Commission, “the cost opportunity of advertising via OTAs is positive. [Commission rates] are lower than the estimated marketing and IT costs necessary to ensure visibility on the market. Interviewees reported that without OTAs they would be unlikely to achieve a similar number of booked rooms.”

While the benefits of the digital economy are recognized, there is also concern that some markets with digital platforms are getting too concentrated and increasingly hard to contest.

II. The need for ex-ante regulation

A consensus is emerging around the world that there is a need for authorities and policymakers to take action to preserve the benefits that digitalization has brought to the economy and society. While expert reports commissioned inter alia by the European Commission, the UK Competition and Markets Authority, The Dutch Ministry of Economic Affairs, and the German Ministry of Economics all agree that the basic framework of competition law is principally well suited to deal with the challenges posed by the digital economy, there is also a recognition that there are instances when competition law reaches its limits.

In particular, in fast moving markets there is a risk that competition law enforcement takes too long in curbing abuse and that markets can be irreversibly harmed in the meantime. The Google Shopping saga is a case in point. There can also be structural limits to effective competition that will not be addressed by competition law alone because it presupposes an abusive conduct. For example, high barriers to entry might make a market non-contestable for a long time. For these reasons and in these instances there is a need for complementary regulation and we support the UK's and the EU Commission's initiatives to these effects.

Yet, regulation is a heavy handed tool. It is potentially very burdensome and it often stifles competition and innovation. It needs to be well targeted and in the case of online platforms take consideration of fast changes and technological developments. Indeed, as Peter Alexiadis and Alexandre de Streel point out in their much quoted paper on *Designing an EU intervention standard for digital platforms*: "Any new regulation should be proportionate and should not exceed what is necessary to achieve its objectives. In this regard, it is anticipated that ex ante regulation would only address the sorts of issues which competition policy cannot address effectively."

The Report of the Digital Expert Panel ("**Furman Review**") and the CMA's Market Study on Online Platforms and Digital Advertising ("**CMA Market Study**") propose to have some sort of regulation towards digital platforms that have gatekeeper positions and enduring market power. This is similar to the EU Commission's initiative for ex ante regulation which is exclusively geared towards large digital platforms.¹ The primary justification for this approach is that online platforms often benefit from direct and/or indirect network effects. These network effects can become so strong that a market tips very fast towards one (or a few) platforms and that once a certain threshold is crossed these network effects present a strong barrier to entry. According to the EU Commission's expert report, this difficulty to dislodge an incumbent digital platform is said to give "reasonable concern that dominant digital firms have strong incentives to engage in anti-competitive behaviour."

However, what is generically referred to as digital platforms is in fact a very heterogeneous collection of business models with different features and incentives. One cannot simply "read across" from one platform to another. Just because some platforms engage in problematic behavior, it does not mean all do. Incentives differ substantially from business model to business model. Platforms also do not equal relevant markets. Just looking at a platform in

¹ Specifically, the Commission's initiative is targeting "Large online platforms with significant network effects acting as gate-keepers in the European Union's internal market"

isolation will not reveal whether or not competition in a market is intact or at risk. It also needs to be noted that size is not a good indicator of a platform's likelihood to exhibit problematic behavior. Big does not equal bad.

III. The proper scope of ex-ante regulation

Regulation (including regulating companies in the form of a Code of Conduct) should only apply in those instances and to those platforms where there is a clearly identifiable competition problem and where competition law alone is insufficient in addressing the problem. Such a targeted approach is important in all European countries, as Europe is currently lagging behind the US and China in nurturing and scaling platforms. Regulation that is too broad and too rigid would further stifle the UK and Europe in this respect.

We therefore believe that three criteria need to be met for regulation to apply: there is a lack of effective competition in a market and it is unlikely to change, there is a loss of competition associated with the presence of a particular platform, and competition law alone is insufficient to deal with it. Only when these criteria are satisfied should certain additional and proportionate obligations be applicable to a platform.

We want to stress the importance of evaluating the need for regulation at the market level. Markets are "relevant to identify barriers to entry, which, in turn, are important to assess the market power of incumbent firms," as Peitz and Franck rightly point out. Moreover, the effect of a certain conduct can only be evaluated by its effect on the market. As has long been held, there needs to be an "appreciable effect" on competition for a conduct to be harmful. This cannot be inferred from looking at a single company in isolation.

In line with the proposal by Alexiadis and de Streel - and conceptually related to similar initiatives inter alia in the UK and Germany - the implementation of these criteria could take place via a three-pronged test. This test asks three sequential questions, all of which have to be answered affirmatively for platform regulation to apply. They are:

- i. Is there a non-contestable concentrated market structure?
- ii. Is the company in question a digital gatekeeper?
- iii. Is competition law alone insufficient in ensuring effective competition?

Having such clearly articulated criteria makes regulation less susceptible to generate false positives (i.e. finding an infringement when there is no harm to competition) while preserving the benefits of regulation, in particular speedy intervention. While there would still be some onerous responsibilities for the responsible authority - e.g. defining the relevant market, establishing competitive deficiencies - it would not have to undertake a full investigation with the burden of proving anti-competitive conduct. We believe such a system strikes the right balance between enabling timely intervention, and avoiding over-regulation.

Let's take a closer look at these criteria.

Non-contestable concentrated market structure

Online platforms are generally characterised by the dynamic environment in which they operate. The dynamics can vary enormously. As the COVID-19 crisis has shown very clearly, not all markets with platforms are created equal. Google, Amazon, Apple, Facebook and others saw their business carry on largely unaffected or revenues even increasing. Others, including OTAs in the accommodation market, saw their revenues decline in line with the demand decrease in the underlying markets. For example, Booking.com saw reservations fall by 85 percent in April 2020. This shows that some companies have become so central to everyday (economic) life that they can act independent of consumers, suppliers and competitors. If some of their consumers or suppliers leave the platform or see their business decline, it does not matter because others will easily make up for it. In other industries, the fortunes of consumers and of supply chain actors are more intimately tied to each other.

One of the most important features that differentiates markets and affects the dynamics of competition is contestability. Some markets are characterised by high barriers to entry, others see regular entry and exit. It is important to take these differences into account when deciding upon which markets should be subject to ex-ante regulation. Taking the accommodation market as an example, below we show how entry barriers differ substantially from one sector to another and how this shapes the environment for platforms.

High barriers to entry make a market hard to contest and can lead to a concentrated market structure. In particular, network effects have been identified as a barrier to entry in the digital economy and as contributing to market concentration. This is why the Furman Review, the CMA Market Study and the EU Commission's proposal for ex ante regulation focuses on platforms with significant network effects. This focus is not unjustified given the high coordination costs for consumers to overcome the pull of network effects. As Hal Varian, who later became chief economist at Google, argues from a company's perspective: "[p]recisely because various users find it so difficult to coordinate to switch to an incompatible technology, control over a large installed base of users can be the greatest asset you can have."

However, the presence of network effects alone is insufficient as an entry barrier. One also has to take into consideration what other options are available to consumers (and businesses) and whether or not they are being used. Such multi-homing is particularly important because it mitigates network effects and means that there are low switching costs between platforms and other sales channels.² If users multi-home, it shows that they are not locked in and can freely choose the channel that offers the best matched service (or price) for the task at hand. With multi-homing a market is unlikely to tip and entry is easier because users are not tied to any one service. A market with multi-homing is likely to be contestable.

Booking.com and other OTAs are characterized by multi-homing on both sides of the market. In fact, specialised distribution channel management software is used by many hotels to coordinate their offers across a multitude of sales channels (for which Booking.com provides a free API). For example, many accommodations sell through their direct channel,

² Customers/suppliers are said to multi-home, when they use more than one channel; they are said instead to single-home if they use only one platform/channel to make/decide on their purchase of a product and/or service.

travel merchants and on booking platforms and use multiple booking platforms to generate room occupancy. Suppliers are very flexible in adjusting the allocation of rooms. The allocation can be changed granularly (e.g. per room per night) and often almost real time. This allows suppliers to directly adjust the availability of rooms between the direct channel and (various providers of) booking platforms. Customers equally use a multitude of booking channels. For example, for a single booking a customer can visit several booking platforms, use a meta search site, a hotel's direct website or a general search engine site like Google (which even offers a full OTA booking capability).

Another possible entry barrier that is considered important in the digital economy are economies of scale and scope. Economies of scale arise when the marginal cost of producing another unit (of service) decreases with production volume. In many online services these costs tend to approach zero (e.g. the cost of one more customer searching on Google is negligible). However, the same does not hold true for Booking.com as we have important variable costs - e.g. customer acquisition costs, partner services, consumer services - that rise with increasing transaction volume on our platform. This is not to say that we do not benefit from some scale economies. However, it is of a different magnitude as other platforms.

Economies of scope arise when a joint production of goods and services is more efficient than doing it stand alone. In the digital economy this is often related to the joint usage of data. For example, a platform selling hotels and flights might be more efficient than two individual platforms selling just either one. The reason is that some consumers might want to purchase both products and a platform can use the data it collects on one product to drive sales of the other product (e.g. showing someone who purchased a business class flight only upscale hotels and thereby improving the likelihood of a match). However, in the travel sector this does not necessarily constitute a barrier to entry because data on travel intent is widely dispersed. Consumers use OTAs but also specialized travel agents, online travel magazines (or increasingly Instagram) with affiliate links, hotel chain websites, and many more. All of these channels provide high quality data points on travel intent for stand alone services that render economies of scope to only a marginal advantage. In addition, there is Google which has a much broader set of data points on any given customer to infer travel intent than any other platform and which sells these customers to the highest bidder.

It is also important to look at market characteristics in detail. For example, the EU Commission mentions zero price markets in its inception impact assessment as a feature that can make markets harder to contest. At first glance, this might seem to apply to Online Travel Agencies (OTAs), such as Booking.com, because consumers are not explicitly charged for using the platform. However, as accommodations include commission fees in the rates offered to consumers and rates can and do differ across distribution channels, there is in fact an implicit price to consumers. The fact that Airbnb was successfully able to enter the market even though it explicitly charges consumers a fee for the use of its platform (and a correspondingly lower fee to accommodations) shows that the price structure does not matter as the incidence is on consumers in any case.³ This is substantially different from platforms like Google where there is indeed no charge to consumers.⁴

³ In fact, absent price parity in the market, OTAs are technically not multi-sided platforms according to the definition in the economic literature because they can only affect the price level but not the price structure.

⁴ Setting aside the debate whether or not consumers "pay" with their data.

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These low entry barriers have led the accommodation market to become a very dynamic place where the competitive environment changes continuously due to shifting consumer demand, business model innovation, and technological advancement. The market is highly fragmented and there is constant entry to the market (as well as exit). This makes a static approach to the competitive environment difficult, just as it is extremely difficult to predict what the competitive landscape will look like in the near future.

An example is the disruption that Airbnb brought to both the accommodation market and accommodation intermediaries. Starting a new consumer segment, Airbnb has grown into a clear competitor of Booking.com. In addition, Google has scaled its travel initiatives since 2012 and has developed full OTA booking capability. Amazon has also been flirting with entering the travel market and has already launched the offering of flights in India. Leveraging its strong base in China and favorable financing condition, TRIP.com has expanded to Europe. In fact, online distribution has become so contested that specialized trade media has called it “the booking wars.” These dynamics are particular to the accommodations sector and quite different from other markets. For instance, the last successful entry into the general search market in Europe took place when Google replaced Altavista 20 years ago.

It is also noteworthy, as Harvard Business School professor Thales Teixeira has argued, that it is not primarily technology driving most disruptions today. Consumers are. This is particularly true for the accommodations sector. As Teixeira points out: “Airbnb didn’t disrupt Four Seasons Hotels. Customers did - by changing their behaviors to satisfy their evolving desires. Travelers wanted family spaces beyond bedrooms. They wanted authentic travel experiences. Airbnb [...] simply managed to deliver more completely and quickly on those requests than the dozens of global hotel chains around the world.” It is important to understand that Four Seasons and others did recognize this shift that was taking place in consumer preferences. In fact, hotels had a wealth of data on consumers, they spotted the right trend early on, they had vast financial resources to create new products and millions of customers to which they could easily market their product. Yet, it was the new entrant that succeeded because it created a better product and customer experience. This shows that in highly dynamic markets there is little incumbency advantage. A better product will triumph over other factors.

These examples from the accommodation market show that it is important to have a thorough understanding of the relevant industry dynamics, the role of technology, consumer trends and what drives purchasing decisions. Without such an analysis it is impossible to determine whether or not a market is contestable. The presence of network effects or scale economies alone is insufficient to draw any conclusions. Market dynamics differ substantially from one sector to another even if platforms all have certain common characteristics. Regulation should only apply to those markets that suffer from an uncontestable concentrated market structure that allows platforms to become gatekeepers.

Digital gatekeeper

The second part of the test asks if the platform in question is a digital gatekeeper. Traditionally, a gatekeeper has been seen in competition economics as a “strategic bottleneck” that guards access to one side of its platform which primarily single homes. However, this criteria alone is insufficient because it does not rule out a niche platform of only

limited importance. As argued above, regulation should target significant risks for competition and this requires a certain minimum threshold of sway over markets.

Furthermore, the problem description in the CMA Market Study correctly states that what sets gatekeepers apart from other platforms (and simply dominant firms) is their ability to control not just one market but entire ecosystems of unrelated markets (e.g. an operating system and a streaming service): “platforms can use ecosystems to protect their most profitable services from competition. If platforms can convince consumers to stay within their ecosystem, a new entrant would need to compete on many fronts to displace them. In addition, by gaining control of certain adjacent markets (for example, browsers and operating systems for Google), platforms can control the entry points to their core markets. Further, where the adjacent market may impose a competitive constraint in the future (for example, specialised search and display advertising for Google), controlling it can insulate the platform from the future threat of competition.”

Since leveraging advantages, such as access to large amounts of data by which a company can improve or develop new services in unrelated markets are potentially very harmful and leave consumers with little choice, it makes sense to focus regulation on such platforms that hold sway over broad ecosystems.

We therefore propose for gatekeeper platforms to have to satisfy two cumulative criteria:

- 1) due to the market conditions it holds sway over a significant share of private and business users
- 2) it has the ability and the incentive to expand its activities to new and unrelated markets in an anti-competitive manner

The first condition captures the traditional gatekeeper function in that a platform needs to hold sway over a significant number of users that have little other choice. The terms of reference for the EU Commission’s support study and academic literature (e.g. Franck/Peitz: *Market definition and market power in the platform economy*) have laid out quantitative and qualitative criteria that could be employed to identify such market power. We believe the following indicative criteria could be useful for such an analysis:

- market significance (e.g. user shares relative to potential market size/market share of transactions/time spent on platform/unique users/unique visitors – depending of type of platform)
- third parties’ turn-over realised on a platform
- strength of network effects
- degree of single homing
- switching costs

These criteria are not cumulative and it will take the judgement of the relevant authority to employ the right criteria in the right circumstances. For example, for a social media platform it might be adequate to look at time spent on the platform relative to other attention markets to approximate its significance. For a marketplace, it would be more appropriate to look at its shares of overall transactions in the market to identify its significance.

The second condition reflects the conglomerate nature of digital gatekeepers. In digital markets, when platforms have acquired a large customer base in a first market, they may adopt an envelopment strategy to expand. Leveraging their sway over certain groups of users (see second condition) they are able to expand their market power into new parallel markets in such a way that even as efficient competitors could not compete (e.g. through bundling, self-preferencing, cross-subsidization). This might be motivated by a desire to expand revenue sources or to protect its core market from potential competition arising from a different market. It is hard to formulate exact criteria to identify these negative conglomerate effects a priori.

However, as Cristina Cafferata and Fiona Scott Morton have argued, looking at companies business models is a good starting point. Different business models have different incentives for abuse. This is tied to a company's ability to appropriate rents in its value chain. Cristina Cafferata points out:

“At a very high level, advertising-funded “super-aggregators” that are free to users raise legitimate questions both around exclusion (because their predominant incentive may well be to colonise and expand in order to protect their position from future threats, and extract larger advertising rents) as well as exploitation (because even in a static sense, once a position of strength is achieved they wish to extract greater rents). Platforms that rely on businesses built ‘on top’, monetising through the sale of devices or commissions, and ‘match making’ platforms, may create less of a concern around exclusion as they may have less of an incentive to exclude complements both statically and dynamically.”

A useful distinction might therefore be the one employed by the German Bundeskartellamt which distinguishes between matchmaker platforms (transaction and non-transaction based) and attention markets. In general, matchmakers, and in particular platforms that can observe and monetize every transaction, will have a lot less incentive to engage in abusive conduct than those that have to monetize indirectly. Indeed, Google's self-preferencing of its own verticals can best be explained by its (imperfect) inability to monetize the value it creates with general search. Regulators should take these differing incentives for abuse into account when deciding on the scope of regulation. If there is neither the ability nor a strong incentive to engage in anti-competitive leveraging, then regular competition law suffices.

Finally, we also note that the problem the CMA seeks to address is one that transcends borders. We therefore urge the CMA to stay in close dialogue with Europe and other countries around the world to ensure that a uniform and consistent solution is pursued. This prevents that companies would need to consider diverging legal approaches to the same problem, which would lead to excessive compliance costs and ultimately consumer harm.

Effectiveness of competition law

The final part of the proposed three-pronged test ensures that regulation is indeed necessary because competition law alone will not be effective in ensuring competition. This is in effect a fail-safe condition. Regularly, when the first two parts of the proposed test are met, it will be appropriate to apply ex-ante regulation. However, this part forces the appropriate authority to check if there are less burdensome options available to remedy any competition concerns

arising out of the analysis. In particular, competition law alone will not be sufficient when remedies cannot be imposed in a timely manner or there are structural impediments to competition, e.g. a non-contestable market structure (see condition 1).

IV. The substance of ex-ante regulation

The substance of ex-ante regulation should build upon the existing body of economic knowledge and established theories of harm. The principle should be that gatekeeping platforms established under the three-pronged test face certain conduct limitations, according to the procedure in Section V. below, unless they can prove these activities are pro-competitive or welfare efficiency enhancing. Such a limited reversal of the burden of proof is in line with other recent proposals, e.g. the German competition law draft, and recommendations of various expert reports, e.g. the EU expert report. It also corresponds to option 3a of the EU Commission's inception impact assessment on gatekeeper platforms. Such a system also ensures that pro-competitive conduct can take place through recourse to a justification mechanism.

In our opinion, the main focus of ex-ante regulation should be on recurring harmful business practices. This applies in particular to self-preferencing of vertically integrated platforms. Gatekeeper platforms, in particular vertically integrated non-transaction platforms, can have an incentive to leverage their market power unfairly from one market to another to exclude rivals, e.g. by giving preferential treatment to one's own products and services. Self-preferencing is at the heart of a majority of recent competition cases involving digital platforms. It thus fits the criteria of recurring anti-competitive business practice.

However, it is important to stress that self-preferencing is not per se an abusive practice, even by a gatekeeper platform. There always needs to be a careful analysis to determine whether the facts of the particular case warrant the presumption of harmful conduct. For example, a vertically integrated platform might give preference to its own lower priced products vis-a-vis downstream competitors. Such a conduct might well be consumer welfare enhancing, even if it is to the detriment of competitors.

Further, in line with the German proposal, we believe that it should be a two-step process. First, the CMA would find a platform to be a gatekeeper. Second, it would impose certain behavioral limitations from an enumerated list, if there is a substantiated belief that it is anti-competitive. This means the restrictions would not apply automatically and not all of them have to be imposed. This is owed to the fact that platforms differ vastly and obligations should be proportionate to the deficiencies determined in the analysis under part III. There should also be the option for a gatekeeper platform to voluntarily notify business practices that are on the enumerated list to get clearance from the CMA. Obligations imposed by the CMA should be time limited and the CMA should be under an obligation, on application of the platform in question, to re-assess them if market conditions have changed. This is specifically important when taking into consideration the dynamic nature of the environment in which online platforms function.

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Since there is no finding of abuse, all obligations need to apply ex nunc and no fines could be retroactively imposed for past conduct. Of course, this leaves open the possibility of a regular infringement procedure for breach of competition law for past anti-competitive behaviour.