

Loyalty discounts: Brazilian experience

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Hypothetical case

- Facts
 - Firm A sells for US\$ 100 the product y but offers a 20% discount to ‘loyal’ consumers.
 - A consumer is eligible to the discount (i.e. to be named ‘loyal’) if he/she comply with a behavioral threshold: to buy 100% of his/her needs from Firm A.
 - Firm A is prosecuted. Subject of investigation: loyalty discounts.

Loyalty discounts

- Why should we be concerned about “discounts”?
- Discounts may be too large.
- But what is the problem with lower prices? May be they are too lower (i.e. predatory pricing).
- Should we follow predatory pricing standard of proof?

Consequences of the 'discount' perspective

- Price and cost comparison
- In predatory pricing the consequences of false positives (Type I errors) are particularly harmful to society. Allowing too much false positives would probably induce firms to refrain from fierce competition.
- Consequence: standards and burden of the proof are such that mitigate false positives at the expense of false negatives.
- And the same would happen with loyalty discounts investigations.

But let us reframe the problem

The very same facts:

- Firm A sells for US\$ 100 the product y for uncommitted buyers and for US\$ 80 for those who buy 100% of their needs from firm A.
- 20% *discount* for loyal consumers or 25% of *penalty* for uncommitted ones?
- The key issue is discrimination and the *incentives* for a particular behavior

The incentive perspective

- Incentives are widespread business practices. The key issue for competition policy is to focus on that *particular behavior*.
- In the hypothetical case:
 - ‘buying 100% of their needs’ = not buying from rivals (*de facto exclusivity*)
 - Analogous to exclusive dealing (*de jure exclusivity*)
- Concern: market foreclosure and raising rival costs
- Consequences: vertical restraint

De facto exclusivity vs *de jure* exclusivity

- Exclusive dealing:
 - allocation of the right of choosing from whom to buy (ex-ante decision)
 - Easier to observe (transparent) and to access the extension of the conduct
- Loyalty discounts (with exclusivity threshold):
 - Incentives for not buying from rivals (ongoing decision)
 - More flexible (adjustable to short run shocks) and allows for more discretion
 - Exclusionary effect depends on the strength of the incentive

Incremental Price

$$p(x^*) = p(x^* - \alpha x^T) / x^*$$

- The larger the discount rate, the threshold and the current level of consumption ($x^T - x^*$), the lower the incremental price (more difficult for a equally efficient rival to compete).
- Exclusionary effect depends on the number of uncommitted buyers (i.e. the proportion of the threshold and the whole market), the size of the discount, and the market share (both determining the minimum offer the rival shall give to attract committed buyers).

Ambev – Tô Contigo

- Ambev's loyalty program with retailers (particularly bars and restaurants).
- Ambev: undisputable dominant position (70% of the beer market)
- Beer market: significant entry barriers, mainly due to vertical differentiation (relevance of the brand portfolio) and logistics (returnable bottles)

Ambev – Tô Contigo (2)

- Loyalty program features
 - Discounts (non-linear pricing) and prizes
 - No formal requirement of exclusivity
 - But Ambev’s representatives required exclusive dealing or limited purchase of third parties’ beer brands (direct evidence)
 - Implausibility of alleged efficiencies
- CADE decision: antitrust offense
 - the highest fine ever applied to a single company (about US\$ 200 million)