

Economic issues from loyalty discounts and rebates.

Marcelo Celani

Universidad Torcuato Di Tella

Buenos Aires, Argentina

mcelani@utdt.edu



Loyalty Rebates and Discounts

- Broad array of business practices that are deployed in a wide range of market settings by “dominant” and “non-dominant” .
- Definition: discounts or rebates triggered only if buyer’s purchases surpass a certain threshold (established by the seller).
- So, these are *conditional* discounts.

Discount Arrangements.

- Type of threshold implemented:
 - Volumen targets.
 - “Market-share” discounts
 - Take into account the buyer’s purchases of rivals’ products.
 - In the limit, transforms the relationship into an exclusive dealing contract.
- Scope
 - Only on incremental units above the threshold.
 - “All-units” discounts: The buyer’s price is reduced on every unit *already* purchased, when transactions exceed the target quantity.
- Array of products:
 - Single product discount.
 - “Bundled” discounts: Discount depends on a conjoint of two or more goods.
- Rebates consists of an amount of money from the seller to the buyer, after the threshold has been reached.
 - It is simply a different arrangement.

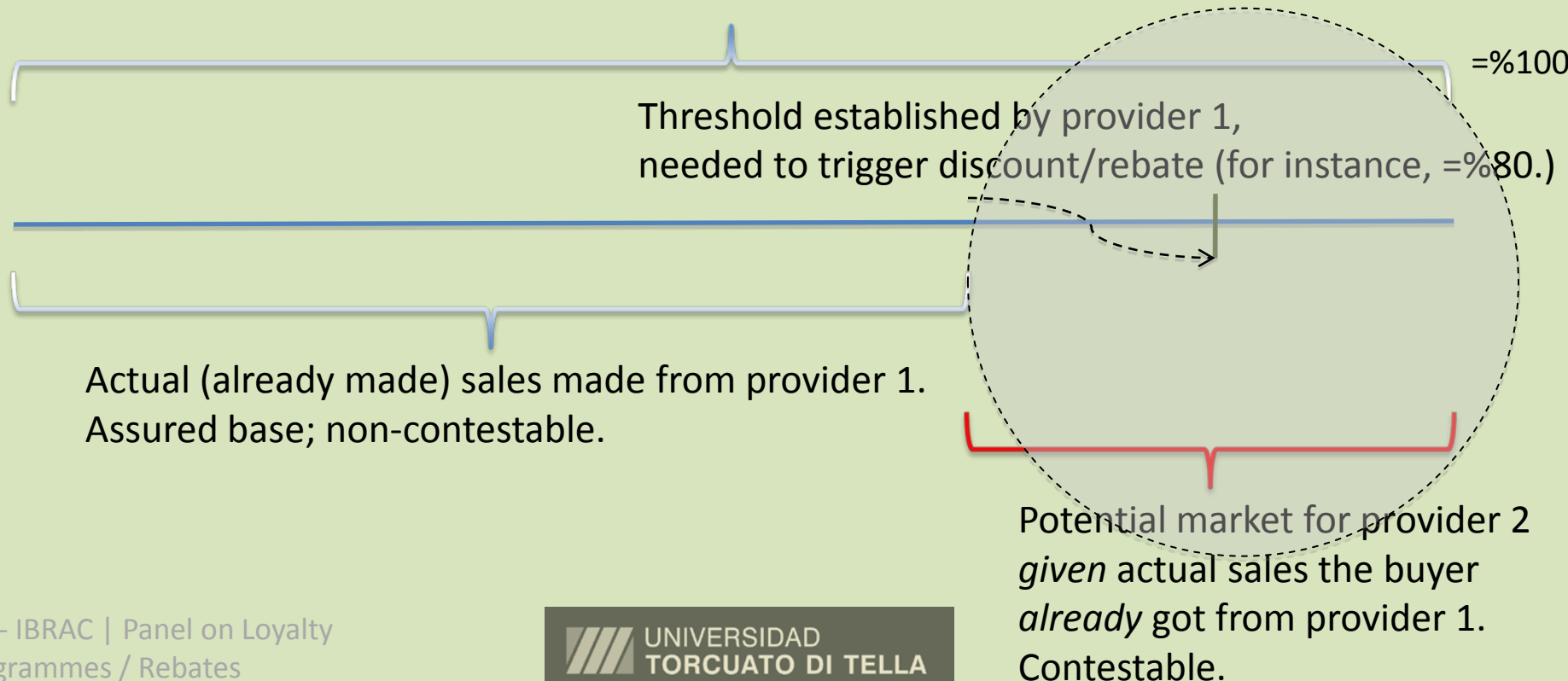
International Regulatory Appraisal

- ICN Unilateral Round Table (June, 2009) shows:
 - Most agencies indicated that single-product loyalty discounts and rebates are considered a legitimate form of price competition and are generally pro-competitive.
 - While loyalty discounts and rebates can create efficiencies and can benefit consumers through lower prices, there is also general agreement that when exercised by dominant firms or firms with substantial market power, they have the potential to cause anticompetitive harm in certain circumstances.
 - Most agreed on loyalty rebates could become a barrier to entry.
 - No consensus around the use of price cost tests but consensus on qualifying these tests as one tool among others.
 - Consensus on the importance of foreclosure as the main point in analysis.
 - Disagreement about what standard of proof should be used.

Anatomy of Loyalty Discounts/Rebates

- We will make focus on conditional, “all units” OR “roll back”, single product loyalty discount.

Annual sales the buyer potentially make from providers.



Anatomy of Loyalty Discounts/Rebates

The essential feature of this arrangement is that purchaser's *net payment* (on the margin) depends on the overall level of activity of the buyer with provider 1.

More purchases, (i.e: nearer the threshold), mean net revenues being more likely negative. So more difficult for provider 2 to “win the client”.

The “Suction Effect”

- From provider 2`s perspective:
 - “...if provider 1`s rebate is aggressive (involving an incremental net revenue negative on that outlay), gaining those sales can be reached only involving losses”
 - If providers are equally efficient, negative net revenues for provider 1, means exactly the same thing for provider 2.
- Suction effect means:
 - An incentive to maintain transactions with provider 1, instead switching to provider 2.
 - An incentive to make even *more* transactions with provider 1 in order to reach the threshold.
- The difference between both firms, rests on provider 1 financing the rebate over the whole set of annual transactions, but provider 2, only on incremental sales.

Alternative standards of liability

- Several standards around the globe.
 - *Net revenues against the average variable cost of whole demand, not just the contestable fraction.*
 - *Uses the monopolist cost, not the “equally efficient competitor”*
 - Why should we be using the dominant firm's costs to evaluate the survival of the rival's products that differ in quality and variety from those of the dominant firm?
 - Uses the whole demand, not the contestable part.
 - European Commission's test*
 - Net revenues against average avoidable costs (AAC).
 - » Net revenues > AAC means no liability
 - » Net revenues < AAC but > LRIC triggers investigation.
 - Applies over incremental or contestable demand.
 - Others...

**Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings (2008)*

Remarks on competitive effects

- Literature shows almost unambiguously*:
 - Loyalty programmes can be profitable for a dominant firm even if there are no cost efficiencies.
 - Conditions under which such loyalty programs are not profitable for a dominant firm are exceptional.
 - Loyalty programmes have implications different from traditional volume discounts, including possible negative prices for ranges of units.
 - Loyalty retroactive rebates change the nature of competition from competition for the last unit to competition for large chunks of the demand.
 - Loyalty programmes introduce entry issues in the discussion

* See, for instance: Nicholas Economides : Loyalty/Requirement Rebates and the Antitrust Modernization Commission: What is the Appropriate Liability Standard? *THE ANTITRUST BULLETIN:Vol.54,No.2 Summer 2009*

Remarks on competitive effects

- Even if the rival cannot profitably provide the necessary increment in the short-term, it is not necessarily impeded from competing.
 - If the rival can finance its first-period losses with profitable sales in the future, the practice may not involve damage.
- ¿Can provider 2 offer the same contract next year, competing in the total annual outlay, not just on an incremental part of that.? If yes, damage proof needs a good theory and factual evidence.
- The suction effect theory is right, but difficult to implement in practice.
 - How competition authorities estimate contestable part of the demand? (recall John Davies claim on this point)
- Some authors (Rabeaux, 2008) proposed implement typical predatory tests in place of suction effect.
 - How do regulators interpret predatory conduct when price is almost unavoidably below cost over the relevant increment in these kind of practices?
 - You can always find a fraction of sales whose revenues netted from discount mean negative profit (or price below cost).

Sum up.

- Loyalty rebates can only have anti-competitive effects when they foreclose equally efficient competitors from a substantial share of the market. So, key questions are:
 - Market share of buyers subject to these practices.
 - ¿Where is the threshold? ¿How is being implemented? ¿Annually? (the so called *progress bonus* in Michellin)
 - Empirical data showing buyers switching to alternative providers, or not.
 - Ability to reproduce same discounts by rivals.
 - Price cost tests.
- Question? Do we need some kind of tiered approach?.
 - May be linking tying, bundling with loyalty discounts.?

Thank you.

