



# E-commerce and Vertical Relationships

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# E-commerce and distribution (1)

- Retail sector in France : heavily regulated
  - Barriers to entry through regulatory constraints (a bit less since the 2008 law « LME »);
  - Relations between producers and retailers also regulated;
  - Opening of new stores should be authorised by a special commission, that involves representatives of incumbents.
- This is true for « brick and mortar » stores, not for e-commerce.
- Competition authorities are in general favorable to e-commerce, because it intensifies competition in a regulated sector.
- Bias in favor of e-commerce?

# E-commerce and distribution (2)

- Many retail networks are selective distribution networks.
- Producers often require a number of conditions in order to allow a retailer to sell their products and to be a member of the network :
  - Commercial services;
  - Before sale : demonstration of the products;
  - After sale services.

# Restriction to competition

- Selective distribution networks have both anti and pro-competitive effects:
- Anti-competitive effects :
  - Selective distribution limits the number of sellers able to compete together, either through price competition or through other dimensions : the level of service may be +/- imposed by the producer.
  - Reduces intrabrand price competition.
- Pro competitive effects (efficiency gains)
  - Better service
  - Solution to the free riding problem
- Competition authorities often take into account the intensity of interbrand competition in order to assess the anti-competitive effects of selective retailing :
  - More interbrand competition should imply less anticompetitive effects of selective distribution.

# Vertical externalities

- Vertical externalities between retailers and producers :
  - the services provided by the retailers increase demand;
  - producers benefit from these services and give :
    - incentives to retailers to offer the services
    - protection against free riding.
  - Through different means : incentive contracts, selective retailing, exclusive territories.

# Introduction of e-business

- Geographical relevant market : no longer restricted to the customer catchment area.
- Costs are different : more delivery costs, less « brick and mortar costs ».
- Changes the nature of price and non-price competition
  - Competition between brick and mortar and e-commerce : no head-on competition;
  - E-commerce offers services that are not (or less) provided by traditional retailers : customers opinions, selection of the products according to the profile of the customers, delivery...
  - And the reverse is also true.

# Other aspects of the competition process

- Asymmetry between both forms of commerce. More specifically :
- Brick and mortar :
  - administrative and entry costs, building, staff...
  - Transport costs mostly beared by consumers (depends on location)
- E-commerce :
  - costs of operating the web-site,
  - Delivery often at uniform price whatever the location of customers.

# Price competition

- Compared to a situation where retailers are located in the space, the introduction of an e-commerce firm (either a pure player or a « click and mortar » player) changes the price game;
- Spatial competition : the e-firm competes with any of the brick and mortar ones.
- The issue of the price game depends on the way delivery costs are paid by customers.
- The market may move from a Hotelling price equilibrium to a Bertrand price equilibrium.
- In general, e-commerce increases the intensity of price competition.



# Effects on other aspects?

- Possible effects on services :
  - If prices are lower at the e-business firm, then free riding on the services offered by the « brick and mortar » firms.
  - May result in less services provided by selected brick and mortar retailers.
  - May have anti-competitive effects : less incentives to provide services.

# The cases before the french competition authority

- 4 decisions on Internet sales, all of them in the context of selective retailing :
  - Festina-Bijourama, n° 06-D-24 (July 2006)
  - Luxury Hi-fi products, n° 06-D-28 (October 2006)
  - Skin-care products sold in pharmacies, n° 07-D-07 (March 2007)
  - Pierre Fabre, n° 08-D-25, (October 2008)

# Festina- Bijourama

- Bijourama, a pure internet player that sells watches and jewelry, faces refusal to deal from Festina.
- Festina argues that it requires a number of investment from his selected retailers, and that it doesn't want to open the sale of its products to internet sales because of reputation problems, services etc..
- The Conseil de la concurrence decided to force Festina to allow its click and mortar retailers to sell through their websites, but did not satisfy the request of Bijourama (who doesn't belong to the selective network).
- Bijourama went before the Appeal court who confirmed the Council's decision.

# Hi-fi products and cosmetics

- In these two cases, the selected retailers themselves were complaining about the prohibition, by the producers to sell through their own internet web sites.
- Cosmetics products that are only sold in pharmacies or in stores where a pharmacist is present.
- Hi-fi products : very high quality products, where advice and demonstration of the products are important.
- Arguments of the producers : the level of service that is required to sell our products cannot be reached by internet sellers.
  - In the case of cosmetics : « our products should be sold by a pharmacist »
  - In the case of hi-fi products : « our products should be demonstrated, adapted to the environment where they will be used ».

# Hi-fi products and cosmetics (2)

- Solution of the conseil de la concurrence
- « Preliminary assessment » of the competitive problem:
  - Selected retailers should be able to open their own website;
  - Producers should be able to impose constraints on services, on the design of the website.
- In both cases, producers accepted to commit themselves to open their networks to internet sales, only for click and mortar selected sellers, but with restrictions.

# Pierre Fabre

- Pierre Fabre was one of the cosmetics producers involved in the previous case.
- He refused to commit to allow its retailers to sell through internet (that is, Pierre Fabre only allows click and mortar pharmacies to sell in their shops)
- The conseil enjoined Pierre Fabre to allow pharmacists to sell through their website, with special requirement and restriction on the level of service, the existence of a hotline etc.
- Sanction.
- The case is now before the appeal court.

# The general principles at work in these decisions

- When it comes in competition with a selective distribution network, exclusive sales on the internet may raise the issue concerning the costs borne for building the network and (...) free riding.
- Online sales : in one sense favorable to consumers (facilitate price competition), may also constitute a source of competitive distortion between distributors (disappearance of services)

# General principles (continued)

- Manufacturers are free to organise the distribution of their products (regulation 2790/1999, block exemption), subject to the limit that the organisation should not affect the functioning of the market.
- No text expressly provides for the possibility to reserve internet sales to the members of its network, but this solution appears compatible with the competition rules applying to vertical restraints.



# General principles (continued)

- In the absence of parallel cumulative networks that could have foreclosure effects, and as long as the manufacturer has a market share below 30% (threshold of the Block Exemption), the supplier can exclude pure internet sellers from its network.
- An outright prohibition of internet sales cannot be justified absent exceptional circumstances.
- Restrictions to internet sales must be :
  - proportionate to the objective,
  - the requirements should be similar to those applying to brick and mortar shops.

# Specific conditions

- Existence of a physical point of sale : the seller may reserve the possibility to sell products on the internet to members of its distribution network.
- Quality of the website : specific requirement on the way products are displayed, the use of information, logos, link to the supplier's website.
- In the cosmetics decision, some requirements were considered excessive (example : « products should be sold on a website only dedicated to products sold on the advice of a pharmacist)

# Specific conditions (2)

- Sales through internet platforms :
  - Cosmetics case : some of the conditions regarding the quality of the website indirectly prevent distributors from using third-party platforms as intermediaries
  - Problem of seller identification, product authenticity, counterfeit products.
- Advice and services to the customers : supplier may require some level of service (existence and quality of the hotline (cosmetics) , after sale services and demonstration in an outlet (hi-fi) ).

# Specific conditions (3)

- Advertising and brand use :
  - In Festina, the Council approved that non tariff advertising and advertising links should be approved by Festina.
  - Problem of the advertising through search engines (brand names as key words)
- Sales :
  - in the cosmetics, some quantitative restrictions to sales (to avoid the development of a parallel market).
  - Some restrictions were considered excessive (recommendation to buy from a physical outlet, restrictions related to on-line sales)
  - Territorial restrictions.

# Pierre Fabre

- One of the cosmetics producers.
- Didn't want to take commitments to allow on line sales, on the ground that it would allow free riding on physical outlets, and exit of these outlet (pharmacies)
- Went into litigation.
- Were fined and obliged to open on line sales.

# Conclusion

- General principles in France regarding on line sales :
  - Bias in favor of e-commerce, partly to remove other barriers to entry in the distribution sector.
  - Problems arise mainly in the context of selective retailing.
  - Number of possibilities to find a way between requirements of the producer (free to choose the organisation of its retail network) and a higher intensity of competition at the retail level.