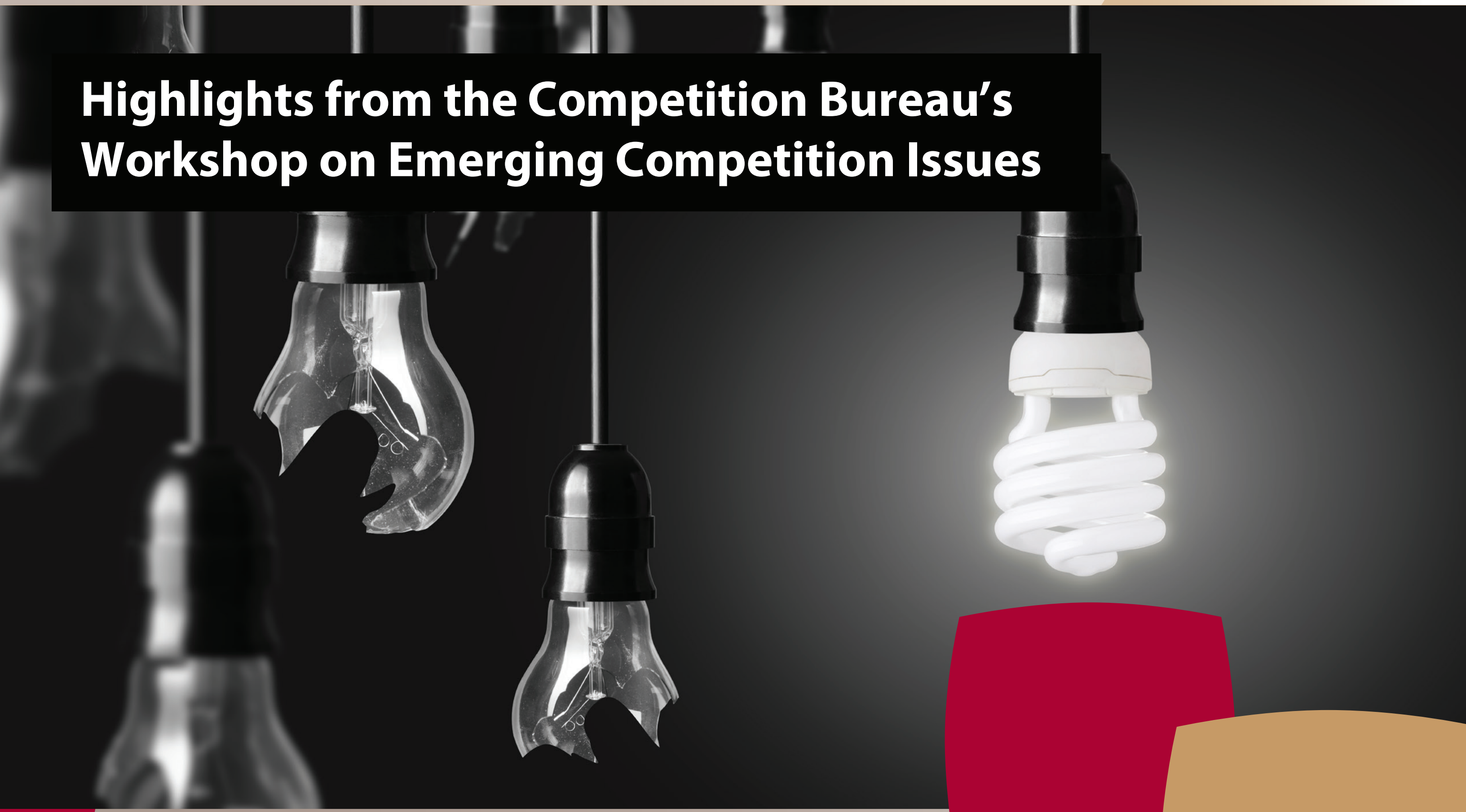
Bureau de la concurrence Canada | Competition Bureau Canada

Workshop Summary Report

Highlights from the Competition Bureau's Workshop on Emerging Competition Issues



Canada

This publication is not a legal document. It contains general information and is provided for convenience and guidance in applying the *Competition Act*

For information on the Competition Bureau's activities, please contact:

Information Centre
Competition Bureau
50 Victoria Street
Gatineau QC K1A 0C9

Tel.: 819-997-4282
Toll free: 1-800-348-5358
TTY (for hearing impaired): 1-866-694-8389
Fax: 819-997-0324
Website: www.competitionbureau.gc.ca

This publication can be made available in alternative formats upon request. Contact the Competition Bureau's Information Centre at the numbers listed above.

Permission to reproduce

Communications and Marketing Branch
Innovation, Science and Economic Development Canada
C.D. Howe Building
235 Queen Street
Ottawa, ON K1A 0H5
Email: ISED@Canada.ca

Cat. Iu54-59/2016E-PDF
ISBN 978-0-660-04655-6

2016-03-04

Aussi offert en français sous le titre Faits saillants de l'Atelier sur les nouveaux enjeux de la concurrence tenu par le Bureau de la concurrence.

Highlights from the Competition Bureau's Workshop on Emerging Competition Issues

A. Introduction[1]

On January 19, 2016, the Competition Bureau ("Bureau") held a one-day workshop on emerging competition issues. The workshop focused on two themes: 1) disruptive business models and the implications for competition policy, and 2) incorporating non-price effects in competition analysis. It featured a keynote address on the topic of competition advocacy and disruptive innovations by Marina Lao, Director of the Office of Policy Planning at the United States Federal Trade Commission.

Approximately 120 participants from both Canada and abroad attended the workshop, including representatives from the business, legal and academic communities, federal and municipal regulators, foreign competition authorities, and the Bureau. The workshop's agenda is included at Annex 1.

B. Rationale and Objectives

Robust competition policy and enforcement nurtures a competitive and innovative Canadian marketplace. Competition policy and enforcement tools must keep pace with current developments as industries and analytical models evolve.

From broadcasting to taxis to hospitality, disruptive new business models used by Netflix, Uber and Airbnb are reshaping Canadian industries. As these innovative business models gain traction with consumers, one potential result is increased competition. In some cases, existing market participants may respond to the threat of new business models by engaging in anti-competitive conduct or asking regulators to enact rules that raise barriers to the ability of these models to operate. Either one of these responses can stifle competition or innovation.

"As disruptive new business models emerge and challenge the status quo, competition agencies around the world play an important role in advocating for the benefits of competition to regulators, and investigating business conduct that stifles competition and innovation."

As disruptive new business models emerge and challenge the status quo, competition agencies around the world play an important role in advocating for

[1] This paper is a summary of the presentations and discussions that took place at the workshop. The opinions are those of the panelists and do not necessarily reflect the views of the Bureau.

the benefits of competition to regulators, and investigating business conduct that stifles competition and innovation.

While disruptive business models may compete on the basis of lower prices, they may also compete through "non-price" aspects such as quality, convenience or value-added features. Traditionally, competition analysis focuses on the effect of the activities being investigated on price; however, new competitive dynamics are increasingly shaping markets. As a result, there is growing interest in developing methods to incorporate non-price effects into competition assessment frameworks. While price remains a key element of competition assessment, it may not capture all of the outcomes flowing from competition, such as those related to innovation, product quality, variety, or service level.

"While price remains a key element of competition assessment, it may not capture all of the outcomes flowing from competition, such as those related to innovation, product quality, variety, or service level."

In order to advance thinking on these critical issues, the Bureau hosted the workshop so that stakeholders could discuss disruptive business models, the implications for competition policy and enforcement, and how best to incorporate non-price effects into competition assessment.

C. Issues

Some key themes that emerged from the workshop are summarized below.

Benefits of Disruptive Business Models

Disruptive business models can offer services to consumers in more efficient ways

Some participants noted that disruptive business models change the way that markets work by offering a different value proposition to consumers. While some disruptive business models make use of new technologies, others leverage existing technologies to provide services to consumers in more efficient ways. Many innovators do so by offering software platforms that facilitate "disintermediation" or the removal of middlemen from the supply chain, and allowing providers to make better use of assets that are not being used to their full capacity.

Some disruptive business models, including Airbnb and Uber, emerged as entrepreneurial responses to perceived gaps in the marketplace. For example, Uber's founders experienced difficulty in securing a ride reliably or efficiently, so they built a platform that allows users to use their smartphones to request rides from everyday drivers that were willing to transport passengers. Similarly, Airbnb's founders designed their website to allow ordinary homeowners to rent unused space in their homes as a means of generating income, while offering a less expensive and more personalized experience for their guests.

Benefits of disruptive business models can include more than lower prices

While some disruptive business models offer lower prices or simpler "no-frills" versions of products than what is offered by existing providers, others may establish themselves in an industry by offering improved service quality, convenience and flexibility, and additional features or experiences that appeal to consumers. Participants agreed that platform-based "sharing economy" models can efficiently shape markets through reduced transaction costs, improved resource allocation, and greater responsiveness to consumer preferences.

"Participants agreed that platform-based 'sharing economy' models can efficiently shape markets through reduced transaction costs, improved resource allocation, and greater responsiveness to consumer preferences."

Disruptive business models can also have a significant impact on existing providers, forcing them to improve their services and adopt new features and ways of doing business to stay competitive with disruptive entrants. In some cases, new business models and technologies may also offer effective tools to resolve policy issues.

Disruptive business models may have a negative impact on some stakeholders

Some participants cautioned that, while disruptive business models can offer many benefits to consumers, they may also have a negative impact on some stakeholders, including participants in traditional industries. For example, the growth of transportation network companies such as Uber and Lyft have resulted in sharp decreases in the value of taxi licences in some municipalities.

Considerations for Regulators

Regulators must strike a balance between allowing disruptive business models and achieving legitimate policy goals

A number of participants highlighted that disruptive business models may pose challenges for regulators. Many regulations were developed in a different set of circumstances that may not have accounted for the innovative services offered by the disruptive model, and may form a barrier to such services. Regulators will thus have to find the right balance between regulating to achieve legitimate policy goals, and amending or eliminating regulations to allow competitive forces to efficiently shape markets. Incumbents that are under threat may ask regulators to maintain or adopt rules that disproportionately

"Regulatory frameworks must allow new models to operate and compete, so that consumers can enjoy the benefits of competition and innovation, while simultaneously addressing legitimate consumer concerns and other policy goals."

and unnecessarily impede the new business model, with the effect of stifling competition and innovation. Regulatory frameworks must allow new models to operate and compete, so that consumers can enjoy the benefits of competition and innovation, while simultaneously addressing legitimate consumer concerns and other policy goals. As part of this process, regulators may also have to consider their timing for regulatory changes. If regulators intervene too early, particularly with broad regulation, they may impose inflexible rules or excessive burdens that may stifle innovators. But if regulators wait too long, there may be negative impacts caused by the disruption, such as harm to consumers.

Disruptive innovations can be difficult to anticipate

Participants agreed that the regulatory challenge may be particularly acute in the case of innovation, given that it can be difficult to predict which innovations will have a disruptive effect on existing markets, and what form that disruption may take. Some business models initially experience little success, but subsequently prove popular when implemented by a different company a few years later. For example, Sidecar preceded Uber in the business of providing ride-sharing services, but was unable to achieve the same success. Airbnb had fluctuating successes in its early days before establishing itself. Predictions in this area are notoriously inaccurate. This is compounded by a dearth of research on the impact that innovations have on the economy, including the impact of government policy and regulatory frameworks on the emergence of successful innovations.

Considerations for Competition Authorities

Competition authorities can help regulators design their regulatory frameworks in a way that promotes competition and innovation

Participants agreed that advocacy by competition authorities can play an important role in helping regulatory bodies enact appropriate rules. Generally, sector regulators have expertise in the industry that they regulate, but may not be well-versed in competition analysis. Advocacy efforts allow competition authorities to share their expertise with regulators and help them understand the impact that their decisions may have on competition.

"Today's innovator can become tomorrow's incumbent."

Participants noted that in providing such advice, the role of a competition authority should not be to favour any particular business model, but rather promote an industry where all participants can compete for customers' business. Today's innovator can become tomorrow's incumbent, meaning that a disruptive innovator can become so well-established in the market that it can in turn engage in anti-competitive conduct to discourage future entrants, so it is imperative to ensure a flexible regulatory environment that will allow the next innovation to develop and operate as well. As part of fostering such an environment, regulatory frameworks should allow all market participants to experiment and find different ways to compete, until there is evidence that the practice causes harm to consumers or other legitimate policy goals. When considering whether certain regulations should apply to disruptive entrants, regulators should also take the opportunity to consider whether restrictions should be removed on existing providers.

Both traditional firms and disruptive innovators, once they become established, may potentially engage in anti-competitive conduct

A number of participants emphasized that competition authorities should be aware of the potential for anti-competitive conduct by both incumbent firms (i.e. traditional market participants) and disruptive entrants. Incumbents that stand to lose much from the successful entry of disruptive business models may have strong incentives to engage in anti-competitive conduct to impede such entry, or to lobby officials to prevent the new business model from being able to operate.

At the same time, as mentioned above, new innovative entrants can soon become the dominant firms in a market. As disruptive business models establish themselves and achieve significant power in a market, they may in turn begin to adopt anti-competitive practices to entrench their market position against both existing firms and potential entrants. For example, a popular online platform could require exclusivity from its providers and/or consumers, making it more difficult for potential rivals to gain a foothold in the market. Large platforms could also attempt to discourage their customers from switching to another platform by limiting their ability to bring important data with them, such as their transaction histories. Several participants noted that competition authorities will need to ensure that they have the right tools and expertise to respond to anti-competitive conduct if and when it emerges in disrupted markets.

Some participants warned that competition authorities should also ensure that they do not give excessive weight to potential entry by disruptive entrants when assessing the competitive impact of an incumbent’s conduct. Incumbents may claim that potential entrants provide sufficient competitive pressure to justify engaging in otherwise harmful market practices, such as a problematic merger, the removal of regulatory restrictions designed to address exercises of market power, or other changes. As innovation may be difficult to predict, competition authorities must weigh the evidence carefully when deciding whether a disruptive entrant is likely to establish itself sufficiently to have a significant competitive impact in an industry.

Intellectual property rights may have an impact on disruptive business models

Some participants felt that policy makers and competition authorities should also consider the impact that intellectual property (“IP”) rights may have on the ability of innovative business models to come to market. Stringent copyright or patent laws may make it costly and risky for innovators to develop offerings, as they risk infringing an IP owner's rights and becoming exposed to liability. In comparison with regulations, IP rights may be less transparent, vaguer in scope, and more difficult for innovators to plan around, as IP owners can in most circumstances refuse to license their IP.

Competition Implications of Innovative Platforms and "Big Data"

Disruptive business models may have network effects that can impact competition

Participants agreed that many of the new business models emerging today are "sharing economy"-based software platforms that form multi-sided markets, bringing together buyers, sellers, and possibly advertisers. Large platforms that achieve significant rates of market penetration may give rise to a number of "network effects", where the usefulness of the platform increases as more users join the platform. As a result, competition may initially exist in the market, but as network effects take hold, one firm may dominate.

Participants noted that, while network effects can have many positive benefits for the company and its users, they can also lead to market power, as rival platforms may have difficulty luring a sufficient number of customers away to achieve a viable size. At the same time, market power in this environment can be fleeting and fragile, especially in sectors that are prone to rapid technological changes. A disruptive business model may be swiftly overtaken by the next innovation that emerges in the marketplace. As such, while competition authorities are working to ensure that they have the expertise to address the challenges brought by disruptive business models, they will need to consider each particular innovation on a case-by-case basis.

Data collected by disruptive business models may potentially raise competition concerns

"[A] particular challenge that may emerge from large platforms such as Uber and Airbnb involves the implications of 'big data' – the vast amount of information that a platform accumulates over time as it tracks the transactions of its users."

Participants also agreed that a particular challenge that may emerge from large platforms such as Uber and Airbnb involves the implications of "big data" – the vast amount of information that a platform accumulates over time as it tracks the transactions of its users. Big data has significant implications for regulations relating to consumer protection and privacy: for example, large platforms that achieve sufficient market power may be able to force users to divulge more information than they would prefer. The more information that platforms obtain, the more they can tailor their offerings to particular users, opening the door to practices that may be of concern to some regulators, such as price discrimination.

Regulators may also wish to obtain information from platforms to contribute to law enforcement activities, city planning, and social policies; however, market participants noted that regulators should take care that their data requests are not too burdensome. Excessive demands, for example requiring that data be submitted daily in a complex format, can be costly for firms (especially entrants) and may constitute a barrier to entry. Regulators should ensure that their data requests are no more burdensome than needed to achieve their policy goals.

Many participants noted that big data, which can be of high value in digital economies, may be of concern to competition authorities. Platforms that are able to collect and analyze large volumes of data may create a barrier to entry, thereby limiting competition in an industry. The quality and scope of the data obtained can affect the quality of a platform's services, for example by tailoring offerings to user preferences, or achieving better algorithms to search and match users.

Some participants noted that big data also has a role to play in merger review. Where data is what is most valuable to market participants, companies begin to acquire firms not on the basis of their assets or customer bases, but rather to obtain their data collections. The data acquired in this way may help the purchaser to create barriers by preventing its rivals from obtaining needed data, or otherwise help it create, entrench or maintain its market power. Although such mergers could have a significant impact on competition, they may be difficult for competition authorities to address under traditional merger review frameworks. Some participants said that while current merger review focuses on whether the merging firms have significant overlap in terms of their products and consumers, data-driven mergers may involve companies that operate in very different product and geographic markets. A number of participants voiced concern that competition authorities may currently lack the tools and human resource capacity needed to analyze and address data-driven mergers and their potential impacts on competition.

Big data may also allow platforms to establish pricing algorithms or other mechanisms to automate the prices charged between their users. Some panelists noted that automated price setting, with minimal intervention by humans, may enable sellers to maintain relatively high prices without the need for agreement between them. This could be a potential challenge for competition authorities and regulators, who will need to consider whether they have the right legislation, tools and frameworks to deal with these issues if and when they arise.

How Non-Price Effects Can Be Used to Inform a Competition Analysis

Competition assessment may involve factors other than price

Participants generally agreed that, while economists have traditionally considered the competitive impact of mergers or other business practices in terms of their effect on prices, firms may also compete on a number of non-price dimensions. Non-price effects can include such considerations as quality, innovation, consumer choice, diversity of business models, convenience, and a host of other factors that may be valued by individual consumers. The Bureau has long investigated cases that involve non-price effects, particularly mergers in innovative industries. However, these effects have taken on more importance than ever following the Supreme Court of Canada's decision in the *Tervita* case.[2] While the Supreme Court was clear that a substantial prevention or lessening of competition may be proved by qualitative evidence, it added an additional quantitative burden in cases where the merging parties have put forward an efficiencies defence pursuant to section 96 of the Act. In those circumstances, Tervita requires the Bureau to quantitatively estimate "all quantifiable anti-competitive effects" where possible.

Some participants argued that analysis of non-price effects in the past have generally not involved significant quantification, or the use of complex models that only apply in a limited number of circumstances. There was general consensus among the participants that the frameworks used by competition authorities currently lack adequate tools to deal with non-price effects. While all stakeholders desire predictability, certainty and objectivity in competition cases dealing with non-price effects, this may be difficult to achieve in practice.

Analysis of retail price maintenance may benefit from consideration of non-price effects

Despite the difficulties involved in measuring non-price effects, consideration of such elements of demand can be essential in the competition analysis of both mergers and vertical restraints, meaning restrictive agreements made between firms at different levels of production or supply. Practices such as retail price maintenance can be seen as attempts by manufacturers to limit price competition among retailers in order to encourage them to use more non-price offerings to attract consumers to buy the manufacturers' products. Some panelists felt that in addition to discouraging "free-riding" by retailers (where some retailers do not offer customer service, but rely on other sellers to do so and then steal away their customers by offering a lower price), price maintenance can help better align the incentives of retailers with manufacturers so that retailers will focus on attracting new consumers to the market, rather than focusing on luring existing consumers away from other retailers. This, however, raises the question of whether competition authorities should tolerate practices that raise prices if

[2] *Tervita Corp. v. Canada (Commissioner of Competition*, [2015] 1 SCR 161.

consumers receive other considerable benefits, such as higher quality or excellent customer service, in exchange.

Merger reviews may include analysis of non-price effects

Considering non-price effects in a market may also help competition authorities determine whether a particular merger is likely to have an anti-competitive impact on the market. In most markets, different consumers will place different values on quality, innovation, service, or other non-price dimensions of a product.

Some participants said that this may affect which segments of the consumer base most influence a firm's decision in the design of its offerings. For example, car insurance companies prefer to attract and retain low-risk customers that are unlikely to get into any collisions.

Where most consumers have a similar value to a firm, then firms generally have incentives to cater to the preferences of "marginal consumers", that is, those consumers who are mostly indifferent between purchasing and not purchasing the product. This is because even if the firm degrades the quality of the product for their average consumer, who places a higher value on the product than the marginal consumer, the average consumer is likely to keep buying the product. In this case, consumers that are considering whether to switch to another provider are likely to have preferences that are similar to the average consumer. In these circumstances, a merger between the firm and the rival provider is likely to be harmful to competition, since it removes the threat of customers switching to the other provider.

In contrast, in some markets, firms consider certain customers more valuable than others. For example, financial companies will generally prefer customers who represent a low risk of default. In such cases, firms will want to selectively attract the most valuable customers away from their rivals, even if that means catering less to lower-end customers. In such cases, customers who switch may be less representative of consumers as a whole. This could result in a greater number of firms competing for a small subset of customers, which may mean that the average consumer does not receive a similar level of service.

Participants noted that caution should be exercised when competition agencies and other stakeholders attempt to quantify non-price effects and consumer preferences. The necessary data to undertake such analyses may not be available in many industries. Quantification of data may also require consideration of the context of the case and specific competition analysis, and what appears to be reasonable based on the particular circumstances and general models.

Participants disagreed concerning whether non-price effects were sufficient to bring forward competition litigation

While participants agreed that objective and quantifiable evidence carried the most weight in competition litigation, there was some disagreement considering whether a case should be brought forward purely based on non-price effects. While some participants said that neither the economic literature nor the judicial system have settled on how such effects should be measured, others said that there are many cases where non-price effects are crucial to the competition assessment, such as mergers between innovative companies. In addition, tools are emerging that will help measure non-price dimensions in future cases.

D. Next Steps

The workshop provided the Bureau with an opportunity to gather valuable insights on emerging competition issues from thought leaders in the areas of disruptive business models and non-price effects. As a result of the knowledge gained, the Bureau will:

- Consider the digital economy, disruptive business models, and the sharing economy as priority areas for the Bureau's advocacy efforts. When providing advice to policymakers and regulators on competition concerns relating to disruptive business models, the Bureau may consider the issues discussed in the workshop to inform its recommendations. This may help the Bureau to more effectively advocate for regulations that are no broader than reasonably necessary to achieve legitimate policy goals. This will allow innovative forces to shape markets and enable disruptive business models to operate.
- Monitor developments relating to disruptive business models in Canada and abroad. This will allow the Bureau to better incorporate, and advance, methods to assess competition in scenarios involving these new business models. The lessons learned from the workshop will help inform this work.
- Consult with international competition agencies and domestic stakeholders, and provide guidance to stakeholders through position statements, bulletins and additional workshops.

Annex 1 – Workshop Agenda

1. Welcoming remarks by John Pecman, Commissioner of Competition
2. Panel 1 – Overview of disruptive business models
   - Moderator: Andrew Little, Bennett Jones
   - Panel Members:
     - Dr. Wendy Cukier, Ryerson University
     - Salle Yoo, Uber
     - Aaron Zifkin, Airbnb
3. Panel 2 – The regulatory and enforcement landscape for disruptive business models
   - Moderator: Andy Baziliauskas, Charles River Associates
   - Panel Members:
     - Maurice Stucke, University of Tennessee
     - Alejandro Faya, Comision Federal de Competencia Economica
     - Simon Constantine, Competition and Markets Authority
     - Ariel Katz, University of Toronto
4. Keynote address: Marina Lao, Director of the Office of Policy Planning, Federal Trade Commission
5. Panel 3 – Non-price effects in competition assessment
   - Moderator: Dr. Renée Duplantis, The Brattle Group
   - Panel Members:
     - Ralph Winter, University of British Columbia
     - Glen Weyl, University of Chicago
     - Joshua Gans, University of Toronto
     - George Addy, Davies Ward Phillips & Vineberg