Discussion of the Unilever Rebates case

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ACE, 2017

Exclusionary Practices: The Economics of Monopolisation and Abuse of Dominance
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Models of anti-competitive effects of price discrimination/rebates:

- exclusionary effect of rebates require economies of scale so incumbents' give discount to reduce scale available for entry
- exclusionary mechanism also depends on buyers being unconcentrated and uncoordinated. In this case, there is no buyer who could individually command a sufficient amount of the entrant's production to make entry viable

case could be related with 2 models of price discrimination/rebates with exclusionary effect:

Model 1

- Dominant firm and rival make offers simultaneously to a number of buyers
- Dominant firm can use explicit or implicit discounts and offer some buyers low prices (recovering losses from high prices from other buyers)
- Explicit discrimination (individualized discounts):
  - observe buyer type and offer different prices to each type.
  - price slightly below marginal cost for big buyer, and monopoly price for other buyer
  - only equilibrium: exclusionary equilibrium (fixed cost of entry not covered for entrant if entrant only serves the smaller buyer).
- Implicit discrimination:
  - offer a menu of price/quantity
  - harder to exclude rival because pricing has to be incentive compatible (cannot be too low)

Model 2

- Conditional rebates to target contestable demand
- Rebates can facilitate exclusion: firm price discriminates between contestable and non-contestable portions of demand
- Incumbent and entrant make offers to buyers sequentially
- Part of the demand of each buyer is non-contestable by the entrant
- Incumbent offers aggressive rebates for earlier buyer which entrant is unable to match and recoup losses with later buyers
- Exclusion more likely if rebate is conditional quantity exceeding a certain amount: incumbent can target aggressive rebate to contestable part

Hence, to form a theory of harm, we should consider:

1. Scale

- Theories that support exclusionary motives for rebates depend on the existence of scale economies
- Due to fixed entry costs but also to characteristics of the demand, such as state dependence (learning, switching costs)
- ice cream market: there could be important brand loyalty building
- Dubé, Hitsch and Rossi (Rand, 2010): structural state dependence in choice consistent with (psychological) switching cots leading to brand loyalty

Unilever case:

- Consistent with scale economies **OK**
- But, evidence that rebates on small fraction of total sales (around 10

2. **Dominant position**

- Necessary to have relevant incumbency advantage, can be proxied by high and persistent market share of incumbent
- reinforced in case of switching costs for example (brand loyalty)

Unilever case:

Unilever market share above 50

3. **Fragmented demand**

- Rebates with exclusionary rebates harder if buyer market is concentrated, with some buyers large enough to buy enough from entrant to make entry viable.

Unilever case:

- Large retailers concentrated and probably some big enough buyers X
But not the case if we focus on the medium, smaller retailers **OK**

4. **Individualized rebates**
   - Explicit vs implicit price discrimination
   - Easier to exclude rivals when using individualized discounts

Unilever case:

standard discounts offered to all buyers (apparently) X

Other comment:

- Models also show that strong downstream competition weakens the mechanisms that could lead to inefficient exclusion
- Not clear from the analysis presented in the case how competitive the downstream market is (no information on demand price elasticities)
- However, evidence in literature that demand for ice cream is more elastic during the summer than during the winter (Perrone, IJIO, 2016)
- Implies that inefficient exclusion is more likely during the winter
- Note that the bigger rebates happen during the winter, and are taken as evidence contrary to exclusionary motives

Comment on dynamics

- We talk about non-contestable parts of the demand as an exogenous characteristic in a given moment in time
- Ok in a static analysis but maybe consider dynamics of demand
- Dynamics of demand affects pricing decisions of firms in relevant ways
- For instance, state dependence in demand means that past purchases directly affect current purchases
- Dubé, Hitsch, Rossi (2010): evidence of state dependence leading to brand loyalty
- In this case, firms could decide on rebates to affect size of future non-contestable demand for example
- or affect future demand price elasticity