MARKET DEFINITION AND MARKET POWER IN TWO-SIDED MARKET: COMPETITION LAW

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DISCLAIMER

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“Modern poets talk against business, poor things, but all of us write for money. Beginners are subjected to trial by market”. -Robert Frost

Indeed market is a place common to the people where they come in order to provide something in exchange of something. As this English word market calls back to its origin from the Latin maxim “mercatus” which means gathering for the purpose of commerce, market, and fair. Another interesting origin point that can be looked at is from South Indian language Kannada is “Maaru means selling and Katte meaning platform”.¹ This paper seeks to analysis in different parts market definition and power in general as well as under the heading of two-sided market with the help of various illustration, case laws and diagrams.

¹ See http://wiki.answers.com/Q/What_is_the_Origin_of_the_word_market
1. Introduction:

A market is generally defined as a group of buyers and sellers of a particular good or service. The buyer determines the demand for the product, and the seller determines the supply of the product. One of the main factors that keep a balance in a market, especially with respect to the consumer welfare is competition, as it reduces the impact of a single buyer or seller, on the market price. However, the dynamics of this concept changes when the structure of the market is changed from a one-sided market, as defined above, to a two-sided market. This paper seeks to analyze the said change with respect to market definition and market power in a two-sided market. The paper does not determine the definition of a two-sided market rather attempts to analyze the “relevant market” in a two-sided market. Further, the paper observes why market power in a two-side market should not be determined through market share.

2. Why is important to define a market for the purpose of Competition Law?

The objective of Competition law is to regulate the competition in the market for economic efficacy, consumer welfare and to promote goals such as, market integration, etc. In order to work towards these objectives; the foremost requirement is to identify a market. Market definition works as an analytical tool to define the boundaries of competition and thereby, affect the creation and application of related policies, between the undertakers. The rationale is to identify the undertakers with the capacity of causing any competitive constraints and preventing them from behaving independently of effective competitive pressure. Competition in a market ensures that undertakers do not determine a price, for their product or service, which does not tend towards the marginal cost as it is against consumer welfare.

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2 Though, the definition of a two-sided market is heavy disputed however, it is submitted that, it can be defined as a market where, an undertaker earns their primary value by enabling direct interaction between their two different but affiliated types of consumers.
6 To scrutinize merger under part 2 of the enterprise act 2002, determiner penalty under the compt act 1998
7 explain and cite.
3. Mechanism of Two sided Market

In order to explain the mechanism of two sided market, I am taking into account the example of a job placement industry, named jobspitara.com. Basically jobspitara.com is a common platform for service providers (Employers) and End-users (Job seekers). It works as an intermediary between the two. It enables the end-user i.e. job seeker to find the most appropriate job throughout the country and on the other hand enables the service provider i.e. the employer to find the most suitable employee for the job throughout the country.

A key feature of two-sided platforms is the presence of “indirect network effects.” Indirect networks effects exist when the value that a customer on one side realizes from the platform increases with the number of customers on the other side. Similarly in the present example of job seeking industry, the number of end users increases or more users register on the website due to more advertisements by the service providers and vice versa. A search platform is more valuable to advertisers if it is more likely that it will reach a larger number of potential buyers. It is more
valuable to users looking to buy something if there are more advertisers attracted to the platform because that makes it more likely that the user will see a relevant advertisement.

Two-sided platforms’ key feature is the symbiotic relationship between the two sides; the platforms must cater to two different customer groups simultaneously. To establish a two-sided platform, the founders must solve the “chicken-and-egg problem”: Employers will not participate without job seekers while job seekers will not participate without the employers. The founders must be able to make credible commitments to one side that if they show up at the platform; the other side will be there as well.

Balancing the demands of both sides is yet another important feature of the two sided market. While setting the prices, the website founder has to charge reasonably from both the sides. If they charge a higher registration fee from the end users, resultant fewer job seekers will register. On other hand charging unreasonably from the employer will result in less interest employers. Also since the number of registrations is less, not many employers would be willing to advertise through this website.

4. Market definition in a Two-sided market:

A relevant market is a set of products\textsuperscript{8} and/or geographical areas\textsuperscript{9} that exercises some competitive constrains on each other.\textsuperscript{10} Thus, consumer’s power of interchangeability between undertakers determines the relevant market. However, in a two-sided market the demand and supply substitutability doesn’t work on the same theory. The said definition works on the principle that, price rise is directly proportionate substitution and interchangeability. But, in a

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\textsuperscript{8} See Article 2 (r) and 2 (t) of the Competition Act, 2002.
\textsuperscript{9} See Article 2 (r) and 2 (s) of the Competition Act, 2002.
\textsuperscript{10} motta pg 102.
two-sided market\textsuperscript{11} the price is based on indirect network effect between the consumers. While one side may be price sensitive and thereby, interchange firms when price increased however, the second side of the market is present for audience-making, for example. The platform merely enables an interaction where both parties can fulfill their requirement. The second side of consumer may get a better price in a substitute firm, but they still might not shift, as their concern is to reach out to more people and not the price level. Further, this test should not be applied on a two-sided market as the firm is only a platform and does not control the two groups of consumers. Hence, the price structure is set because of the firm but the price level depends upon both the consumers and thereby, will not be an effective method to see whether there is any competitive constrain.

4.1 The SSNIP test:

The US Department of justice introduced the \textit{Small but Significant Non-transitory Increase} (SSNIP) test, which was applied to define a product market.\textsuperscript{12} The test assumed a firm to have hypothetical monopoly. Under the said monopoly, the firm increase price to a small level. If on price rise, the consumers do not go for a substitute than that will mean that, such a product should be consider as a separate market. However, if the consumer shift and the demand drops on the price increase then the said product will be consider to be part of the market with the other substitute products. Though in my personal opinion, this test is not the most accurate test as there can be other factors for the lack of interchangeability on price rise. For example, consumer preference, which is dependent of factors such as, price requirement, desire, ability to access, habit, etc. Additionally, this test doesn’t take into account degree of substitution between the products.\textsuperscript{13} However, for the purpose of competition law this test does serve consumer welfare.

The applicability of SSNIP test in a two-sided market, can be questioned in twofold: a) What will be considered as “price”? b) How the substitute of the product will be determined?

In a traditional market the price for the purpose of SSNIP test, is consider to be the price of the product that the consumer has to pay. However, in a two-sided market there are two prices for two different services offered by a single undertaker on the same product to two different consumers.

\textsuperscript{11} A two-sided market is where a firm enables two groups of buyers to interact and gain from their affiliation. The demand from one group of buyers depends on the demand from the other group of buyers.
\textsuperscript{13} http://arno.uvt.nl/show.cgi?fid=123016
In order to determine what is to be considered as “price” in a two-sided market, it is first required to determine whether the market is to be analyzed with respect to total investment and total return of the undertaker or per interaction with each consumer. This is important because of the indirect network effect in a two-sided market. For example, in the newspaper example, the more the advertisers the cheaper the paper will be, as the consumers are price-sensitive they will purchase more of the said newspaper. Due to the increase in readers the advertisers will use the newspaper more. This affiliation between the two consumers of the newspaper shows that the price of one consumer cannot be analyzed in isolation to determine a relevant market. Hence, it is submitted that the traditional application of SSNIP test will not be accurate for a two-sided market, unless, the same is modified.\(^{14}\)

Moreover, the objective of the SSNIP test (and of competition law to a great extent) is to ensure that that market doesn’t go against consumer welfare. For the purpose of this paper, consumer welfare is understood around two concepts i.e. innovation and price. In a two-sided market monopoly is not always detrimental, especially for consumer welfare. The indirect network effect between consumers works like a self-regulatory mechanism with respect to price. Eg, if operating systems (OS) would increase their price for the end-users, the latter group will not use the same and thereby the developers would stop making applications for the said OS.

However, this does not mean that this market doesn’t require regulation. In most cases, there is a price-sensitive consumer and a consumer whose limitation is of other factors than price, for example audience. If, there is monopoly of an undertaker in the side-which is less price sensitive, then the MSP, might overcharge such consumer. It can result in the number of consumer on the other side increase due to the price discount arriving from overcharging the other side or the firm making more profit. In the former case, there is still no base effect of the monopoly as even though the consumer is being overcharged however, the reduce of price on the other side will give such consumer more audience and hence more profit in suture. However, if it the case of the latter then the same should be regulated as it will only lead to market power not good for the consumer and economic efficiency.

Thus, price level should be considered as price of both side of the market and the indirect network effect on the consumers. Simultaneously, more importance should be given to the end result of the price structure. Until the price structure is optimally adjusted\(^{15}\) between the two consumers, an undertaker in a two-sided market, even if in monopoly, will not increase the price.

Substitution can be a very complex factor in a two-sided market. This paper, looks into what are the problem with determining a substitute in a two-sided market and thereby, analyzing the applicability of SSNIP test in a two-sided market. In a two-sided market, both consumers are

\(^{14}\) See Conclusion.

using the same product in different ways. For example, for a gamer it’s the game on the gaming console, while for a developer it is the code of the gaming console, to make games for the games to be played on the gaming console. Thus, there is scope for two different substitutes for each consumer. Further, it is possible that each consumer may face a single-sided market or a two-sided market. Also, one side of a MSP may face a single sided market while the other has a MSP, available as a substitute. Thus, a consumer might not shift based on the availability and the type of substitute available.

Thus, it is submitted that, determination of substitute is important to define “relevant market” in a single sided market however; it might not be a significant factor in a two-sided market. The rationale behind it is that, even when there is a substitute available for a consumer on one side, it might still not go for the substitute because, even after the price rise, it can be getting more gain from the other side of consumer because of the indirect network effect. Thus, the lack of shift to a substitute on price rise will show that there is no substitute and the market consists of only the said undertaker. However, in reality there might be substitute but they might not be shifting because of the effects of the affiliation from the other side of the market. One can argue that, for the purpose of competition law, the lack of shift is more important than the actual existence of a substitute or that the lack of shift shows that they are not actually a substitute of the said product for a said consumer. However, this argument will be against the objective of the consumer welfare as if the lack of shift is actually because of less price charged due to “elimination of duplication, minimizing transition costs, audience-making”\(^\text{16}\) etc.

Thus, it is submitted that a SNNIP test is not accurate in order to determine a market definition in a two-sided market.

\(^{16}\) Evans & Schmalensee, *Industrial Organization*, supra note 1, at 158
5. Market Power

“Market power exists when one buyer or seller in a market has the ability to exert significant influence over the quantity of goods or services traded, or the price at which they are traded. In perfectly competitive markets, market participants have no market power. The ability of an incumbent firm to raise its price above competitive levels is limited by the existence of or threat of competition.”

Significant market power is when prices exceed marginal cost and long run average cost, so the firm makes economic profits.

Market power is capable of affecting the demand and supply as price increase lead to lower quantity demanded and the decrease in the supply as a result of the exercise of market power.

1. Oligopoly Market Power: in an oligopolistic market, since few number of sellers have significant share, therefore, there is a high degree of interdependence among the sellers regarding their price and output policy. These firms exercise market power through cartels. A cartel is a ‘collusive agreement’ among the firms under oligopoly. Firms collude to avoid competition. They fix their output quotas and product price. Collectively they try to earn monopoly profits.

2. Monopoly Power: Monopoly power exists when a single firm is able to influence the prices in specialized market. Predatory pricing, brand loyalty, economies of large scale production are some of the ways through which monopoly power can be maintained.

A well-known example of monopolistic market power is Microsoft's market share in PC operating systems. The United States v. Microsoft case dealt with an allegation that Microsoft illegally exercised its market power by bundling its web browser with its operating system. In

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this respect, the notion of dominance and dominant position in EU Antitrust Law is a strictly related aspect.18

5.1 Sources of Market Power

The most important factor to obtain market power is to drive out the competitors out of the market through high barriers to entry.

1. **Exclusive control over inputs**: Since the firm has exclusive control over the inputs and no other firm in the market can have access to those inputs, it has the market power and can raise price of the products without losing any customers. For example Railways in India. No other firm can enter into the market and construct all the new railway tracks and start their own railway services. Therefore the current railway company has the market power.

2. **Patents and Copyrights**: This type of source of market power is a kind of barrier to entry created by the Government. Since the firm which has the patent or the copyright over the product, no other firm can enter into the same product market and the firm having patent has the market power and can increase the prices of their products. For example, pharmaceutical companies are granted patents over the drug which creates a virtual monopoly of the firm over the patented product.

3. **Economies of scale**: According to investopedia, economies of scale can be defined as “the increase in efficiency of production as the number of goods being produced increases. Typically, a company that achieves economies of scale lowers the average cost per unit through increased

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production since fixed costs are shared over an increased number of goods.” Economies of scale are factors that cause the average cost of producing something to fall as the volume of its output increases. “There are two types of economies of scale:

- Internal. These are cost savings that accrue to a firm regardless of the industry, market or environment in which it operates.
- External. These are economies that benefit a firm because of the way in which its industry is organized.

Internal economies of scale arise in a number of areas. For example, it is easier for large firms to carry the overheads of sophisticated research and development (R&D). In the pharmaceuticals industry R&D is crucial. Yet the cost of discovering the next blockbuster drug is enormous and increasing. Several of the mergers between pharmaceuticals companies in recent years have been driven by the companies' desire to spread their R&D expenditure across a greater volume of sales.”19

4. **Network Economies**: “Firms can often evade patent laws by making slight changes in design of products. Patent protection is only temporary, in any case. Finally, governments grant very few franchises each year. But economies of scale are both widespread and enduring. Firmly entrenched network economies can be as persistent a source of natural monopoly as economies of scale. Indeed, network economies are essentially similar to economies of scale. When network economies are of value to the consumer, a product’s quality increases as the number of users increases, so we can say that any given quality level can be produced at lower cost as sales volume increases. Thus network economies may be viewed as just another form of economies of scale in production.”20

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5.2 Strategies of Market Power

Common strategies in one-sided markets like innovation, advertising, and quality investment can take on added dimensions in a two-sided market. I discuss such strategies briefly in this section, as well as some strategies that are specific to two-sided markets. Many businesses in two-sided markets rely on pricing, new technology, openness and innovation. Investment is also one of the major concerns for the platforms in a two sided market.

- **Introducing Latest Infrastructure:** Products and services that bring together groups of users in two-sided networks are platforms. They provide infrastructure and rules that facilitate the two groups’ transactions and can take many guises. In some cases, platforms rely on physical products, as with consumers’ credit cards and merchants’ authorization terminals. In other cases, they are places providing services, like the above given example jobspitara.com. For the end users, most important features regarding latest infrastructure/technology are: Registration through SMS, E-mails, Telephonically and at Offline franchise centers with the minimum cost of Rs. 50. On the other service providers are provided with the service of ‘E-shots’ (Data for Marketing). With the help of E-shots, the service provider can get the details like E-mails, contact details of a particular group of people.

- **Value Change of Services Offered:** Two-sided networks can be found in many industries, sharing the space with traditional product and service offerings. However, two-sided networks differ from other offerings in a fundamental way. In the traditional value chain, value moves from left to right: To the left of the company is cost; to the right is revenue. In two-sided networks, cost and revenue are both to the left and the right, because the platform has a distinct

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group of users on each side. The platform incurs costs in serving both groups and can collect revenue from each.

For example, in the case of jobspitara.com, it offers services at local level also as it is a local search engine and performs throughout the country. Moreover, no particular education qualification is required for someone to register oneself on the website. Even an illiterate person can get registered through offline franchise centers. For example a person is willing to work in a provisional store and a shopkeeper is looking for a person to be employed there. Both of them can register themselves on this website and can even get help at a local level.

- **Pricing Policy:** “Pricing in two-sided markets has received considerable attention in formal economic research. The main result is that pricing to one side of the market depends not only on the demand and costs that those consumers bring but also on how their participation affects participation on the other side and the profit that is extracted from that participation.”

For example, in the above mentioned case, the services to both sides of the market i.e. service providers and end users are being provided at very low cost. Since the registration cost for the employees (end users) is very low, more people are willing to get registered on this website, as a result of which, the number of employers (service providers) willing to register also increases.

Due to increasing competition, prices are set keeping in mind the entry of new rival firms and existing firms in the market. Well established firms can lower down the prices of their products in order to drive out the other rival firms out of the market. But during my research, I have seen that jobspitara.com, being a new launch in the market has already set the prices for services very low as compared to the other rival firms. Moreover, it has established more than 1000+ offline centers.

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6. Market Power in a two-sided market:

Table -1

<table>
<thead>
<tr>
<th>Industry</th>
<th>Platform</th>
<th>Side 1</th>
<th>Side 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment</td>
<td>Credit cards (Visa, Master card)</td>
<td>Consumers</td>
<td>Merchants</td>
</tr>
<tr>
<td>Portable document</td>
<td>Document standard (Adobe PDF)</td>
<td>Readers</td>
<td>Publisher</td>
</tr>
<tr>
<td>Employment</td>
<td>Recruitment website (Monster.com; jobpilot.de)</td>
<td>Applicant</td>
<td>Employer</td>
</tr>
<tr>
<td>Auction</td>
<td>Online auction website (eBay)</td>
<td>Buyer</td>
<td>Seller</td>
</tr>
<tr>
<td>Scientific publishing</td>
<td>Academic journals (ASQ, management science)</td>
<td>Reader</td>
<td>Author</td>
</tr>
<tr>
<td>Real estate</td>
<td>Real Estate agents; online portals (property.com)</td>
<td>Home buyer</td>
<td>Home seller</td>
</tr>
<tr>
<td>Advertising supported</td>
<td>Magazines (the Economists)</td>
<td>Consumer</td>
<td>Advertiser</td>
</tr>
<tr>
<td>(Heterosexual) dating</td>
<td>Online dating websites (match.com)</td>
<td>Men</td>
<td>Women</td>
</tr>
</tbody>
</table>
Table 1 above shows that in the payment industry in case of use of credit cards the merchants on one hand benefit on the other the consumers who use the cards also benefit. Another example is in case of online auction websites, the person who auctions benefits by advertising and selling for which the seller pays for the advertisement and the buyer benefits by buying it for a market price.

In a two sided market the market would be further divided as:

1) Two-sided single-homing model and
2) A competitive bottleneck model.

In the single-home model, agents of both groups i.e. both the companies join only one platform (single-home). In the competitive bottleneck model, one set of agents joins as many platforms as they like (multi platforms) while the other set single-homes. Night clubs are an example of the of the single home where men and women both share the same platform, where men and women choose one club. Magazine advertising is an example of the latter, where advertisers advertise in multiple magazines while readers choose one magazine in each segment. In case of the newspaper market, it is a two sided market because on one side is the readers market and on the other side is the advertisers market.

In UK there are few newspapers which are sold to the readers free of cost where the readers don’t have to pay anything to buy those newspapers. The newspaper needs revenue and as the readers don’t have to pay for buying the newspapers, the advertises in the newspaper are a source of revenue. There are more ads in these newspapers as but they are more widely read as the readers get the benefit of not paying for the cost of the newspaper. The readers read these newspapers and these advertisements in these which results in more sale of the products. So therefore one hand the advertisers capture the market and increase their profits by adding on more market power on the other hand the consumer i.e. the readers also benefit which helps the newspaper to be more famous and it is sold more. So from a single platform the advertisers benefit and also the consumers benefit.

Market power is the ability to price above short-run marginal cost. It refers to conditions where the providers of a service can consistently charge prices above those that would be established by a competitive market. This concentration of power is bad for consumer welfare and leads to productive and dynamic inefficiencies. The two ways to determine whether there an undertaker

23 Available on http://books.google.co.in/books?id=wCzdoiVyz0YC&pg=PA38&dq=two+sided+market+examples&hl=en&sa=X&ei=m3yqULz6B8XMhAeRIY4Ag&ved=0CCwQ6AEwAA#v=onepage&q=two%20sided%20market%20examples&f=false

24 Fernando L. Alvarado, USA : Market Power: A Dynamic Definition, University of Wisconsin Madison, Wisconsin 53706.
has market power, in a traditional market, are the indirect test and the direct test. This paper only deals with the indirect test.

6.1. In-direct test to determine Market power in a two-sided market:
The Commission’s Guidance on Article 102 Enforcement Priorities states that market shares provide as a first indicator of the structure of a market. The in-direct test, in an antitrust case, is conducted on the same principle. First a relevant market is defined and then the market shares held by the firm(s) is observed. Since, the paper has already discussed above the problems of defining a relevant market in a two-sided market, this section of the paper will only look into the whether market share is the required factor to determine market power for a two-sided market and what are the limitations of the same.

In a two-sided market this test does not help to determine the market power, as:

i) The ability of an undertaker to price above marginal cost is not related to the market share of such an undertaker in a two-sided market. This is because of the fact that the consumers in a two-sided market are affiliated. Thus, the indirect network effect gives a MSP market share in both markets. Hence, one might not hold major market share in one side of the market but still be in a position to restrain competition because of the presence of the other side of the market and the benefit from their affiliation. Thereby, even if market share is determined within both sides of the markets, it will still not amount to market power as a two-sided market is price structure is more important than the price level.25

ii) Market share analysis is based only on the actual competition in the market and does not take into account the potential undertaker. In a two-sided market it is important to keep into account the potential undertakers of both side as the indirect effect between the two can affect the other side of the market also. Further, Market share doesn’t not look into factors that decided potential increase in market power such as, new technology

iii) Market share may be a useful first indicator for a market where there are homogenous goods however, in a two-sided market, there are two different consumes and goods thereby, the market share will not be able to identify the accurate power that the MSP enjoys and is thereby, capable of abusing.

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COMPETITION ISSUES FOR TWO-SIDED PLATFORM:

The various competition issues faced in the two-sided market platform are as follows:

1) Economics of two sided platform:
   - Unlike traditional product markets, multi-sided platforms uniquely involve a choice over price structure and price level that "gets both sides on board". A platform can subsidize one side to attract a large user base (particularly if the users are exclusive), the other side's elasticity is reduced and the platform can exert market power to impose a higher mark-up. Therefore, this approach has become much popular in the present world.

2) Anti-competitive strategies in two-sided markets:
   - Network externalities of such platforms also present prospect for the exercise of market power and unique anti-competitive strategies to exclude rival platforms. This is done through means of attaining monopoly in the market and reversing the theory of perfect competition where there is easy exist and entry in the market. The various strategies which are followed are:
     - Exclusivity arrangements:-
       - Platform with market power, derived from the indirect network externalities from a large user base on one side, can potentially impose exclusivity arrangements on the other side or extend its market power into related markets through bundling. In the context of two sided platforms, the benefit to a platform of exclusivity arrangements are heightened since exclusivity on one side enhances market power on the other side.
     - Price Coherence as a form of exclusivity:-
       - Requirements for "price coherence" in the context of two-sided platforms (such as the no surcharge rule for credit card payments) represent vertical restraints that may limit inter platform competition
     - Facilitating collusion through two-sided platforms:-
       - A platform might be used to facilitate collusion between users on one side of the platform, both resulting in inefficient diversion of volume to that platform and leveraging the value of access to the platform (and the detriment to an individual member if access is revoked) to enforce the terms of an effective cartel.
Possible ‘Competition’ Concerns

1) One side of a market ‘tilts’ in favour of one platform

   Platform might leverage market power (abuse dominance e.g. exploitative behaviour, apply restrictive terms)

2) Vertical integration

   Refuse to deal favouring own affiliates (possible anti-competitive discriminatory conduct)

3) Collusion

   May arise if there are few sellers and many platforms, or more likely few platforms and many sellers
   In October 2002 Sotheby’s was fined £12 million by the European Commission for rigging the art market in collusion with rival Christie’s. Christie’s escaped a fine because it blew the whistle. The fine represented 6% of the company’s annual turnover.

4) Horizontal bundling across platforms
Conclusion:

It is submitted that market power should not be seen anti-competition as, market power of one side of the market is good for both side, as it will give MSP the potential to charge the prize sensitive side of the market less and maintain such a position. Further, it will help the MSP to reach economies of scale and thereby be good for total welfare i.e. consumer welfare and welfare of the platform. Further, the chances of undertakers increasing their price is almost nil due to the indirect network effect between the two firms. Additionally, though unobserved but the effects of the interactions are beyond the interaction. For example, a newspaper get more advertisers, the readers will benefit from the low price of the paper, which has been possible from the advertisement money. However, the consumer giving the advertisement also gains from the effect of the interaction i.e. in this case a reader going a purchasing a product due to the ad. At all times affiliation of consumer must be kept in mind, as it is one of the key features of a two-sided market.\(^{26}\)

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\(^{26}\) Weyl, 2009 and Evans 2003.