Two-Sided Markets

Characteristics & Implications for Airports' Competition Assessment

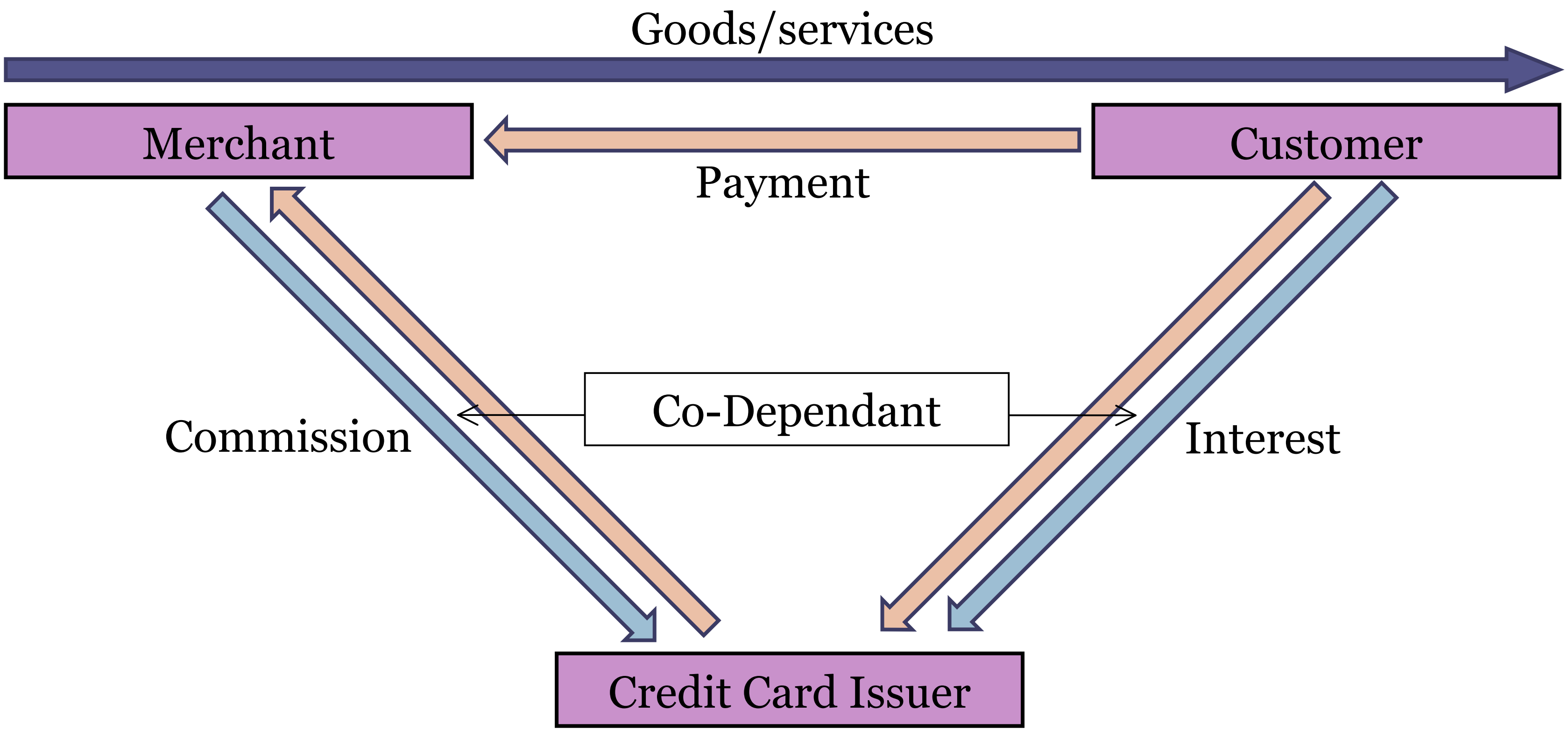
CAA 11th November 2010

Characteristics of Two-Sided Markets

- Two-sided markets are interesting when the platform does business with two groups who need each other and when the demand from both sides depends on the demand from the other, so:
  - if there are no merchants, then no customers are willing to carry the card; &
  - if there are no customers, then no merchants are willing to accept the card.

- This co-dependency leads to a cross-price effect in both directions:
  - if the card issuer raises the rate of commission (cost to merchants), the number of merchants falls and so there are fewer customers willing to carry the card; & similarly
  - if the card issuer raises the interest rate (cost to customers), the number of customers falls and so there are fewer merchants willing to accept the card.

Example of a Two-Sided Market



Competition Analysis

- Because both the level and structure of prices matter[1], neither side of the market may be considered in isolation, so:
  - competition authorities must therefore consider the whole operation, when assessing issues of SMP/dominance; &
  - this assessment may become more complex, if it appears that one side of the market has market power, but not the other.
- It may be that a platform can exploit its market power on one side of the market, but not the other, because:
  - high prices on the one side would put off customers on the other (competitive) side;
  - which in turn would put off customers on the non-competitive side.
- Airports may at first sight look like one such example – and this is certainly what LGW is seeking to imply.

[1] See also 'Two-Sided Markets: A Progress Report', Rochet & Tirole 2005.

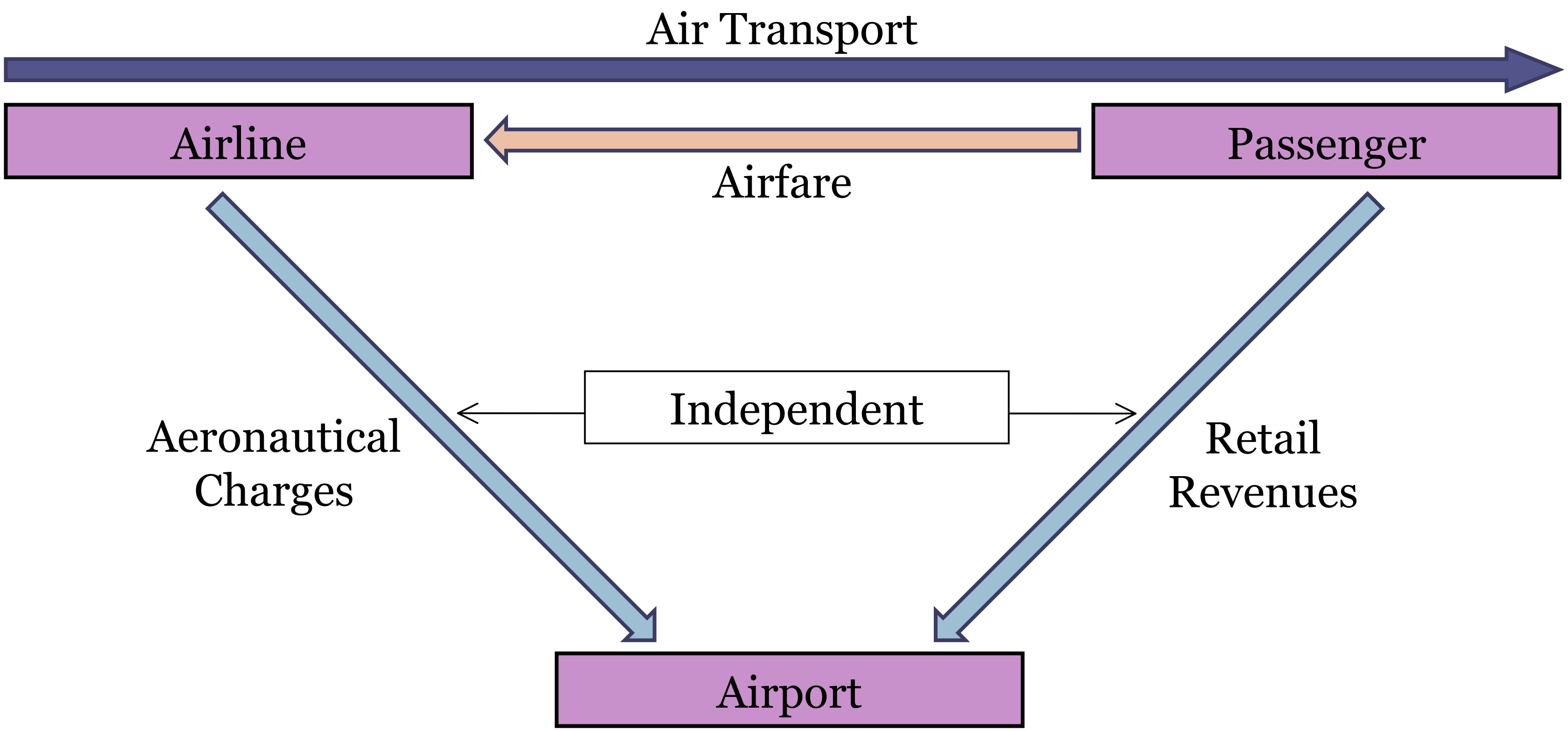
Airports as Two-Sided Markets

- Two-sided market thinking is useful in considering the relationship between airports, airlines and retailers, because:
  - the price paid for aeronautical services can't be considered without reference to an airport's retail function; &
  - this is why there is a single-till.
- It is not useful to suggest that if retail is competitive, this reduces market power on the aeronautical side, because demand from retailers for terminal space is dependent on passenger numbers; however
  - the number of passengers is independent of the number of retailers so it is not a two-sided relationship/co-dependency that may be solved simultaneously; rather
  - it is a one-way dependency, wherein retail profits are a positive spin-off from the airport operation.

Airport Retail

- Whether or not retail is competitive at the shop rental level, market power is not reduced on the aeronautical side because for the airport, it is a one-way calculation:
  - maximise profits from aeronautical services, taking into account the spin-off profit from retail.
- The absence or presence of market power on the retail side has no bearing on the airport's ability to exploit aeronautical market power, so:
  - a monopoly airport would set the same aeronautical charges, irrespective of whether or not retail is competitive; because
  - the price of retail does not effect the number of passengers.

Airport Retail



Conclusion

- The competitiveness of aeronautical services should be assessed on their own merits, without regard to two-sidedness; however:
  - two-sidedness is useful when it comes to efficient pricing; because
  - competitive airports know that additional passengers will generate additional retail revenues - and so
  - they factor this *externality* into their aeronautical pricing; hence
  - they adopt the single-till.