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ORIGINAL RESEARCH PAPER

Economics

TIE-IN AGREEMENTS: EXPLOITATIVE OR BENEFICIAL

KEY WORDS: tie-in, agreements, base-commodity, exploitative, consumers

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ABSTRACT

Study shows that Tie-In arrangements are not an exploitative strategy, but a facility provided by suppliers pursuing greater consumer preference and convenience. It is an exercise of the freedom of firms to determine the form of their supplied commodities. It is not an anticompetitive measure, but instead a co-operative measure undertaken for mutual benefit of firms & consumers. If the Tie-In is unable to cater to the consumer preferences against the charged price, then such tie-in would result in loss of preference of both commodities in a free market.

1- INTRODUCTION

Under mainstream economic literature, tie-in agreements are explained as an arrangement whereby the purchase of a commodity is conditional to the purchase of a second commodity, either related or unrelated to the first. It is termed as a form of price discrimination, wherein a base commodity with a strong market preference is used to tie a second commodity with small market share, to increase its sales. The tying or base commodity is decided as per the market of dominance of the firm, and the tied commodity is from a market without dominance.

2-Research Methodology:

The main objective of the study is to find out whether the tie-in agreements by firms are exploitative or beneficial to firms & consumers. Other supportive objectives are-

1- To understand the meaning of tie-in agreements
2- To explain consumer preferences
3- To elaborate Inter-Market Dominance by firms
4- To find out the causes & benefits of tie-in agreements
5- To discuss case studies

The study is based on secondary data collected from reference books, journals & articles.

3-Definition and Concept of Tie-In:

Tie-in agreements are defined under section 3(4) explanation (a) of the Competition Act, 2002 as any agreement that requires a buyer to purchase some other goods as a condition for the original purchase agreement. This concept introduced the leverage theory, which further developed into the Barriers of Entry theory of Harvard School of Thought. The leverage theory states that the tying product, in which the firm has dominance, acts as a leverage to improve the performance of the tied product by raising its sales indirectly. This leverage of the dominant commodity assists the tied product to perform better in its own market. This increases the complexity of entry for new entrants, as the tied product can avail the benefits of dominance of a separate product from a different market. This is considered to be harmful for consumer welfare and is thus prohibited under the Act.

4-Consumers Preference:

In a free market, all transactions are voluntary exchanges. The parties would enter into a transaction only if their self interest is met. The general explanation follows that the buyers seek to purchase only the base product and are instead pressured to buy the tied product, as a condition imposed on their preference and value judgment. While the given explanation appears intuitive, the preference ranking of consumers is a much more complex procedure. The researcher adopts an example of product A tied to a base product B, for simplified elaboration. Consider a consumer seeking to purchase a product A, when product B is tied to A. Then, under such a tie-in, the choice is not separate for A and B. They are no longer individual products to be considered separately, but are a package set with a joint price. Thus, the preference consideration given for the tied-in products would be distinct compared to individual products.

If a consumer seeks to purchase only A, then comparison shall be made between the price, quality and other factors of preference of the A-B set and competitors of A. Competitors of B shall not be considered as B is not the primary object of purchase. If the price of A-B set, and the quality and related parameters of A are more preferred to the competitors, then the consumer will buy the tie-in set regardless of the preference for B. The price of B shall not be viewed separately, but will be combined with price of A. If A draws higher preference even at the higher set price, then it implies that the price differential created by the additional price of B in the set is covered by the preference value assigned to the other characteristics of A.

If the buyer seeks to purchase both A and B, then consideration shall be given to both A and B. Depending on the individual characteristics and their preference of each product, the buyer shall be able to determine the collective preference for the set A-B. This collective set shall be compared to the various sets that the consumer can create from individual product alternatives purchased separately from the market. If the A-B set provides the best value compared to such individually purchased alternatives, then the set will be preferred even if B is of lower quality than its competitors. If not, then the consumer will prefer to buy alternative products individually in an attempt to maximize their perceived value.

It means, for all purchasing decisions, the buyers consider the tie-in as a distinct entity, rather than individual products tied together .i.e. single set product A-B. This perception is more conducive for a cleaner comparison with other competing products made into customized sets by the consumer. Thus, it cannot be truly said that the choice of the consumer is being limited. What the product comprises is determined by the supplier, while the success of it is decided by consumer preference.

5-Inter-Market Dominance by Firms:

Another point that the mainstream theory puts forth is that the position of dominance in one market is of little effect to the purchasing decisions of buyers in another market. To explain the same, the researcher follows the provisions of the Act and assumes a firm to be dominant in the market of product A and not in market of product B. The dominance of A shall imply that A is differentiable from its competitors on the basis of brand, quality, and other features, which may allow it to charge a higher price in the market without discouraging demand. This price differential is the extent of preference for A over its competitors in the market of that line of commodities. This price differential is unique to A and is not available to B. If the firm attempts to raise the price of B by relying on the tie-in, the total price of the set will increase. Here, the buyer does not view the product B as being differentiable in a manner to warrant a premium price. Thus, the higher price of the set is assigned to product A in the consumer's perception. The consumption decision shall be made by comparison of the perceived higher price of A, with the value of other features of A. If this higher price of A is felt greater than the value of A by the consumer, then the set will not be purchased. Instead, the consumer may shift their preference to the individual competitors of A and B. It means the dominance of A has very low impact on the profitability of B. Therefore sustained method to create and expand market share is attracting consumer preference by providing value.

6-Causes & Benefits of the tie-up arrangements:

The researcher now seeks enquiry into the causes of the tie-up arrangements between firms. As discussed earlier, all alleged anti-competitive agreements are undertaken by the firms to maximize their profits. The risks and issues involved in an exploitative practice are known to the firms. In free markets each firm attempts to draw consumer preference. Tie-in agreements are drawn to serve the interests of the firms, as well as the consumers. The free market is not a zero sum game. Entering a tie-in allows the firms to be able to sell both products at a lower cost & also helps the brands to differentiate themselves and participate in a stronger inter-brand competition. It acts as a deterrent to the free riding issues and assists the growth of new, innovative entrants by tying them to market leaders. A tie-in also acts as a quality test of the tied product, since no tying product would risk being related to a poor quality product which could damage its brand value and consumer loyalty. The buyers benefit by lower search costs, quality assurance & benefits of competition. It reduces the uncertainty of supply faced by the consumers. It is true that all consumers may not agree with all aspects of a business contract. Therefore there exists the need to recognise and rank the various segments of the agreements. This comprehensive ranking helps the consumers in making consumption decision. In this context, it is also necessary to safeguard the rights of the firm to operate with their freedom.

7-Case Studies:

The researcher gives brief facts of two cases and comments on the necessity for the intervention from Competition Commission of India. The CCI charged a hospital for operating a tie-in agreement in case of Ramakant Kini vs D.R. L.H. Hiranandani Hospital (2012). In this case, a young couple had registered with Hiranandani hospital for maternity related services, including prenatal consultancy and delivery of the child. They had also separately hired M/S Life Cell India Pvt Ltd for its service of stem cell bank collection and storage for the child. The collection of the stem cell must be performed within 10 minutes of delivery. The couple made a request to the hospital for cooperation and permission for the same. The hospital refused and instead offered the services of Cryobanks International India for the same, since the hospital had a tie-in, exclusive agreement with Cryobanks for the services relating to stem cell collection and banking. This was not known to the couple before. The couple having priority of services of Life Cell India Pvt Ltd over the set of Hiranandani Hospital – Cryobanks services shifted to Seven Hill Multi-Super Speciality Hospital and continued their agreement with Life Cell. Thereafter, the couple filed a suit with CCI against Hiranandani Hospital. As a result of this suit, the hospital was levied a penalty for contravention of the provisions of the Act. It reveals that couple, preference lies with separate products than the offered set, which they followed in their choice. Hiranandani hospital is a dominant firm in its geographical market, but still lost sales due to the adverse preference of the consumers regarding its tie-in. If this adverse preference to the tie-in exists then more of its potential sales are lost. If the tie-in survives in the long run, it is the tacit revelation of consumer preference for the set of products tied together. Then the need for the CCI to act has no concrete basis. There was no exploitation, valid competition and protection of consumer freedom.

Another case is Noida Software Technology Park Ltd (NSTP) against Star India Pvt Ltd (2017). In this case, NSTP accused Star India, Sony Pictures and Indian Broadcasting Foundation (IBF) of price discrimination, tie-in agreements, abuse of dominant position, among other contraventions of the Indian competition law. The claimed tie-in agreement was made in the set of channels offered through distributors, by broadcasters. In such a set, called bouquets, popular channels are bundled with a few unpopular channels to increase the subscriptions of the latter. Since the subscription is made for the whole bouquet, it applies to all channels. This increases the advertisement revenue earned by even the unpopular channels. The offers were made at very low prices. This incentivizes the distributors to promote the bouquet, even though it has some unpopular channels. So the distributors by passing forward the low price advantage, to the users, can attract a larger market share. The prices are set so that the bouquets are more preferred by the users, thus providing subscribers to the unpopular channels. Though the price of the set is lower but the choice provided in reality was illusory. The rise in advertisement revenue thus earned by the unpopular channels is termed as unfair.

This perspective seems mistaken. When the broadcaster offered a set of channels, the set became a product distinct from the individual channels offered. By this view, the unpopular channel of the set, which is assumed to be undesirable, is an aspect of the quality of the set, and not a separate product therein. Following this line of thought, the lower price of the set is considered as a compensation or discount for the presence of the unpopular channel. The users are offered a choice between the price difference of the set and the selection of individual choice. If the value of the price difference of set is greater than the disutility from the unpopular channel, for the user, then the set shall be subscribed. If not, then channels will be selected individually or distributor will be changed. But in either case, the choice is not illusory. Another flaw in the reasoning is the unsustainability of the strategy adopted for generating advertising revenue for the unpopular channels. The advertisement provider places advertisements, for getting value from the viewership. If, as per the claim, the unpopular channel only has dummy subscribers as a result of the tie-in, then the provider would witness no translation of the viewership into sales. In that case provider would withdraw their advertisements from the channel to a separate channel with better viewer-to-sales conversion ratio.

8-Conclusion:

Thus, study shows that Tie-In arrangements are not an exploitative strategy, but a facility provided by suppliers pursuing greater consumer preference and convenience. It is an exercise of the freedom of firms to determine the form of their supplied commodities. It is not an anticompetitive measure, but instead a co-operative measure undertaken for mutual benefit of firms. If the Tie-In is unable to cater to the consumer preferences against the charged price, then such tie-in would result in loss of preference of both commodities in a free market.

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