Discussion of Justin P. Johnson’s “MFN Clauses and the Agency and Wholesale Models in Electronic Content Markets”

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Research Question: Investigation of Agency Model of Sales and Interaction with MFN Clauses

- Important issue examining the contractual relationships between retailers and content suppliers
  - Agency model allows for supplier to reach through retailers and set end-customer prices
  - MFN clauses in this context are guarantees of best prices for the end-customer
- Growth of agency models in marketplaces for electronic applications as well as e-books
- Related questions and implications: welfare impacts, incentives for content development, entry & exit

Summary of Results

- Agency model leads to higher prices in the first period and lower prices in the second period relative to wholesale model
  - Depends on retailer lock-in created by first period choice: retailers have incentive to “subsidize” first period prices, suppliers do not
  - In the wholesale model, retailers do not fully pass through first period price cuts: consumer welfare is higher under the agency model
- The ***combination*** of the MFN and agency model’s reach-through pricing force prices to be the same across retailers
- As a consequence, suppliers have no mechanism to favor one retailer over another in response to different revenue-sharing
  - Retailers have no incentive to compete to offer a higher revenue share to the supplier leading to higher retailer profit
  - May serve to induce retailer entry into the marketplace and encourage market investments

Comments on MFN clauses in Agency Model

- MFN clauses have typically been viewed as a way to soften competition and raise prices
  - Solve time inconsistency or dynamic issues faced by the monopolist seller; not applicable here, no effect of MFNs in wholesale model
  - May not always constrain downstream retail competition
- MFNs change the retailer competitive dynamics but with no ultimate effect on retail prices
  - Result depends in part on the symmetry of the retailers; different levels of market power for retailers might impose a cost for implementing MFNs
  - Alternative/additional substitute product formats introduce other incentives

Comments on Retailer/Platform Entry from MFNs

- Retailer/Platform entry raises consumer surplus through added variety (Hotelling model)
- The presence or introduction of MFNs can spur entry by providing higher retailer profits
- MFNs also can help spur entry
  - By restricting retail pricing, it also can resolve uncertainty over revenue sharing between the supplier and the retailers
  - Ex ante beliefs about incumbent behavior restricted by MFNs
- The use of MFNs to resolve uncertainty at each level (consumer, retailer, and supplier) is intuitive with interesting extensions

Thoughts on Further Potential Extensions

- Consumers with access to multiple retailers/platforms
  - Effects from weakening lock-in effects?
  - Vertical integration of suppliers and selected retailers/platforms? Does that affect the preferred contracts? Pricing of retailer/platform access?
- With multiple retailers/platforms, MFNs might have further implications:
  - Reducing consumer search costs
  - Effects from purchasing from non-preferred retailer/platform
  - Incentives to buy multiple platforms to “bargain hunt”
  - Simplify retailer pricing problem and avoid constant “real time pricing” updates

Wrap-up

- Topical and relevant question
- MFNs take on an interesting role in the agency model leading to interesting results
- High relevance for antitrust analysis and brings attention to important trade-offs in examining these contracts