

Agenda

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Parity agreements and theories of harm in the hotel booking sector: a ‘no-show’?

On 6 April 2017, the European Commission and ten national competition authorities published a joint report on the online hotel booking sector. The report’s primary focus was the impact on prices and commission rates of the removal of parity or ‘most-favoured-nation’ (MFN) clauses in European countries. The results were not as conclusive as some economists and lawyers expected. Why might this be, and what’s next for MFN clauses?

In the hotel booking sector, MFN (or parity) clauses are contractual terms agreed between hotels and online travel agents (OTAs) such as Expedia. MFN clauses usually stipulate that a hotel will offer its rooms to the OTA on terms (usually room price and availability) that are as good as, or better than, the best terms offered elsewhere (e.g. to other OTAs such as Booking.com).

These clauses are usually classified as ‘wide’ or ‘narrow’. Wide MFN clauses typically require hotels to give the OTA the lowest room prices and best room availability relative to all other sales channels, whereas narrow clauses allow the hotel to offer lower room prices and better room availability on other OTAs, and typically on offline sales channels, but not on its own website.

Such clauses can be attractive to OTAs as they can help to prevent other companies from ‘free-riding’ on the OTA’s investment in its own website and services (such as a user-friendly reviews system). In this context, free-riding can take place when consumers use the OTA to find their preferred accommodation, and then book it elsewhere online at a lower price. When that happens, the OTA does not receive a commission from the hotel for the booking, even though the sale originated from its website.

However, MFN clauses can be detrimental to competition. For example, these clauses can soften competition between OTAs, increase commission rates and prices, and even foreclose the expansion of new and smaller OTAs. As a result, a number of national competition authorities in Europe have carried out separate investigations in relation to MFN clauses based on similar ‘theories of harm’.

In November 2015, the heads of the European Competition Network (ECN) commissioned a ‘monitoring exercise’

focusing on the hotel booking sector. The results of the exercise—carried out by the European Commission and ten national competition authorities—were published in April 2017.¹ Although the evidence did not provide clear support to the authorities’ theories of harm, it did provide greater clarity on how the sector operates and the potential effects of MFN clauses.

This article looks at the motivation behind the exercise and its main results, before providing some thoughts on the weight of the resulting evidence.

Why did the ECN undertake the monitoring exercise?

Since 2010, several competition authorities in Europe have opened investigations into the hotel booking sector, and specifically the agreements between the largest OTAs and hotels. The authorities have been concerned that these agreements might have infringed EU and domestic competition laws.

Although some competition authorities decided to coordinate their work due to the similarity of such clauses across Europe, others have acted independently. Consequently, different approaches and remedies have been adopted. For example, in Germany, the Bundeskartellamt prohibited all MFN clauses for Hotel Reservation Service (HRS, a major German OTA) in late 2013, and for Booking.com in late 2015. In comparison, in France, Italy and Sweden, MFN clauses were not subject to an outright ban, although in April 2015 Booking.com committed to using less restrictive clauses. Later that year Booking.com and Expedia opted to remove the wide clauses across the EU.

The ECN decided to commission a Europe-wide analysis of the clauses used by the larger OTAs, primarily in order to ensure consistency in the treatment of such clauses in the future. This monitoring exercise focused on analysing the results of the removal, in mid-2015, of wide MFN clauses. Their removal across Europe at around the same time meant that a during-and-after analysis could be undertaken of the impact that MFN clauses had on the industry, and the effects of the policy changes could be evaluated.

What were the main results of the monitoring exercise?

To monitor the effects of the removal of wide MFN clauses, the ECN mainly used a database constructed from a survey of around 1,600 small and large hotels and hotel chains across ten European countries. In addition, price data over time was obtained from metasearch websites. As well as a simple during-and-after analysis, the ECN used econometrics to compare how prices in Europe had evolved compared with prices in Canada.²

The main focus of the analysis was to assess whether, following the removal of wide MFN clauses, OTA commission rates had fallen, and whether the extent of differentiation in room prices and availability across sales channels had increased.

Commission rates

One of the theories of harm, considered in most of the competition authorities' investigations, was that wide MFN clauses can reduce OTAs' incentives to compete on commission rates. Therefore, the ECN sought to examine whether OTAs' commission rates had decreased following the removal of these clauses.

The results showed that there was no clear evidence that commission rates had changed between July 2015 and June 2016.³ Around 90% of hotels saw no difference in the commissions charged by the OTAs. In addition, a very small number of hotels sought to proactively offer OTAs better room rates or availability in return for a lower commission.

Price differentiation

The main reason why the ECN monitored price differentiation between OTAs was to understand the extent to which hotels distinguished their offer across their OTA partners. High price differentiation might indicate that hotels were taking advantage of the removal of MFN clauses by varying their prices to better reflect the relative attractiveness of different OTAs.

The econometric analysis indicated that, for most of the ten countries, there was some price differentiation, which was driven mainly by the pricing decisions of hotel chains.⁴ However, in answering the questionnaire, nearly 80% of

hotels said that they had not knowingly price-differentiated between OTAs.

Room availability

The ECN also looked at whether the removal of MFN clauses motivated hotels to reward certain OTAs with better room availability. Again, the evidence showed that, for the vast majority of hotels, this was not the case. For example, more than 80% of hotels that replied said that they did not change their behaviour after the MFN clauses were removed.

Why weren't the results more conclusive, according to the ECN?

Ultimately, the analysis undertaken by the ECN did not provide conclusive evidence that MFN clauses caused harm in the hotel booking sector. Indeed, the ECN recognised that there were a number of limitations with its analysis, which could have undermined the strength of its conclusions.

According to the ECN these relate, among other things, to the hotels' awareness about the MFN clauses in their contracts having changed, the representativeness of the sample that participated in the surveys, and the fact that, in many European countries, a mix of narrow and wide MFN clauses are still in place.

More specifically, nearly half of the hotels (47%) were not aware that their MFN agreements with hotels had changed (either because OTAs had chosen to remove the clauses or were forced to do so). Even among those that did know about the changes, the majority had not acted on them in any way. This might indicate that the sector has not yet fully adapted to the changes made to the major OTAs' parity clauses.

In addition, the response rates in the surveys were low, especially for some countries, which may have limited the accuracy of the results. The average rate was 12%, which was driven mainly by a high response rate from Germany (92%). In many European countries it was significantly smaller; for example, the response rates in France and the UK were 3% and 5%, respectively.⁵

Lastly, it is worth noting that, within many countries, there are differences between OTAs in the application of MFN clauses. For example, in Germany, Expedia still uses narrow MFN clauses, while Booking.com and HRS are prohibited from doing so. In many European countries smaller OTAs may still apply wide MFN clauses, while these have been removed by Expedia and Booking.com. These differences could create confusion about how the different OTAs allow hotels to set prices and availability, and might therefore mean that hotels apply the same conditions across all of them.

Is this the beginning of the end for MFN scrutiny?

Following the publication of the report on the monitoring exercise, the ECN 'agreed to keep the online hotel booking sector under review and to re-assess the competitive situation in due course'.⁶

Some national competition authorities also decided not to move ahead with additional work. For example, the UK CMA 'has decided not to prioritise further investigation on the application of competition law to pricing practices in this sector' and 'plans to...raise awareness among UK hotels of the changes made by Expedia and Booking.com'.⁷ So, is the ECN report the beginning of the end for MFN scrutiny in the hotel booking sector? This is unlikely to be the case for a number of reasons.

First, as highlighted by the ECN, the results of the monitoring exercise were subject to a number of limitations that could have undermined the strength of its conclusions (such as low response rates and awareness among hotels about their MFN clauses).

Second, the following features of the hotel booking market mean that, currently, MFN clauses are not necessarily the primary driver of pricing behaviour and outcomes.

- **Compliance with contractual obligations:** it is possible that some hotels already discriminated between OTAs even though they were not allowed to do so by the MFN clauses. For example, for the same room price a hotel might have offered a free breakfast or a better room if a customer booked through certain OTAs. The ECN recognised that this was a possibility.⁸ As a result, it is likely that MFN clauses were not necessarily as restrictive as the various national competition authorities assumed.

- **Relative importance of OTAs:** according to the evidence gathered by the ECN, the combined 'offline' channels (e.g. telephone bookings) and sales through a hotel's own website accounted for more sales than those through OTAs.⁹ Therefore, it is possible that hotels are not yet incentivised enough to discriminate between OTAs and to price-differentiate, and would rather focus their efforts on the channels that are responsible for the majority of their sales.
- **Preferred partner programmes:** many OTAs have a 'preferred partner programme' in place. These are voluntary schemes that promote the ranking and visibility of member hotels and usually come with parity clauses. Therefore, it is possible that, although the compulsory clauses were banned or removed by the OTAs, hotels still decided to use them since they helped them to achieve better visibility.

However, if these conditions change in the future (for example, if the algorithms used by OTAs increase monitoring and compliance), it is possible that MFN clauses will have a stronger impact.

Concluding remarks

Ex post policy evaluations, such as the one undertaken by the ECN in this case, are crucial in ensuring effective enforcement of competition rules. They can provide important evidence on the effects of competition policy, and help national competition authorities in future cases.

Overall, the decision of the ECN to keep the online hotel booking sector under review appears sensible given the low awareness of changes regarding MFN clauses in the industry, especially as the market evolves and adapts to these developments.

¹ European Commission and the Belgian, Czech, French, German, Hungarian, Irish, Italian, Dutch, Swedish and UK national competition authorities (2017), 'Report on the monitoring exercise carried out in the online hotel booking sector by the EU competition authorities in 2016', April, http://ec.europa.eu/competition/ecn/hotel_monitoring_report_en.pdf.

² The econometric analysis that involves comparing a 'treatment' group (in this case, European countries) with a 'control' group (in this case, Canada) over time is called 'difference-in-differences'.

³ It is possible that, had wide MFN clauses been valid in that period, commission would have increased significantly instead. If this was the case then the removal of the MFN clauses would have had an impact (i.e. because commissions were lower than they would otherwise have been). The ECN did not carry out such analysis.

⁴ This result was also subject to a number of caveats, such as whether price differences reflected differences in quality.

⁵ The Competition and Markets Authority (CMA) in the UK is 'generally cautious of giving evidential weight to surveys where the response rate is below 5% because of the non-response bias potential'. See Competition and Markets Authority (2015), 'Anticipated acquisition by Poundland Group plc of 99p Stores Limited', August, Appendix, para. 26.

⁶ European Commission (2017), 'Antitrust: Commission publishes report on online hotel booking', Daily News 06 / 04 / 2017, 6 April, http://europa.eu/rapid/press-release_MEX-17-896_en.htm.

⁷ See Competition and Markets Authority (2017), 'Online travel agenda: monitoring of pricing practices results', update, 6 April, <https://assets.publishing.service.gov.uk/media/58e61bd5e274a06b00000e8/update-6-april-2017.pdf>.

⁸ European Commission and the Belgian, Czech, French, German, Hungarian, Irish, Italian, Dutch, Swedish and UK national competition authorities (2017), 'Report on the monitoring exercise carried out in the online hotel booking sector by the EU competition authorities in 2016', April, http://ec.europa.eu/competition/ecn/hotel_monitoring_report_en.pdf, para. 23.

⁹ In the first half of 2016, only around 41% of hotel sales came through OTAs. The figure for chain hotels was around 35%.