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# Competition between Captive Consumers and Sales Channels

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## Introduction

We investigate strategic interactions in marketplaces where companies sell to customers both directly and through a competitive channel, such as a price comparison website or marketplace, where numerous vendors' offers are displayed at the same time. When certain consumers have inadequate price information, we investigate how the size of a competing channel affects market outcomes. A larger competitive channel means more consumers will compare prices, resulting in more rivalry within the channel. However, we show that, by decreasing between-channel competition, such ostensibly pro-competitive changes can boost prices and hurt consumers.

Many goods and services can be purchased directly from a seller (e.g., through their own store or website) or through a competitive channel in which numerous sellers' pricing can be compared at the same time. Competitive channels (CCs) come in a number of shapes and sizes; for example, price comparison websites in the utilities and financial services industries allow consumers to compare rates for products like broadband and insurance. Vendors of durable products frequently use online markets such as eBay as an additional sales channel, where they compete with other sellers of the same product. Consumers can compare multiple sellers' offers in one location using offline marketplaces such as shopping malls. Consumers frequently use advisers and brokers as competitive channels in a variety of marketplaces.

Competitive channels make price comparison easier and so increase vendor rivalry. However, operators of competitive sales channels are also economic actors, and their motivations do not have to coincide with consumer interests. As a result of these concerns, competition authorities in several jurisdictions have increased their scrutiny of industries where CCs play a prominent role, fearing that CCs may distort competition between sellers in damaging ways. 2The ramifications of rivalry between and within sales channels are examined in this research, which adds to the current discussion. We recognise the competitive channel's strategic agency and investigate when and how the direct sales channel helps to discipline a CC's behaviour, and vice versa.

The relative importance of direct and competitive channels has fluctuated throughout time and between markets. Indeed, technological advancements have aided the formation and quick expansion of new competing channels. Furthermore, the operators of such channels frequently invest substantially in marketing, resulting in many of them becoming household names in their own right, ranging from major regional brands like Compare the Market in the United Kingdom to global platforms like eBay.

We offer a model that allows both competitive and direct routes to vary in their market power, or 'size,' in contrast to previous work. We utilise our model to investigate the consequences of changes in the competitive channel's relative size, demonstrating how this is a key predictor of market pricing and consumer surplus. The central tension identified in our research is between-channel versus within-channel competition: competitive channels provide environments in which competition can be fierce; however, when they become dominant, they can use their power to relax the competitive constraints that channels impose on each other. Even as consumers grow more aware of rival price offers, this can make them worse off.

We use a model in which the key component is customers' (limited) price information to highlight this tension. Consumer information heterogeneity is arguably a key element of the modern retail environments vast and crowded consumer markets. Pricing would equal the marginal cost of production in our model if all consumers received all accessible price information, and the law of one price would be realised in a symmetric equilibrium. At the other end of the spectrum, if all customers were captive, that is, only aware of prices at one location (is it a seller or a CC), the monopoly price would be the only price on the market. Richer results can be produced if there is heterogeneity in information, with some consumers captive while others compare prices. We operate, characterise equilibrium, and present our outcomes in these intermediate circumstances.

Related literature and contribution

In our scenario, the actors are vendors, a competitive sales channel, and a large number of consumers. Sellers specify two prices: one for direct purchases and, if desired, another for purchases made through a competitive channel. A seller pays a charge to the competitive channel each time it makes a sale through the CC. We employ a clearinghouse approach a la Varian (1980), which was designed specifically to investigate the effects of heterogeneity in customers' price knowledge. Some customers, in particular, are'shoppers,' who buy at the lowest price offered on the market. The remaining customers are 'captives,' meaning they only look at one sales channel, either a seller's direct channel or a competitor channel, and buy at the lowest price they can find. Captives can be defined as those who are influenced by brand marketing, who face significant search or information frictions, who suffer from default bias, who regard a certain channel to be particularly important, or who are just inert or naive. A seller's or CC's market strength or size is measured by the number of captives it has. The hordes of captives and shoppers are referred to as the 'market composition.'

Competition within versus between Channels

The impact of market composition on equilibrium pricing and consumer surplus is investigated. Two consequences emerge when the competitive channel grows larger. More customers are exposed to the (frictionless) CC, where prices are easily compared, which tends to raise consumer surplus. However, the endogenous competitive behaviours of enterprises have a countervailing influence. When a vendor has a small number of captive customers, it is more concerned with gaining new customers, and hence is more prepared to undercut

CC rates with its direct price. The CC finally gives up trying to prevent undercutting and shifts to a high-fee regime, where prices are higher and the concentration is on selling to its own captive base. This means that ostensibly pro-competitive changes in market composition that result in more customers comparing more prices (for example, uninformed people becoming aware or adopting a price comparison tool) might raise prices and damage consumers.

Understanding the effects of customers' information on market outcomes is critical for policy and more broadly. While it is obvious that an individual consumer's welfare improves as they become more aware of the market's alternatives, it is less clear I how firms respond to broader shifts in consumer awareness, (ii) how the information of some consumers affects others, and (iii) how the presence of a competitive channel alters any effects.