

# Dutch Authority for Consumers & Markets investigates sponsored rankings

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On 2 February 2021, the Netherlands Authority for Competition & Markets (the '**ACM**') published a study on sponsored internet ranking and its effects on competition and consumer welfare. Sponsored ranking means that suppliers pay extra commission for a better ranking in the search results. Many platforms use paid search engines. The ACM has investigated whether this practice causes risks for consumers and whether current transparency measures on sponsored ranking are effective.

The ACM has concluded that sponsored rankings indeed entail risks for both competitors and consumers. Many of the transparency measures used are poorly visible and/or unclear. The measurement of the effects carried out by the ACM shows that the transparency measures had hardly any effect on purchasing behaviour. The ACM will conduct follow-up research into the effectiveness of transparency.

However, the ACM notes that on most platforms investigated by the ACM the role of sponsored rankings is still limited and therefore do not, for now, result in any great risks for competition and consumer welfare.

## Sponsored Rankings

If companies pay an extra commission, they can appear higher in the search results on many internet platforms, such as Amazon.de, Beslist.nl, Booking.com and Thuisbezorgd.nl. Companies pay for a higher ranking because this leads to extra 'traffic' and purchases, as consumers tend to click on higher-ranked items sooner. Broadly two types of sponsored ranking models can be distinguished: auction-based and commission-based sponsored ranking. Under the former, the platform reserves a number of positions in the ranking (typically at least the top or near-top positions) and sells these positions through auctions. Bidders pay a cost-per-click and the positions are awarded both on the basis of the amount of the bid as well as the relevance of the bidder's listing. Under the commission-based model, all suppliers can improve their ranking by increasing the commission level that is paid to the platform for transactions. All else equal, the larger the commission increase, the larger the improvement in the rank position. Sponsored results are shown in the search result order that is presented by default. This sorting order can appear as "Recommended" or "Our choice" or similar terms.

For most platforms in the study, the share of orders derived from sponsored results in the total number of orders does not exceed 10%, and in some cases, this share is only a few percentage points. However, the highest observed share is 50%. The platforms' revenues from sponsored listings as a share of platforms' total revenues from intermediation services (typically pre-negotiated commission fees per transaction) lie in the range of 1 through 5 per cent for most platforms. However, the maximum observed is 30%.

## The Study of the ACM

The ACM has conducted research on sponsored rankings and their effects on competition and consumer welfare. The first objective of this study was to assess the extent to which these concerns actually occur in practice. The second objective was to explore any possible efficiency rationales for sponsored rankings. In particular, economic literature suggests that a payment from a supplier for a better ranking position may act as a signal of high quality. The underlying idea is that a high-quality supplier is willing to pay more for a better ranking position. Only a seller with higher quality would be able to recoup the payment for a higher ranking because consumers are more likely to engage with that seller now and in the future (repeat sales). The third objective of this study was to analyse the efficacy of transparency of sponsored ranking as a way to deal with concerns. The Unfair Commercial Practices Directive considers a practice a misleading omission if it "*fails to identify the commercial intent of the commercial practice*". Applied to sponsored ranking, this means that platforms should clarify how they determine the ranking and clearly identify those results in the rankings that are sponsored. A recent example of enforcement on the basis of consumer protection rules in this area is the ACM's and other European consumer authorities' intervention in the practices of Booking.com. As a result, Booking.com has committed to applying eight important changes in order to bring its website in line with consumer law, including a clarification of how search results are ranked, for example clarifying that certain search results are ranked higher because the providers of those accommodations have paid for these higher positions.

The ACM presents in its report a framework for assessing the effects of sponsored ranking on consumers. This framework shows how the ACM assesses the likelihood of harm and benefits for consumers from sponsored ranking in individual cases. The framework is also useful for online platforms that wish to evaluate the effects of their sponsored ranking activities and to identify ways to reduce potential negative impacts on consumers.

## The ACM's Findings

According to the ACM, sponsored ranking may limit competition between suppliers on price and quality. Firstly, suppliers may pass on the extra commission on the price. Secondly, payments for a better position can be at the expense of competition on price and quality. After all, it is possible to appear higher in the ranking with an extra payment instead of making a better offer. Finally, the suppliers who occupy a higher position in the search results because of their payments may be less relevant to the consumer than the other suppliers. Platforms normally sort suppliers primarily on relevance to consumers, such as review scores and repeat purchases. But with sponsored ranking, the platform also takes into account its own reward. Moreover, consumers can be misled by this if it is unclear that the order of the search results presented has been influenced by payment. The study shows that suppliers pay around 15-40% extra commission for a higher position in the search results, on top of the usual commission to the platforms.

However, as mentioned above, sponsored ranking can also have advantages for the consumer. Sponsored ranking can work as a quality signal towards the platform or the consumer. Nevertheless, it is necessary that paid results are recognisable as such to consumers. Sponsored ranking can also help to introduce new products or make better use of capacity. Although such benefits may occur, it appears that platforms already have a lot of information to sort by relevance and that alternatives exist for this type of benefit. A case study by the ACM also shows that suppliers do not use sponsorship to make better use of capacity.

One of ACM's theories of economic harm is that sponsored ranking leads to a softening of competition on price and quality and to an increase in suppliers' costs for using a platform as a result of a bidding war. If a prominent position in the ranking is important or even crucial for boosting consumer attention and sales, suppliers may end up in a bidding war to obtain a prominent position, the cost of which may be passed on to consumers in the form of higher prices.

Nonetheless, the ACM concludes that in most cases the presence of sponsored results in the highest positions and the share of platform revenues from sponsoring is relatively limited. Therefore, it is unlikely that a bidding war between suppliers will lead to a substantial increase in costs and/or that sponsoring would replace competition on price and quality to a substantial extent. However, there are exceptions where the share of sponsored results in the top positions is substantially higher. In such cases, the possibility that sponsoring increases marginal costs and therefore price is more realistic. Furthermore, competition between platforms may provide an incentive to limit sponsoring. It may also counter adverse price and quality effects from sponsored rankings because consumers can make use of alternative options. In case there is strong competition between platforms, it is, therefore, less likely that sponsored ranking is harmful. However, the mere existence of more than one platform does not imply that platform competition is substantial. In case all platforms use sponsored rankings and price parity clauses are in place, the beneficial effect of platform competition may be limited.

Other reasons why platform competition may not prevent harm from sponsored ranking may be that platform competition is limited because of network effects, and that platform competition is limited to competition for 'sophisticated' consumers (that is, consumers who search critically, as opposed to quickly following recommendations by platforms). The ACM also finds that some sponsoring models are designed in such a way that they seem unlikely to flatten competition and/or raise marginal cost for suppliers. This holds true for the cases where only a small number of suppliers are allowed to sponsor their listing and, moreover, they are eligible for sponsoring only if they deliver the highest value-to-money to consumers.

Regarding the theory of harm that sponsored ranking leads to consumers buying suboptimal products, the ACM considers – again – the extent to which sponsoring is present on the platform. As indicated above, this is relatively limited in most cases. The risk of consumers buying suboptimal products will therefore also be limited in these cases. However, there are also platforms where the share of sponsored products in top positions is substantial. In these cases, the risk of consumers buying suboptimal products may be more significant. Secondly, platform competition may limit this form of harm because it provides consumers with opportunities to buy elsewhere. Again, this beneficial effect of competition does not always arise.

Apart from the reasons mentioned above why platform competition may be limited, platform competition may not necessarily provide incentives to platforms to curb sponsoring even if sponsoring were to lead to consumer buying suboptimal products. Removing sponsoring schemes or educating consumers about the commercial nature of sponsored listings, may not be profitable for the platform, especially if a significant share of consumers does not search critically. Also, the nature of the product matters: the better the consumer is able to determine the quality of the product before purchase, the more likely it is that platform competition limits harm from sponsored ranking.

## Conclusion

The ACM is concerned that transparency measures taken by some platforms only have a limited impact on preventing the risk that sponsoring leads to buy suboptimal products. Transparency about paid results may mean to mitigate the risks of sponsored rankings, but that does depend on the way in which this is done. Transparency about sponsored rankings helps consumers to recognise paid results. It also prevents them from unintentionally clicking on paid search results. However, the ACM has also established that in practice, transparency statements about paid search results are often poorly visible or unclear. The ACM has studied the introduction of a label on sponsored results on a platform active in the Netherlands. This label appeared to have hardly any effect on the purchasing behaviour of users. This may be because users do not see the label, do not understand the label, or because users find sponsored results just as relevant as non-sponsored results.

The ACM concludes that on most platforms investigated, the role of sponsored rankings is still limited. However, there are exceptions. Especially in those cases, the ACM sees risks for both consumers and competition. However, ACM notes that its study does not lead to the conclusion that sponsored ranking in itself is by definition misleading and/or an infringement of competition law. Neither does the ACM conclude that new measures to limit sponsored rankings should be taken straight away. There could be a need for such measures in case the possibility of sponsoring significantly restricts competition on the merits between suppliers, or if transparency measures do not change consumer behaviour despite clear evidence that sponsoring leads to suboptimal outcomes for consumers. The ACM considers the outcome of its study does not justify restricting sponsored ranking as such. Furthermore, the ACM believes that imposing transparency measures on platforms is less intrusive than restricting or even prohibiting the practice itself. Finally, the

effectiveness of transparency measures depends on their content and case-specific circumstances (including the knowledge of consumers and the nature of the product or service). The ACM believes that at present, more research into the effectiveness of transparency measures is required before conclusions can be drawn whether these are sufficient or instead should be replaced by further restrictions or even an outright prohibition. Nevertheless, the ACM expects that a prominent disclosure of the commercial nature of sponsored results is both capable of reducing the possible harms as well as stimulating certain efficiency gains. Prominent disclosure of sponsored results is therefore likely to contribute to consumer welfare. The ACM however still sees a genuine risk, however, that disclosure measures taken by platforms are overlooked and/or misunderstood by a significant portion of consumers. Therefore, the ACM is now conducting follow-up research into the role of transparency in sponsored rankings. Once the results of this additional research shall be made public, we intend to devote a follow-up post to this subject.