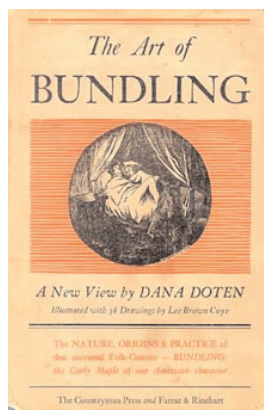


## Does the tying and bundling of products harm consumers?

*Since two years Microsoft has been under judgment for "dominant position abuse". How is it that the European Commission, a supposed supporter of market reforms, launches itself out in such a battle? Far from regarding the introduction of the free market as the best means of making the interests of consumers prevail over the particular interests of producers, the Commission considers that "market forces" must be channeled. When a firm is in a dominant position, it can exclude competitors thanks to practices known as restrictive practices, such as the tying or the bundling of several products in one sole "package". A firm seizing such opportunities harms the consumer by depriving him of more satisfactory solutions that the excluded competitors would have proposed to him<sup>1</sup>.*

The integration of the Microsoft multimedia player in its operating system Windows is one of the objections which determined the ruling against the computer giant<sup>2</sup>. Whereas the Commission today accuses Microsoft of not making sufficient efforts to facilitate the compatibility of its operating system with its competitors' software<sup>3</sup>, one often omits to mention that the solution imposed by the Commission concerning the multimedia player has already been applied and that it is a failure. A Windows version without Media Player is available. Competition was "restored". The consumers should thus have benefited from this separation and they do not do so<sup>4</sup>. Was integration then so damaging for them?

At the moment where the Commission proposes a re-examination of the application



methods of Article 82<sup>5</sup> of the Treaty of the European Community relating to dominant position abuse, it is appropriate to point out the flawed character of its conception of "restrictive" practices. The tying and bundling of various products do not require any intervention from public authorities to protect consumers from these alleged abuses. These practices often provide a service to them and it is precisely by letting play full contractual freedom in this field that decisions of whether or not

to tie products can be as much in harmony with their preferences as possible, even when a firm is in a dominant position. On the contrary, it is by supervising the development and sale of products that governmental authorities defy consumers' preferences.

### Disadvantages and advantages of tying and bundling for consumers

One speaks about "tying" when the sale of a product is conditioned to another transaction. An individual or a company agrees to sell the product only if its purchaser agrees to acquire another product from the same salesperson or another salesperson appointed by the first. The first good is called the "tying product" and the second the "tied product". One speaks about "bundling" of the products when a set of several products is sold in one sole "package".

<sup>1</sup> Cf. DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, pp. 54-60:

<http://europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf>

<sup>2</sup> Cf. Commission concludes on Microsoft investigation, imposes conduct remedies and a fine:

<http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/382&format=HTML&aged=1&language=EN&guiLanguage=en>

<sup>3</sup> Cf. European Commission says Microsoft must do more to avoid fines, OUT-LAW News, 13/03/2006:

<http://www.out-law.com/page-6723>

<sup>4</sup> At the Champs-Élysées FNAC, it is indicated that "there are no sales for the moment". Certain computer manufacturers have even decided not to propose them: "We carried out a study with our commercial outlets to find out if customers wanted Windows N. The conclusion: the consumer does not want it; thus we do not propose it" says a representative of Dell France. Cf. Le Windows sans Media Player fait un bide- ZDNet.fr (3/10/2005):

<http://www.zdnet.fr/actualites/informatique/0,39040745,3927143,4,00.htm>

<sup>5</sup> Cf. Article 82 Review:

[http://europa.eu.int/comm/competition/antitrust/others/article\\_82\\_review.html](http://europa.eu.int/comm/competition/antitrust/others/article_82_review.html)

Bundling or tying can present disadvantages. Let us consider for example the purchase of a computer provided with an operating system and a certain number of software already installed, a word processing facility, a drawing facility program, etc. It is an obvious case of integration. It is quite possible that the potential buyer does not need the drawing software or that he prefers another word processing program. Bundling and tying are frequent practices. Cars are sold with car radios, photocopiers with ink, etc. The examples are innumerable and in all cases it is possible that consumers see themselves proposed a set of goods inferior to what can be obtained in separate transactions.

If tying or bundling of products can present disadvantages for consumers, it can also be advantageous for them. Thus, a computer and software are usually regarded as complementary goods. In other words, the computer is bought to use certain applications. When one deals with complementary products, tying or integration can provide a significant advantage: to obtain the wished for goods at a lower cost, ready to be used.

A familiar example should clarify this point. When one wishes to eat a sandwich, the separate purchase of a bread roll and some slices of ham are not enough to obtain what one wants. The sandwich is not ready. The question is: is it necessary to make it oneself or let somebody else prepare it?<sup>6</sup> It can be advantageous to directly buy the already made sandwich, the ham being "bundled" into the bread, because one "does not have time to waste with that". The on-going prosperity of the trade dedicated specifically to the snack-lunch of office workers testifies to the services provided by such "bundling".

Thus, even when the price of a set of products is higher than the sum of the prices paid

“When one deals with complementary products, tying or integration can provide a significant advantage: to obtain the wished for goods at a lower cost, ready to be used.”



in separate transactions for the same products, bundling or tied sale can prove to be interesting: the consumer considers that it is better to spend the additional sum rather than to prepare the bundle himself<sup>7</sup>. If that is obvious for a sandwich that everyone is capable of making himself, the advantage of bundling should be even more obvious for products the combination of which requires knowledge that is not given to everyone.

The seller of a product is often in a better position than a purchaser to know how it works with complementary products. While choosing for the buyer which software should be integrated with the operating system of a computer, he makes sure that the bundle wished for by the consumer works as well as possible. If computer lovers or people seeking quite specific products prefer a "piecemeal" computer, other users will greatly benefit from the purchase of a ready to use bundle, saving them a tiresome search for information on the various products, as well as time and the necessary moving about to make their separate purchases.

Thus, the tying and bundling of products cannot be regarded a priori as harmful. Like other commercial choices, they can benefit consumers or not, according to the cases.

**To identify abusive practice: the flawed theory of market "foreclosure"**

Since it is established that the tying or bundling of various products can be beneficial to consumers, the only observation of such practices does not make it possible to conclude that those who do it practice "anticompetitive" behaviour. It becomes necessary to establish a criterion making it possible to distinguish between "normal" practices, benefiting consumers, and "restrictive" practices, harming consumers. The European Commission recognises that "tying and bundling are common practices that often have no

<sup>6</sup> One generally leaves the production of bread to others, because one can obtain it more easily thanks to income obtained by concentrating ones productive efforts in a field where one is relatively more qualified. It amounts to productivity gains that one can obtain through the division of labour. To carry out what one owes to the development of the division of labor, it is enough to wonder how one could have otherwise obtained everything one has, not only food but all the necessities of life. Obviously, most of us could not even survive if each one of us had to separately produce all that he needs.

<sup>7</sup> Moreover, tied sale or product integration often makes it possible for producers to decrease their unit production costs, for example by making economies on packaging, storage and more generally on "sales costs". It can then be profitable to sell the integrated bundle at a lower price than the sum price of the separate products.

anticompetitive consequences"<sup>8</sup>. It must thus propose criteria making it possible to distinguish what is legal and what is not.

According to the Commission, the problem is that by leverage action, the firm in a dominant position on the market of the tying product can exclude competitors on the tied product market because demand on this market depends strongly on the other market. As the Windows operating system is in a dominant position on the operating systems market, the integration of a multimedia player makes it possible for Microsoft to improve its position on this market without offering substantial benefit to the consumer. The majority of consumers would have preferred to combine the Windows operating system with another multimedia player than the one proposed by Microsoft if they had had the choice but the integration of it restricts this choice in "foreclosing" access to the market from competitors.

The Commission claims that bundling or tying is anticompetitive when it has a foreclosure effect, that-is-to-say when it has as a likely consequence to "deny partially or completely profitable expansion in or access to a market to actual or potential competitors"<sup>9</sup>. This principle, aiming at distinguishing "good" and "bad" integration is fundamentally flawed.

"What proves too much does not prove anything", so says the proverb, because to offer the best solutions to consumers also prevents competitors from growing or from entering the market! How does one then differentiate this situation from an abuse? The "foreclosure effect" is not an answer. Carrying out a transaction always implies an exclusion. Whether one buys a computer or a sandwich, the sum spent in this purchase cannot be spent elsewhere, with a direct competitor or in another market. The purchase

"With or without a dominant position, a market is always "foreclosed". Consequently, the theory of foreclosure does not make it possible to distinguish a competitive practice from an anticompetitive practice."

carried out always prevents existing or potential competitors from doing business. An unforecasted market would be a market where any new entrant could run its production at a profit, which is strictly impossible, consumers' demand being always limited by their budgets. With or without a dominant position, with or without bundling, a market is always "foreclosed". Consequently, the theory of foreclosure does not make it possible to distinguish a competitive practice from an anticompetitive practice.

### **Selection of the best commercial practices in the free market**

The practice of tying can have advantages as well as disadvantages for consumers but the criterion of "foreclosing" suggested by the European Commission to distinguish harmful practices from others suffers from a fatal defect: it does not allow any distinction to be made. Consequently, any decision which is based on this criterion is arbitrary. Is there not nevertheless a means of ensuring that only tying that serves consumers remains on the market? Indeed. The selection of best practices is a by-product of the competition process in a market free of any intervention. Governmental interventions in this field can only block the permanent adjustment of production to consumers' wishes.



Various firms sell ink cartridges and their consumers judge them to have equivalent

qualities. Certain manufacturers offer these products without tying or bundling them into any other product. Others, also producing photocopiers, sell only one bundle. They practice integration or tying. No manufacturer has a significant market share, neither on one market nor on another. Let us suppose that the customers having bought the set are increasingly dissatisfied with it. The manufacturer having over-estimated the interest in his "package", records losses as consumers confer their purchases on more satisfying competitors. It is the sanction of an ill-advised tying.

The situation would be reversed if consumers' choices were different. The fundamental point is that producers losses and profits in competition are used as indicators of the relevance of their choices to tie or not tie products with regard to consumers' preferences and that

<sup>8</sup> Cf. *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses*, p. 54, § 178: <http://europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf>

<sup>9</sup> Cf. *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses*, p. 4, § 1: <http://europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf>

producers' wishes to make their businesses thrive encourages them to serve consumers better. Of course, that does not guarantee ideal solutions at all since producers decide to proceed to tied or separate sales according to their anticipation of consumers' choices. Nevertheless, the interests of everyone converge and the sanction of losses and profits directs the decision. The suitable degree of integration or separation of the products is thus approached closest to what the entrepreneurial skill of the producers allows.



Contrary to what the Commission suggests, nothing basically changes with a firm in a "dominant position". Can one not however agree with the Commission that if the firm commits itself to tying, "it becomes necessary to compete with it to enter into the tying market and the tied market?"<sup>10</sup> Certainly, but why would it be more difficult to enter into these markets than before? Either the choice to integrate the multimedia player into Windows is beneficial to consumers and it is for this excellent reason that competitors on the two markets do not have any more business to do, or it constitutes an inferior solution compared to what would be possible. In this case, the integration of poor quality software harms the value of Windows. It supports the success of alternative operating systems and adapted multimedia players.

“When the decision to tie products or not is transferred to governmental authorities, the keys of adjustment are lost. Only competition in a free market can discriminate between "good" and "bad" tying.”

As in the example of the ink cartridges and the photocopiers, consumers' demand tends to shift towards non-bundled operating systems and multimedia software. Thus, profits and losses sanction the adequacy of the productive choices to consumers' preferences, even when a firm is in a "dominant position". There is no means for it to keep its position in a free market without continuing to surpass its competitors in the eyes of the bulk of consumers.

When the decision to tie products or not is transferred to governmental authorities, the keys of adjustment are lost. The losses and profits of the producers can no longer reflect the quality of decisions as regards integrated or separated sales with respect to consumers, since these no longer have the possibility of "voting" for prohibited practices. Consequently, the public decision is made without a reference point. Only competition in a free market can discriminate between "good" and "bad" tying.

## Conclusion

Commercial practices of bundling or tying do not have to be treated differently from other production choices. In the same way that a farmer must decide if he produces apples or pears according to what consumers are ready to pay for one and the other, the choice of separate or tied sale is sanctioned by losses or profits according to its relative adequacy in meeting consumers' preferences. The fact that a firm has a dominant position does not destroy this inherent "mechanism" of the free market. Only governmental intervention, by prohibiting some practices, hampers the selection of the best commercial practices for the consumers.

The stake at issue is considerable and exceeds the framework of a debate on tying and bundling. It is a matter of identifying the outcome of the transfer of decisions relating to the development and the sale of products in governmental hands. At the moment where the European Commission goes as far as choosing the name of an operating system from which it forced the manufacturer to extract his multi-media player<sup>11</sup>, it is advisable to recall that governments are inapt at replacing the competing process of a free market to guarantee the best possible services to consumers.

## Institut Economique Molinari

rue Luxembourg, 23 bte 1  
1000 Bruxelles  
Belgique  
Tél. +32 2 506 40 06  
Fax +32 2 506 40 09  
e-mail:  
cecile@institutmolinari.org  
www.institutmolinari.org

The Molinari Economic Institute is an independent, non-profit research and educational institute. It endeavors an economic approach to the study of public policy issues.

Reproduction is authorized on condition that the source is mentioned.

© Institut Economique  
Molinari

Printed in Belgium

<sup>10</sup> Cf. *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses*, pp. 54-55, §181: <http://europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf>

<sup>11</sup> The Windows version without a multi-media player has been the object of long negotiations between Microsoft and the Commission as regards its name. After having rejected "Windows XP reduced media edition", the Commission finally chose "Windows XP N". It should be noted that such negotiations imply an additional penalty for consumers, since resources must be diverted from their productive uses on this occasion.

Design by LEONard