

Unclassified

DAF/COMP/WD(2016)50

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

07-Jun-2016

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

DAF/COMP/WD(2016)50
Unclassified

ROUNDTABLE ON FIDELITY REBATES

-- Note by Indonesia --

15-17 June 2016

This document reproduces a written contribution from Indonesia submitted for Item 6 of the 125th meeting of the OECD Competition Committee on 15-17 June 2016.

*More documents related to this discussion can be found at
<http://www.oecd.org/daf/competition/fidelity-rebates.htm>*

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JT03397524

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INDONESIA

1. Introduction

1. Creation of customer satisfaction and loyalty certainly became one of important assets in running a business. Such a cliché, but in any case the customer is the key factor to gain a huge advantage for the company. Whether consumer satisfied or not of the product offered, it would provide the development of business impact. If consumers get the satisfaction of a marketed product, we can be sure they will make repeat purchases in the future. In contrary, if they were disappointed with the services provided, it is possible that they do not want to make a purchase and turn to other companies. The question is whether consumer is being forced to buy your brand? Or can consumers who shopped for price-oriented, become a loyal customer? Many business people say "can not", "difficult", "very difficult" as the answer to the two questions above. Then what can make customers more loyal? The answer is simple, the company should know exactly, who is the best customers.

2. Strategy for Fidelity Rebates

2. Company's strategy to obtain loyal consumer is to create programs that enable them to increase the frequency of arrival of their loyal customers, who have a warm feeling towards business, and minimize the arrival of customers who only search for promotion or discount. Their strategy is almost the same, providing higher level of service than the competitors. Companies that provide higher service tends to have a larger market share and grew faster than competitors and putting the customer at the center of their business. So that customers always come first, hoping to feel satisfied, comfortable, and ended up being loyal to the company. Usually companies start by offering a membership or special members which will provide many benefits for loyal customers. For example offer special discounts for consumers who have a membership card or a specific bonus offers for its members to spend large amounts. This strategy is competition term called as fidelity rebates.

3. Fidelity Rebate is one of the strategies undertaken by the dominant company in an attempt to maintain market share through promotions on loyal customers. In general, fidelity rebate is a rebate or award given to consumers who buy part or all parts requests from their demand for the products or services sold by the dominant firm. Another definition of the Fidelity Rebate (by Office Trade Commission OFT Draft Guidelines on Assessment of Conduct), in example when manufacturing or suppliers to effectively offer their customers (both wholesale and retailer) scale discounts based on certain conditions not based on consumer demand but by the needs of consumer purchases are expected by the manufacturer. Based on the terminology of the OECD, Fidelity Rebates defined as a pricing structure that offers a lower price in return for the buyer's approval or de facto committed to buy the more part of the request to the provider discounts. From these definitions, the discount given by company will not be based on the amount of consumer purchases, but rather to bind consumers to make purchases more on their next purchase.

4. The uniqueness of this strategy covers the purchase of goods, but does not require tie-in, and there are no explicit exclusive purchase prices, while the cost is not necessarily a price below cost. The price factor is one important factor in the competition, so the strategy of pricing discounts can be a reason to distort competition. Price strategy was very influential especially if the business actors are dominant. The positive thing of fidelity rebate strategy is to increase customer loyalty and increase the demand for producers who can cover the fixed cost in efficiency. However, if it is carried out by a dominant company, to consider whether the scheme can be justified or even have an impact cover the

market that affect competition in the market. With the effort of tying in with fidelity rebate scheme, consumers are expected to switch do not use products from competitors in the market that it interferes with competition scheme.

5. Another side effect of fidelity rebates that affect consumer loss is the significant reduction in the supply of various types of products and the consumer's decision has no effect to generate cost efficiencies from the manufacturer. Or a reduction of the amount of the power supplier is causing the increased one or several unilateral power givers discount raise prices above competitive prices or facilitate anticompetitive coordination between suppliers. More over is the potential decrease in the level of competition resulting from the offer of inducements customer discounts by a dominant company. Even when the company is integrated, it may create unfair competition because it can provide a rebate supported by the profits they earn from their branch.

6. The discount deals could trigger long-term impact on market structure and the impact of short-term opportunities in the form of rising prices in those markets. The impact assessment should be carried further to the strategy, if it is considered bad, it can be suggested in order to offer customer discounts was stopped to allow other companies able to compete better.

7. One of the good examples for loyalty program in Indonesia offers by Garuda Indonesia, the state-owned airline company. Garuda Indonesia acts to anticipate the changes that occur in a competitor business environment of aviation services by launching a program service Garuda Frequent Flyer (GFF). GFF is a membership and a tribute to passengers who frequently fly with Garuda Indonesia. GFF provides ease in flight, their appreciation of the passengers were repeatedly flying with Garuda Indonesia by getting travel mileage. GFF Membership also provides a variety of special services such as exclusive check-in counter, additional facilities luggage and access to Garuda Indonesia Executive Lounge at many airports. GFF also provides services and products offered by GFF Partners, thus the frequent passengers using GFF will have their comforts. This program is one aspect to maintain the loyalty of passengers through the four dimensions of the benefit in the form of (i) the benefit (benefits and convenience of membership and rebates); (ii) the interest of this program, (iii) personal greeting, and (iv) prestigious.

3. Interference with the Indonesian Competition Law

8. The most relevant article relating to fidelity rebates in Law No. 5 of 1999 concerning Prohibition of Monopolistic Practices and Unfair Business Competition are in Article 6 on Price Discrimination. It stipulates that, "*businesses are prohibited from making agreements that result in the buyer that one has to pay a different price than the price paid by other buyers for relevant goods and services*".

9. Price discrimination is a form of prohibited agreements. This practice can occur through different pricing conducted by the business for the same goods and services from a manufacturer based on certain criteria. Article 6 is a per se illegal, meaning that assumptions have been violations of the law without having to prove the impact. Price discrimination must be distinguished from the price differentiation. In a technically economic view, the sale price differentiation also defined the same commodity to different buyers at different prices. However, price discrimination prohibited by law is the one done with an agreement.

10. A pricing strategy applied by the company can be categorized as price discrimination when meet several requirements, namely (i) the seller or manufacturer has a monopolistic strength (market power) in at least one market; (ii) there is a separation between the market which do not allow the buyer to resell (no arbitrage); (iii) buyers in different markets have high levels of demand and the elasticity of demand is different; and (iv) the seller or monopolistic producers could take advantage of differences willingness to pay of each consumer.

11. There are three ways to analyze price discrimination. First, price discrimination in the form of a rebate (pay cut) is charged to the seller by the buyer certain not given to other buyers. Rebate said the price discrimination because buyers get a rebate to pay a cheaper price than other buyers that buy the same goods. The rebate category are; first, the quantity rebate based on quantity of purchase. But the quantity rebate given to large-scale purchaser is not categorized as price discrimination, but rather the cost efficiency. Second, fidelity rebate that discounts offered to buyers who have committed themselves to the seller so that the rebate is given both in volumes large or small. Fidelity rebate is generally considered as a strategy aims at preventing competitors thrive. Third, the target rebate is a rebate given to business counterpart sales targets over the previous periods.

12. The second technique is selective price cuts, which the seller selectively cut prices on certain buyers on specific market segments that are not given to buyers in other market segments. This selective discount are usually given to buyers in high opportunity markets switched to other competitors, but for other buyers in different markets remain subject to higher prices. The third technique is tied and bundled pricing, where a company selling at a bargain price if you buy two items in one package than if buyers only buy two items individually. However, not all discrimination is prohibited, for example, price discrimination because the difference in level of competition. For example, the purchasing power of people in Jakarta is much higher than people of Kalimantan, where to maintain market share in the region, the seller to apply a lower price than in Jakarta.

13. Price discrimination is also not prohibited in terms of their cost structure. This means that business operators may apply higher price when their cost is much greater. In addition to price discrimination is not a prohibited transaction to small businesses, because normally business activity aims to increase the value of sales of small and medium entrepreneurs.

14. Another related article is dominant behavior regulated by Article 25 in Law Number 5 Year 1999. The article says, “the business agent are prohibited from using a dominant position directly or indirectly to set the terms of trade in order to prevent or deter consumers to obtain goods and or services that compete, in terms of both price and quality”.

15. Another article that govern the dominant behaviour is the exclusive dealing by Article number 15 (3) (b), “the business operators are prohibited from making an agreement on the price or price cuts of certain goods or services, which includes the requirement that businesses that receive goods and or suppliers of services businesses” (b) “will not purchase goods or services identical or similar from other businesses that became a competitor of the supplier businesses”.

16. Other article associated with the price below cost is predatory pricing. “Predatory pricing” is a term that refers to businesses which set their prices far below the cost of production with the explicit intention of snuffing out their competitors. Article 20 of Law No. 5 Year 1999 stipulates that, “*Business practitioners are prohibited from supplying goods and/or services by way of unprofitable sales or setting extremely low prices with the intention of eliminating or obstructing the businesses of their competitors in such a way as to establish a monopoly or an unhealthy business environment.*”

4. Fidelity Rebates Issues in Indonesia

17. The Commission has not been addressing problems directly related to the fidelity rebate. Nevertheless, if dealing with this case, KPPU will consider the previously mentioned articles on the case-by-case approach, and review it based on the following stages: (i) obtaining proof of market dominance; (ii) obtaining proof of the rebate agreement that led to markets disclosure; (iii) proving whether the behavior is causing exclusionary effect on the market the manufacturer; and (iv) evidence of adverse effects for the consumer, whether it create restriction on consumer choice or not. If the agreement cannot be found, it is difficult for the Commission to put the case under violation of Article 6 (price discrimination) and Article 15 (3) (b) (exclusive dealings). The only closest articles are abuse those of unilateral conducts like dominance and predatory pricing, but meeting their own unique specification. If this behavior is associated with the price below cost such as predatory pricing, it is

necessary to have long observation period, from the implementation of strategy, observations of the prices in force, accurate data on the marginal cost, recoupment test, and sacrificed profit carried by the dominant. So most importantly is to understand what article it may breach based on the impact it may create.

5. Conclusion

18. Competition is a normal and become highly empirical self-taught school for actors of the market. Competition is not a war or a battle, because the competition is how business strategies collaborating on a single goal to get into the minds of customers and the end of the estuary is persuaded to buy. The growing number of businesses these days would result in the market competition becomes increasingly fierce. Even now that the competition between entrepreneurs with other business players are in a state of increasingly complex, so that each of these companies now compete to create innovations to maintain their existence. For example, by creating unique and attractive products, take advantage of modern technology product, and improving the quality of human resources and services. Fidelity rebate considers as one of strategies use by the enterprise to win the market.

19. Due to the unique feature of fidelity rebates, competition law may difficult to adapt the practice. Some says it may not raised competition concern. When it become a concern, then the violation only can be reviewed with other related provisions like price discrimination, abuse of dominant, predatory pricing, and exclusive dealings. However, an indept analysis should take place before we can apply such provisions, specifically in understand whether such rebates can affect the entire market.