

11.04/28587

29 August 2017

Russell McVeagh
PO Box 8
Auckland 1140

Attention: Troy Pilkington/Hannah Loke

Dear Troy and Hannah

Letter of Issues - Trade Me Limited / Limelight Software Limited

1. We refer to the application (the Application) dated 11 July 2017 from Trade Me Limited (Trade Me) to acquire up to 100% of the shares in Limelight Software Limited, trading as Motorcentral (Motorcentral).
2. At this stage, we are not satisfied that the merged entity would not give rise to competition issues in the provision of online classified motor vehicle advertising services (we refer to providers of these services as "listing platforms") and/or dealer management systems (DMS) products as a result of vertical and/or conglomerate effects.
3. In reaching the preliminary views set out in this letter, we have considered information provided by Trade Me and Motorcentral as well as information gathered from industry participants. The Commission has not yet made any decisions on the issues outlined below (or any other issues) and our views may change, and new competition issues may arise, as the investigation continues.
4. We will advise you if we identify any further issues during our analysis of the proposed merger that are not discussed in this letter.
5. We are available to meet with Trade Me to discuss this letter.

Timeline

6. The Commission would like to receive submissions from Trade Me on the issues raised below. We request that Trade Me provides this by close of business on 11 September 2017 and provides a public version at the same time.

Market definition

7. In the Application, Trade Me identifies that the relevant markets are:¹
 - 7.1 the national market for the supply of motor vehicle advertising to motor vehicle dealers;
 - 7.2 the national market for the supply of website development and maintenance services;
 - 7.3 the national market for the supply of DMS products;
 - 7.4 the national market for the supply of vehicle information reports; and
 - 7.5 the national markets for the supply of private motor vehicle and private mechanical breakdown insurance.
8. The markets that are most relevant to the issues in this letter relate to motor vehicle advertising and DMS products.
9. Trade Me's defined advertising market includes: both display and classified advertising; and both online and print advertising. We are still considering the precise boundaries of the relevant markets. However, market feedback has indicated that there are particular features of online classified advertising which means that other forms of advertising are not good substitutes for dealers. We have heard that:
 - 9.1 Display advertising serves a different purpose to classified advertising. The former serves to raise awareness of a dealer and attract customers to its site, whereas classified advertising provides a list of vehicles for sale for customers looking for a specific vehicle. These services are typically used together as part of a broader advertising strategy.
 - 9.2 The vast majority of customers now search for vehicles online. Classified listings in print account for a small share of total listings and do not represent a good substitute for online listings in terms of ensuring that a large number of customers view the vehicle.
10. Market feedback also suggests that there is differentiation between DMS products. In particular, some of the rivals listed in the application (at [9.17(a)]) provide a much greater range of functionality than others. For example, we understand that Motorcentral provides a wide range of functionality (including, but not limited to, inventory management, customer relationship management (CRM), uploading of vehicles, export of accounting information, and access to vehicle check reports). In comparison, AutoPlay (for example) has a main function of lead management and CRM. Dealers that use Autoplay normally use it in conjunction with another DMS for inventory management. Customers of Motorcentral may not view

¹ The Application at [9.4].

Autoplay as a good alternative. At this point, we do not conclude whether these differences justify separate markets. However, these differences are relevant when considering the extent to which other DMS products provide a constraint on Motorcentral.

The counterfactual

11. Relevant to our concerns, Trade Me has indicated that in the without-the-merger scenario [] That may not be the case in the with-the-merger scenario.
12. The Application identifies that [] in the without-the-merger scenario.²

Foreclosure of rival motor vehicle listing platforms

13. At this time, we are not satisfied that the merged entity would not have the incentive and ability to prevent or hinder competition from rival motor vehicle listing platforms through vertical or conglomerate effects. The main concern that we are testing is that:
 - 13.1 Motorcentral may have market power for the provision of DMS products to motor vehicle dealers;
 - 13.2 if Motorcentral had market power in respect of the provision of DMS products, it may be able to use that market power to restrict the feed of listings to rival listing platforms or otherwise raise the costs of listing on rival listing platforms, leading dealers to switch away from those listing platforms (that is, the merged entity may have the ability to foreclose); and,
 - 13.3 the loss of listings (and revenues) may result in rival listing platforms losing scale or facing higher costs and imposing a weaker current competitive constraint or preventing an emerging competitor from imposing a constraint (that is, the merged entity may have the incentive to foreclose).

Motorcentral may have market power

14. Trade Me has argued that Motorcentral does not have market power for the provision of DMS products as there are many rivals and low barriers to entry.³ The Application estimates that around [] of all dealers use Motorcentral.⁴
15. The evidence we have viewed suggest dealers using Motorcentral may account for a significant proportion of listings and revenues that motor vehicle listing platforms receive. We have been told that Motorcentral is popular among small and medium-

² The Application at [8.9].

³ The Application at [9.17]-[9.18].

⁴ The Application, Figure 10.

sized dealers, due to the range of functionality it offers. These dealers tend to supply used cars and therefore account for a relatively high proportion of listings on motor vehicle listing platforms. The Application identifies that Motorcentral is growing, and therefore Motorcentral's importance to listing platforms may increase over time.⁵

16. We are still considering whether dealers view other DMS products as good alternatives to Motorcentral. Trade Me identifies CarUpdater and AutoPlay as two commonly used DMS products. However, as noted in the market definition section above, market feedback suggests that these have more limited functionality than Motorcentral. AutoPlay's core functionality is lead management and CRM, while CarUpdater's main function is to upload vehicles to websites. These products are typically used by large dealers who use a separate DMS for inventory management. The market feedback suggests that dealers value Motorcentral because it provides a wide range of functionality within one product. These dealers may not view products such as CarUpdater and AutoPlay as a good alternative.
17. There are other DMS products that provide more functionality and it is possible that other DMS products could emerge. However, rival DMS providers may face barriers to entry and expansion.
 - 17.1 First, some market participants have argued that the wide range of services that Motorcentral offers (including DMS, CRM, and website maintenance) raise switching costs for dealers. This is because such dealers would have to find an alternative DMS provider that fulfils all the functions that it currently enjoys with Motorcentral. A dealer for whom Motorcentral integrates with many parts of its business may also view switching as more risky compared to if the DMS integrated with only a few parts of its business.
 - 17.2 Second, as we explain further below, Trade Me's position as an important listing platform may allow the merged entity to induce dealers to switch to Motorcentral or raise barriers for rival DMS providers.

The merged entity may have the ability to foreclose

18. We are considering whether the merged entity would be in a position to make uploading to rival online classified sites relatively more difficult or raise the costs of its rivals. This may be achieved in several ways (or a combination of ways):
 - 18.1 stopping the feed between Motorcentral and rival listing platforms;
 - 18.2 making it less convenient to upload to rival listing platforms, for example, by only allowing infrequent uploads or having a delay between the time that it receives the request to upload and the actual upload; and,
 - 18.3 introducing a charge [] that rival listing platforms pay for receiving the feed from Motorcentral.

⁵ The Application at [4.4].

19. Trade Me has identified that it expects the merger to produce a more attractive product for dealers. This includes better return on investment information []. Such improvements may be initially to the benefit of customers. However, if it attracts revenues away from rival listing platforms, it might further add to the harm from the conduct described in the paragraph above.
20. We are concerned that the conduct described in the paragraphs above could lead dealers to reduce the number of vehicles they list on rival listing platforms. Given Motorcentral dealers appear to account for a large proportion of vehicle listings, the impact of the conduct on those rival listing platforms – in terms of lost listings and reduced revenue – could be significant. We are continuing to investigate the extent to which such losses could occur.
21. In the Application, Trade Me argued that restricting uploads to rival listing platforms would only be a minor inconvenience to dealers as they could find other ways to upload.⁶ Market feedback indicates that these may not be a good alternative to a direct feed from the DMS.
- 21.1 Sending inventory to listing platforms using CSV or Excel files may not be an efficient means to upload. Market feedback indicates that the process of sending, receiving and uploading using email would be more burdensome for both the dealer and the listing platform than through a feed. For example, if the dealer changed the price or sold a vehicle, the dealer would have to send another email whereas a DMS feed could automatically update the listing.
- 21.2 Web scraping may be costly because the listing platform would need to produce code specifically for each dealer’s website. That code may need to be updated regularly to reflect changes in the website. In addition, Motorcentral provides website maintenance for approximately [] of the [] dealers that use its DMS, and may be in position to make it difficult for listing platforms to scrape these websites.⁷
- 21.3 Uploading from services such as CarUpdater and AutoPlay may be possible, but it may be costly for dealers to purchase these services in addition to Motorcentral.
- 21.4 Uploading from DealerBase (a free inventory aggregator that TradeMe offers) may be possible currently, but the merged entity may also impose restrictions on those uploads.
- 21.5 Market feedback suggests manual upload of listings may impose a significant burden on dealers who are used to the convenience of uploading through their DMS.

⁶ The Application at [9.28].

⁷ The Application at [3.7].

22. Trade Me has argued that it would not have the incentive to engage in the conduct identified because negative sentiment would lead Motorcentral customers to churn to alternative DMS products and listing platforms. We continue to investigate these claims. However, as discussed further below, if Trade Me has market power for the provision of online classified advertising for motor vehicles it may be in position to discourage customers from switching. That is, the merged entity may be able to restrict (or threaten to restrict) uploads from rival DMS products to Trade Me. Although this might fall short of foreclosing rival DMS providers, it could nevertheless make rival DMS products less attractive and reinforce a strategy to foreclose rival listing platforms.

The merged entity may have the incentive to foreclose

23. We are considering whether the merged entity may have the incentive to engage in conduct to restrict uploads or raise rivals' costs.
24. Market feedback indicates that the success of a listing platform relies on attracting both viewers and listings: if the listing platform has few viewers then dealers will not bother listing; if there are few listings, buyers will not bother viewing. If the merged entity was able to deprive a rival listing site of a significant number of listings, the listing platform may fail to achieve sufficient scale to operate efficiently. If Motorcentral was to introduce a charge [] for receiving a feed, it could directly increase the costs of rival listing platforms. This could force those rivals to raise prices and reduce the degree of constraint on Trade Me.
25. If the merged entity were to engage in the conduct described, it could affect existing competition between listing platforms. However, the conduct could also adversely affect emerging competitors. Trade Me is the leading listing platform in terms of number of listings, dealers that advertise and revenue. Some parties consider Trade Me the most important listing platform to ensure buyers view vehicles. To the extent that Trade Me already has market power, the merger may entrench that position by raising the barriers to entry and expansion for emerging listing platforms.
26. A submission has alleged that Trade Me has engaged in similar conduct in the past using AutoBase.⁸ According to the submission, following Trade Me's investment in AutoBase, it cut the feed of listings to Autotrader and AA Carfair. At this stage, these claims are unsubstantiated. We are seeking further information in respect of these claims.

Foreclosure of rival DMS providers

27. We are also considering whether the merged entity would have the incentive and ability to prevent or hinder competition from rival DMS providers through vertical or conglomerate effects. The main concern that we are testing is that:

⁸ Anonymous submission (14 August 2017) at [14]-[16].

- 27.1 Trade Me may have market power for the provision of online classified advertising for motor vehicles;
- 27.2 if Trade Me had market power for the provision of online classified advertising for motor vehicles, it may be able to use that market power to restrict the feed of listings from rival listing platforms or otherwise raise their costs, leading dealers to switch away from those DMS providers (that is, the merged entity may have the ability to foreclose); and,
- 27.3 the loss of dealers may result in rival DMS providers losing scale or facing higher costs and imposing a weaker competitive constraint (that is, the merged entity may have the incentive to foreclose).

Trade Me may have market power

- 28. Trade Me argues that it operates in a highly competitive market that includes: dealers' own websites; Google and other search engines; Facebook; print publications; other online platforms; radio advertising; digital display advertising; and other media channels.⁹ As identified in the market definition section, market feedback suggests that online classified vehicle advertising serves a specific purpose and that other forms of advertising are not good alternatives.
- 29. We are considering whether Trade Me has market power for online classified vehicle advertising. By its own estimates, Trade Me has the largest share of motor vehicle classified advertising revenue of the listing platforms. Some parties view Trade Me as the most important listing platform due to the views it receives. The economic benefits associated with the high number of viewers that Trade Me attracts may provide it an advantage over smaller rivals. We are continuing to assess Trade Me's market position.

Trade Me may have the ability to foreclose rival DMS providers

- 30. Trade Me may be able to prevent or hinder competition from rival DMS products through various means. This might include conduct such as: preventing or hindering the feeds from rival DMS products to Trade Me; and imposing a charge on DMS products for uploads to Trade Me.
- 31. However, the DMS products available on the market appear to be differentiated. Dealers may have strong preferences for their current DMS. The merged entity may have to offer significant inducements to encourage dealers to switch. If so, this would make it less likely that such a strategy is effective.

Trade Me may have the incentive to foreclose rival DMS providers

- 32. We recognise that Motorcentral's revenues are relatively small compared to that of Trade Me. It is unclear that it would be worthwhile to risk those upstream profits in the effort to gain greater profits for the supply of DMS products.

⁹ The Application at [9.8].

33. We further recognise that the scale and cost structures of rival DMS providers differ. For example: there are some “family owned” DMS businesses that serve a small number of dealers; some DMS providers that use the same platform to provide similar products in other industries; and global DMS products that franchises are required to use by upstream license holders. This may suggest that scale in New Zealand is not critical to operating in the market. This may make it harder to foreclose or harm rival DMS providers.
34. We note that the concerns over foreclosure of rival listing platforms and foreclosure of rival DMS providers that we are considering are not mutually exclusive. We are considering whether the merged entity may engage in both – to some extent – in order to reinforce the impact of a foreclosure strategy.

Yours sincerely



David Shaharudin

Chief Adviser