

Executive summary

Digitalisation is creating disruption across the economy, enabling the emergence of new goods and services and changing the way familiar services are delivered or the way consumers interact with businesses or with each other. One of the sectors where the impact of digitalisation is most clearly visible is advertising.

Advertising is one of the key sectors for competition throughout the economy, as it allows advertisers to reach their current or potential consumers when they have new or improved products. Therefore, a more competitive functioning of the advertising industry will help start-up or innovative companies to better communicate their messages. This will increase the efficiency of the whole economy by empowering businesses and consumers with greater choice to make optimal decisions.

Within the different advertising channels, the online channels have been particularly relevant in recent years. **Advertising has become the main source of funding for the content we consume on the internet.** And some of the large technological platforms that have acquired a notable weight in the provision of various digital services have grown especially financed by advertising revenues, most notably Google and Facebook. Other platforms not so prominent in the marketing of online advertising (such as Amazon, Microsoft or Apple) are increasingly beginning to include it among their main sources of revenue.

This relevance of digital platforms explains certain changes in the **legal framework** that have been addressed or proposed. For example, the European and Spanish data protection regulation introduced in recent years (although it is a horizontal regulation that also applies to non-digital sectors) has an important impact on digital markets and particularly on online advertising, given the fundamental role of the accumulation of personal data for the personalisation of advertising and the measurement and management of campaigns. Data protection law requires the individual's informed and clear consent to the use of his or her personal data.

On the other hand, there is a recent proposal by the European Commission for a Digital Markets Act (DMA) that establishes a specific regulation on certain agents (gatekeepers) relevant to the provision of certain digital services, including online advertising. This proposal considers, for example, the obligation to provide advertisers and publishers with information on the remuneration of the different services provided by the intermediary (so that the advertiser also knows the final payment to the publisher) and access to performance measurement tools that allow their own independent verification. A number of other requirements are also

set out (notably those related to interoperability or data accumulation), which may have a particular impact on digital platforms funded with online advertising.

The **economic characterisation** shows that in Spain, as in most developed countries, the volume of revenue from **online advertising exceeds that of traditional media** (such as television, radio or the press). The CNMC's internal estimates (obtained from requests for information to sector agents) suggest that **its weight in Spain could have exceeded 3,450 million euros** in 2019 (more than the traditional media combined, approximately 2,000 million euros from television advertising, 700 million in press and magazines and 500 in radio) with annual growth rates that may have been around 20% per year in the most recent years.

This revenue volume comes from two main channels (given the lesser importance of other channels, such as "classified" ads or advertising via e-mail, which are not analysed in detail in this report).

On the one hand, **search advertising**, which results from advertisements that may appear alongside "organic" results associated with keyword searches in a general search engine. Search already denotes consumer interest in certain products or services, so advertisers seek to "monetise" this interest with consumer actions that bring the consumer closer to purchase or actually lead to the purchase (website visit, account registration and creation, direct purchase, etc.). According to the CNMC's internal estimates, **search advertising could have generated around 1,500 million euros in Spain in 2019 and the weight of Google in it may exceed 90%** (in line with what happens in other geographical areas).

On the other hand, **display advertising**, which results from advertisements that may appear in different formats (video, banners, "native" advertising...) during our browsing on websites and mobile applications (apps). In general, with this advertising, advertisers aim to improve brand awareness and brand image, although they may also, in certain ad formats, seek specific consumer actions (such as clicks and visits to the website that may lead to purchase or other actions, such as registration and account creation). According to the CNMC's internal estimates, **advertising on display could have generated in Spain some €1,950 million in 2019 and the weight of Facebook (including Instagram) may exceed 40%** (in line with what happens in other geographical areas), with Amazon and Youtube (the latter owned by Google) at a notable distance.

Display advertising is already outpacing search advertising in Spain (and this trend is common in most developed countries). Display advertising is growing on average more quickly than other forms of online advertising, heavily relying on

video formats, mobile devices and social media inventory. In this respect, two marketing models in online advertising should be highlighted.

On the one hand, the **inventory of platforms**, notably Google, Facebook and Amazon, which **market their own offer directly** (without intermediaries). For example, within the total display advertising in Spain (€1,950 million in 2019), platforms can account for up to €1,150 million, with growth rates that can be around 25% annually in the most recent years.

On the other hand, the **inventory of publishers with a primarily national audience** (such as digital newspapers or internet TV and radio or apps), where **intermediaries** are needed to close deals with advertisers and media agencies. This is the so-called **open display**, which may have accounted for around €800 million in 2019 in Spain. New technologies and forms of trading mean that intermediaries are needed to match transactions, notably advertisers' ad servers, demand side platforms (DSPs), supply side platforms (SSPs) and publishers' ad servers. **Concentration in these intermediation services is also high in Spain, with Google's weight accounting for more than 50%-70%** depending on the type of service. Amazon and Facebook are also present in this intermediation work, although with lower weights than Google.

One of the main keys in this evolution is that these companies so prominent in the monetisation of their own inventory (such as Google, Facebook or Amazon) are also competitive in the intermediation of third-party inventory (in the open display). The reason for this is the **fundamental role played by data**: these companies accumulate first-hand data from consumers' navigation within their ecosystems and this data allows them to increase their ability to personalise and optimally manage advertising campaigns, not only on their own inventory but also on that of third parties.

The analysis of the online advertising sector, with a special focus on the Spanish market, allows us to draw a series of **conclusions**.

On the positive side, online advertising implies **substantial efficiencies**, which should be sought to be preserved. On the one hand, digitalisation has endowed advertising with new features, such as the capacity for **personalisation** (which allows advertisers to better reach their target audience; revalues publishers' advertising space; and makes advertising less annoying for consumers by being more relevant to their interests) and for **measuring the performance** of campaigns (helping *a priori* better decision-making by advertisers, agencies and publishers). It has also favoured the entry of **new players and media**, broadening the possibilities for advertisers and consumers. Finally, it has led to the emergence of **new forms of contracting**, which shift from the physical to the digital space, and in which transactions are mass matched in real time.

At the same time, however, there are a number of **risks to competition** that may ultimately harm overall efficiency and, in particular, consumer welfare.

Firstly, the sector tends towards a **notable concentration in very few players**, with two companies (**Google and Facebook**) estimated to account for more than **70% of revenues** in the sector in Spain. By segments, **Google** has more than **90%** of income in **search advertising** and **between 50% and 70%** in the various **open display intermediation services**; while **Facebook** can account for **more than 40%** of revenue in **display advertising**. These figures are truly exceptional, considering that this is a market that has emerged in the last 20 years and where there are no relevant regulatory barriers. They reflect the fact that the dynamics of the sector lead to positions that are difficult to contest. On the one hand, economies of scale and scope are conducive to large, service-integrating operators. But the main cause of this concentration is the role of **data accumulation as a competition variable** and its interaction with network effects. Data increases the competitiveness of platforms in the buying and selling of personalised advertising, also in third-party inventory, and may introduce certain interoperability problems when using different providers, generating **switching costs** and a tendency to concentrate or integrate services in a single provider (**single-homing**). As a result, data can be a barrier to entry and growth in the sector. The role of data also implies the relevance of the merger policy that may be pursued by incumbent operators (such as Google, Amazon or Facebook).

Secondly, there is a **problem of opacity and lack of transparency** in the sector. Actors at the ends of the value chain face a problem of asymmetric information that hinders their optimal decision-making and distorts market power in favour of platforms and intermediaries. On the one hand, advertisers and, to a lesser extent, agencies, **do not have perfect information on the destination of their investment**, especially with regard to the distribution of the budget between intermediaries and the final publisher. On the other hand, medium-sized publishers, who market their inventory on the open display, **do not have perfect information about the end advertiser's** (and their competitors') willingness to pay either, which will make it difficult to make inventory optimisation decisions. In short, while platforms that market their own space directly absorb the advertiser/agency budget, in open display there is a gap between what the advertiser pays and what the publisher receives of between 30%-40% (i.e. the publisher would only receive 60%-70% of the advertiser's committed expenditure). This gap reflects the remuneration of intermediaries, which is not problematic per se (as intermediaries also add value through programmatic matching of transactions and enrichment with audience profiling data), but because of the lack of transparency on the specific remuneration of individual intermediaries, as it hinders optimal decision-making and may consolidate the market power of certain operators, particularly vertically integrated ones. In

addition, lack of transparency may also entail the discriminatory imposition of certain conditions or technical standards that unduly restrict **interoperability**.

Thirdly, integration and concentration in the sector may generate **incentives or risks of competition-distorting behaviour**. Some platforms (notably Google, but also Amazon and, to a lesser extent, Facebook) market their own inventory on an exclusive basis while at the same time they take part in brokering third party inventory. In other words, they combine in a unique way in the market the simultaneous access to their own attractive space, with large and well-profiled audiences, and to the inventory of third parties. This leads many advertisers/agencies to use them as priority or even exclusive buying tools (single-homing), especially in the case of advertisers, generating potential incentives for the extension of market power from one market to another (**leveraging**). It can occur both from the supply side (as publishers) towards their ad buying tools, and in the other direction (as there is a potential conflict of interest if the platforms' buying tools divert the demand in favour of their own inventory). These problems may increase with the vertical integration that characterises the intermediation of ad buying and selling in open display, where Google has a preponderant presence on both sides of the market. Another potential competition-distorting behaviour is discrimination in favour of one's own services (**self-preferencing**). In the open display system, intermediaries order their bids in a sequential auction system. Vertically integrated operators may have incentives to favour their own services. Although such conduct could in theory be sanctioned by advertisers/agencies and publishers (as they are not necessarily accessing the best option), the market power and interoperability advantages of a vertically integrated operator limit the ability of advertisers/agencies and publishers to switch to alternative providers. In addition, the lack of transparency affecting advertisers/agencies and publishers can also make it difficult for them to make optimal decisions when choosing their intermediaries.

Competition problems in the area of online advertising can end up **reducing overall and consumer welfare**. First, **costs** may be higher for **advertisers** compared to an alternative scenario of increased competition, and are likely to be passed on (wholly or partially) in higher prices for final goods, eroding consumer welfare. As a result, **the role of advertising as a driver** of competition suffers: if firms (especially newly created, small or innovative firms) find it more difficult to publicise their products, efficiency and general welfare suffer across the economy, particularly for consumers, who will be less able to make optimal choices from a wider range of products. On the other hand, the fact that **publishers** also suffer from competition problems in the intermediation and marketing of their inventory may lead them to **reduce their content creation**, with a negative impact on consumers, **or their advertising space**, with a negative impact on advertisers (and on consumers as mentioned in the previous

point). Apart from these effects, it should be borne in mind that online advertising-based business models require a high level of **consumer attention** and **data disclosure**. In a more competitive environment, consumers could even be compensated more for the use of their data. Or they could have more options regarding privacy, price and advertising alternatives, unlike the current model where the only option in order to benefit from certain digital services necessarily involves the transfer of personal data (take it or leave it).

To address the challenges associated with potential competition problems in the area of online advertising, the CNMC makes a series of **recommendations**. The proposed measures are complementary and should be jointly implemented:

- 1. Competition authorities must keep enforcing competition policy continuously and decisively as the first line of defence in the online advertising market.** This policy provides the flexibility to assess on a case-by-case basis the effects of a conduct, or of a structural change, on effective competition in the market against the potential efficiencies that may result. An optimal application of competition policy in a market such as online advertising requires action on several fronts, with the aim of ensuring that markets remain contestable (by reducing barriers to entry or switching costs). For example, merger analysis or the use of interim measures or remedies where necessary, in the event of anti-competitive conducts.
- 2. Competition policy tools should be complemented by regulation on digital platforms likely to create competition problems.** Regulation and enforcement of competition rules are complementary in nature. In this sense, the European Commission's proposal for a "Regulation on contestable and fair markets in the digital sector" (Digital Markets Act or DMA) is a tool that can improve competition in markets such as online advertising. The current proposal of the DMA includes, within its scope, online advertising and related or adjacent services as core services where platforms with significant market power in the EU internal market (gatekeepers) are obliged to a set of actions. Among the conducts proposed to be regulated by the DMA that may improve the competitive performance of the advertising sector, there are improved transparency in online advertising, interoperability obligations, obligations related to data accumulation, horizontal obligations or obligations aimed at minimising conflicts of interest.
- 3. National and European legislators must take into account the complex relationship between consumer and privacy protection and the promotion of competition in digital markets in order to empower consumers and ensure their maximum welfare.** Business models based on online advertising are very data-intensive. Some authors have shown that there is evidence that the EU data protection regulation (GDPR) may have

favoured platforms with large audiences to the detriment of smaller publishers. This also implies that the disclosure of data to the platforms is also significant without the consumer being fully aware of it at times. Therefore, to be truly effective, data protection regulation must take into account the incentives it generates in the behaviour of agents and, therefore, its impact on competition in digital markets such as online advertising. In this respect, imposing additional obligations on actors in terms of privacy should avoid creating unduly cumbersome burdens on less systemically important operators. It is definitely not about reducing the protection of a good such as consumer privacy. On the contrary, it is about empowering consumers and making them more aware of the use and value of their data. One way to achieve this is to ensure effective compliance with European data protection regulations, for example with regard to data portability. Moreover, it would be desirable for consumers to have more, better and real choices of alternative models, rather than the use of services being necessarily linked, in virtually all cases, to the transfer of personal data. These could be options to benefit from the service without the need for data release (e.g. with a positive monetary price) or the possibility for consumers who voluntarily opt for the release of their personal data to be compensated for it to a greater extent, including monetary incentives.

4. **A multidisciplinary and cooperative approach should be adopted between the institutions involved.** Competition Authorities have to be in the front line to enforce competition policy (should possible anti-competitive behaviour be detected) and to promote competition (to ensure the competitive functioning of the sector, e.g. through an optimal regulatory response). But there are also challenges for independent regulators in related sectors and for Data Protection Authorities. Institutional cooperation between all actors involved is needed. This spirit of institutional cooperation must go beyond the national level, given that in online advertising the competitive dynamics and associated challenges are similar in most developed countries. The CNMC, as competition authority and independent regulator of the telecommunications and audiovisual sectors, integrates a convergent and multidisciplinary vision to provide a global response to the challenges posed by online advertising.
5. **The capacities and means of competition and regulatory authorities must be strengthened.** The Competition and Regulatory Authorities need sufficient resources (means, qualified staff and resources in the financial, technical and technological fields) to cope with the complexity that actions in sectors as complex as online advertising entail. The most important element is that the Competition and Regulatory Authorities have the autonomy to organise their resources in a flexible manner. In this respect, the existing framework in Spain is insufficient to provide the CNMC with full autonomy to manage its human

resources, organisational structure and budget. It is therefore recommended that the national legislator adopts the necessary legal reforms.