Platforms operate in markets with two or more distinct types of users. Their value lies in creating an interdependence which facilitates transactions between the users. Examples include shopping malls, credit cards and search engines.

The multi-sided markets in which platforms operate are characterised by network externalities and the ability to affect the volume of transactions through pricing structures.

While platforms can operate online and offline, the internet has created new opportunities to lower transaction costs by linking users. Recently, there have been calls at EU level for a special regulatory framework for online platforms.

However, there are concerns that regulation would be inappropriate because it could not be sector-specific, as platforms operate across a wide range of sectors, with many different business models and pricing structures.

Additionally, it is believed that premature intervention might do more harm than good. Online platforms are a very recent phenomenon in a highly dynamic and competitive environment which regulation could stifle.

Internet-enabled platforms have the potential to significantly improve economic welfare. The likelihood of costly errors suggests that policy-makers should refrain from regulating such a broad and innovative range of businesses.

Platforms are a widespread economic phenomenon. They emerge to connect two or more groups of distinct users, and in this way they make transactions possible which otherwise would not take place. Platforms operate online and offline – common offline examples are newspapers and shopping malls, while online ones include search engines and social networks (Rochet and Tirole, 2003; Kennedy, 2015). Recent technological developments – notably computer software, the internet and smartphones – have considerably expanded the scope for platforms to lower transaction costs (Munger, 2015). As platforms have become an important part of the online ecosystem, they have attracted scrutiny from regulators, not least the European Commission, which launched a consultation on the matter on 24 September (European Commission, 2015). The following discusses what defines platforms, their value proposition, as well as how they should be approached from a competition perspective.

**Defining platforms**

Platforms operate in two- or multi-sided markets with distinct groups of end users (Rochet and Tirole, 2005). Their value lies in creating an interdependence between the different types of users in a way that facilitates transactions, thus improving the welfare of both (Lamadrid, 2015). To use the example of free-to-air television channels, these finance themselves through advertising revenue and can then bring content to viewers “for free.” Both sides get what they want: advertisers get attention from potential customers and viewers get cheap (zero-priced) entertainment (Rochet and Tirole, 2003). Crucially, this business model resolves a transaction problem, since it would be hard to charge viewers for content that can be accessed by anybody with a television set (Booth and Mingardi, 2015).1

The markets in which platforms operate exhibit positive network externalities, meaning that growth in scale through the incorporation of new users increases the value of the platform to existing users. The more shops there are in a mall, the greater the variety of choices open to customers. And the larger the number of customers, the more likely it is for any individual shop to make a sale. But it is not just network effects that make platforms valuable: the way in which they structure pricing – i.e. who they subsidise and who they charge – can have a disproportionate impact on the overall number of users. For instance, a credit card provider’s decision not to charge cardholders and even to offer rewards is an incentive for the latter to use the card, which in turn makes merchants more likely to accept the card as payment, and to agree to pay a commission to the card provider (Rochet and Tirole, 2003; 2005).

**Platforms, intermediaries and the internet economy**

While platforms have a long-standing presence in many parts of the economy, their prominence has risen with the advent of the internet and the growth of computing power that made smartphones possible. Technology has opened up new ways of reducing transaction costs through innovations in the way goods and services are delivered. Furthermore, the ability of information to be transmitted cheaply and reliably across long distances has made it possible to connect disparate end users, to grow networks and to structure business models in previously unthinkable ways. In other words, the opportunities for economic betterment through platforms have grown substantially.

In its consultation, the European Commission describes as an online platform any undertaking “which uses the internet to enable interactions between two or more distinct but interdependent groups of users” (EC, 2015). According to this definition, internet-based intermediaries connecting buyers and sellers of goods and services – such as eBay and Uber – can be classified as online platforms. Thus the Commission’s definition is broader than the one commonly used in
economic research, which focuses on the presence of network effects and whether price structures can affect the volume of transactions (Rochet and Tirole, 2005). The below analysis applies to both broad and narrow definitions.

A special regulatory regime for online platforms?

The feature common to platforms is that they link together interdependent groups of users who would otherwise not interact due to high transaction costs. Beyond that, there is little that platforms share with each other: they operate in a wide variety of sectors – retail, information services, advertising, transport, to name a few – which also means that their business models and pricing structures differ from one another. Crucially, online platforms compete with platforms and non-platforms, both online and offline (Maxwell and Pénard, 2015).

Nevertheless, there have been calls at EU level for a special regulatory regime for online platforms. They follow a 2014 non-binding vote in the European Parliament to “unbundle” search engines (EPICENTER, 2014), as well as a number of antitrust investigations by the Commission into online search, e-commerce and mobile software (EC, 2015). The arguments used are often the same: that the high market shares of a small number of players imply abuse of dominance; that some platforms can act as ‘gatekeepers’ and create ‘competitive bottlenecks’ – preventing other online services from reaching potential users (Lamadrid, 2015). Additionally, it is argued that, because network externalities favour scale, market dynamics may lead to the emergence of one dominant platform, at the expense of competing ones.

Ex ante regulation vs. ex post competition policy

Others have argued that regulation would be inappropriate and even counterproductive. Maxwell and Pénard (2015) point out that ex ante regulation in the European Union has traditionally been limited to sectors where the state once had a monopoly, such as telecommunications. Regulation was introduced to ensure a level playing field when these sectors were opened up to competition, and the Commission envisaged that, over time, competition law would replace ex ante rules (EC, 2009). It is important to underscore that regulation has always been sector-specific; however, this would not be the case for online platform regulation, as platforms operate across many different sectors.

Alex Chisholm from the UK Competition and Markets Authority recently spoke against platform regulation, and favoured instead ex post enforcement of antitrust violations (Chisholm, 2015). He pointed out the danger that legislation with regard to online platforms might be ill-defined and premature, and that it could ossify what is a highly dynamic and evolving market by constraining the development of new business models. Lamadrid (2015) also underlines the complexity of analysing competition in two-sided markets, where what might look like exclusionary conduct on one side may have pro-competitive effects on the other side, and even improve overall welfare. Kennedy (2015) argues that competition authorities already have adequate tools to deal with anti-competitive behaviour by online platforms.

Uncertainty, error costs and market dynamics

There is still much uncertainty surrounding competition policy in the internet sphere. First of all, the evolution of the digital sector in recent years – where the giants of yesterday have been debunked by new players – shows that market share is a poor indicator of market power. This is not least due to the fact that the most effective challenger might come from outside the incumbent’s relevant market: the decline of Microsoft as mobile software rose is a case in point (EPICENTER, 2015). Secondly, two-sided markets magnify what is already a difficult exercise, namely to ascertain whether certain business practices online are pro- or anti-competitive. Thirdly, intervention could well hamper innovation and the emergence of new challengers, at a time when online and offline markets are in flux as a result of the introduction of new technologies and data analysis on a massive scale.

In the face of uncertainty about the consequences of regulatory action, authorities should favour the solution that minimises the potential for damage. Easterbrook (1984) called such damage error costs, and he demonstrated that errors on the side of overlooking anti-competitive conduct were preferable to errors on the side of condemning beneficial practices. That is because anti-competitive practices and monopoly rents create incentives for entry into the market and for innovation to overcome the incumbent’s exclusionary practices. On the other hand, regulatory and legislative action, even when mistaken, is hard to reverse, as the difficulty of reforming taxi regulations across Europe illustrates.

Conclusion

The internet is a relatively new phenomenon, and it is hard to predict the consequences that it will have for many sectors across the economy. There is reason to believe that ex post antitrust enforcement of perceived anti-competitive practices online could do more harm than good, in the light of previous experience (EPICENTER, 2015). This is even more true of ex ante legislation, which is unable to foresee future innovations and quite capable of stifling market dynamism.

Nobel Prize winner Ronald Coase, whose insights had a significant influence on competition law and economics, pointed out that “if an economist finds something […] that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, […] the reliance on a monopoly explanation is frequent (Coase, 1972, cit. in Veljanovski, 2015). In the face of uncertainty and a rapidly evolving internet economy, regulatory restraint is essential.
As the rise of subscription online streaming services shows, technology now enables content providers to charge viewers for content.

According to the European Commission (2009), “the aim is progressively to reduce ex ante sector-specific rules as competition in the markets develops and, ultimately, [for them to be replaced] by competition law.”

Vertical integration in online search, for instance, has been shown to be pro-competitive (Wright, 2011). See also Lamadrid (2015), who speaks of a “double duality” in two-sided markets.

References


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