Antitrust and the challenge of regulation for online platforms

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Platform businesses bring together distinct but interdependent sets of users in such a way as to improve the welfare of each side of the market. Their central value proposition is the reduction of transaction costs, which increases the number of viable exchanges in the market.

The rapid growth and large size of the leading online platforms has given rise to concerns from regulators and policymakers. Three areas of controversy stand out in particular: market definition, market power, and platforms’ use of data.

Regulators and competition authorities have historically maintained a comparably light-touch approach towards digital industries. However, a number of recent announcements signal a more interventionist outlook, with potentially chilling consequences for competition and innovation in the digital sphere.

Introduction

The internet has brought down barriers to interaction between individuals and firms, creating opportunities for intermediaries to emerge and facilitate online transactions. Internet platforms achieve this primarily by lowering search costs, enabling the safe transfer of money, and providing feedback mechanisms which increase trust among users who, in the majority of cases, will interact only once or a few times. Thus, the widespread adoption of the internet and associated opportunities for low-cost exchange of information have led to the emergence of a whole range of new online platform businesses. Currently, the largest digital firms – such as Apple, eBay, Google and Microsoft – operate in whole or in part as platforms, as do some of the most highly-valued start-ups such as Uber.

For this reason, the economic and competitive analysis of platforms, and associated phenomena such as the presence and importance of network effects, the extent of market power and contestability, and the potential for exclusionary conduct have received a great deal of attention from regulators around the world.

The economic significance of platforms

Platforms are characterised by the presence of network externalities: the welfare of an individual user on any side of the market depends on the number of users on her own and other sides.

Network externalities and user interdependence also make pricing in a platform context essentially different from price-setting in one-sided markets. Whilst in the latter case price will approach marginal cost – plus a mark-up if the market is not perfectly competitive – in multi-sided markets where the presence of one side is especially important to lure other types of users into participating, that side may face below-cost (and sometimes even negative) prices.

Online platforms have not only expanded the scope for viable transactions across a range of markets, but as a by-product have often increased competition in traditional markets. For example, the emergence of subscription-based forms of media consumption (e.g. Netflix, Amazon Prime and Spotify) has made entertainment cheaper, led to a more diverse set of products and stimulated innovation within older, established, players. On top of this, platform innovations often result in the creation of new markets or a multi-fold expansion of existing ones.

Market definition: who are platforms competing against?

The first area of controversy that stands out in discussion of competition policy with regard to online platforms is market definition. In particular, regulators such as the European Commission typically conduct SSNIP tests to establish the scope of the relevant market. But a number of economic features of internet and platform markets complicate the qualitative and geographic definition of the relevant market.

Firstly, many digital products and services are available at zero price. This means that users of, for example, search engines can make their queries at no monetary expense, whilst developers are able to write applications for a particular software platform – and
to charge for app downloads – at low or zero cost. Secondly, the multi-sided character of platform markets means that pricing decisions are made not just with regard to demand from the users who pay that price, but also considering the likely effects on demand from users on other sides of the market.

The third complicating factor in digital markets is the dynamic nature of competition. In fact, when compared to more traditional sectors, the internet is characterised by rapid innovation and comparably low barriers to entry. This means that new entrants, if successful, can swiftly debunk incumbents and amass large market shares for specific products or services. Indeed, most of the firms currently under scrutiny are less than a quarter-century old and have become large players only over the last decade.

**Market power and anticompetitive harm**

Closely related to market definition is the question of when and how online platforms can abuse market power to harm the competitive process. As with market definition, the multi-sided nature of platforms makes establishing market power and the welfare effects of platform conduct more complicated than in one-sided markets.

The use of even limited powers of exclusion and the enforcement of common standards is an essential part of platform governance. Recent studies have documented how platform rules have evolved through trial-and-error to manage the trade-off between flexibility and homogeneity. Indeed, the commercial success of a platform is defined by the extent to which it balances this trade-off optimally, since that is what will determine user participation and the associated network effects.

Thus, enabling online platforms to decide on governance mechanisms – including exclusion under specific circumstances – is important to ensure platform markets are sustained and that they reduce barriers to successful transactions. Furthermore, competition between rival platforms is as relevant to antitrust analysis as competition within a single platform, and the former will increase when rival platforms can differentiate themselves by deciding on their internal governance.

**The use and abuse of data**

The third main area of controversy focuses on the use and abuse of data collection. The ability of platforms to improve their algorithms using past data has given rise to a concern that network effects might be particularly pronounced in online platforms. However, it is vital to remember that platform markets do not exhibit the characteristics commonly associated with monopoly or oligopoly, primarily because their high profit rates are usually matched by high rates of R&D investment.

Even more importantly, making data an antitrust concern would require defining precisely what data is and in which instances it can be used for anticompetitive purposes. But the nature of the object eschews a precise definition: any information deemed valuable for economic purposes might be included, but technology and business innovations are constantly expanding the information to which this definition can apply. The ‘Internet of Things’ is just one example of how improved techniques for information collection are spreading across the economy and being used across all sectors.

The central issue with data is that its use is non-rivalrous – that one firm holds information on a user’s browsing history does not prevent others from having access to it and using it for their own commercial and other purposes. Moreover, even if one grants that indirect network effects are especially acute in platform markets, and that they will tend to result in a few big players’ dominating, it is not a given that this state of affairs would be harmful to welfare if markets are contestable and economies of scale make large firms more efficient.

**Conclusion**

Regulators and competition authorities have historically maintained a comparably light-touch approach towards digital industries. The rationale has been that online markets, because relatively new and rapidly evolving, could be stifled and innovation chilled if regulators acted prematurely. However, under legislation announced on 10 May as part of the Commission’s mid-term review of the Digital Single Market strategy, new restrictions would be introduced into freedom of contract between platforms and businesses.

Whilst these new rules are well-intentioned, they may harm rather than protect user welfare, and they appear to misunderstand some of the crucial features of online platforms: what their role is, how they add value, and under what conditions they can increase the welfare of those who use them.
References