No platform? On the economics of P2B exchange

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The European Commission is worried about the market power of platforms in their dealings with businesses. It is not a pointless concern. In the digital age, online platforms are a gateway to consumers and information – that's why they're so valuable to society. Some of them have large shares in the narrowly defined markets typically analysed by regulators. In this context, economic theory suggests there may be instances where platforms might abuse their market power by raising price or, more likely in this case, by degrading the quality of service granted to businesses.

The evidence and its discontents

The Commission's 2016 communication on online platforms and the Digital Single Market quotes a Eurobarometer survey in which 75 per cent of respondents were in favour of greater transparency, "in particular on how platform remuneration influences the listing of search engine results." An official study conducted by Ecorys found that 46 per cent of business users of platforms had experienced problems in the course of their business relationship, a figure that was as high as 75 per cent for heavy users.

This may seem decisive evidence until one drills down into the detail of the studies. A number of concerns emerge. The online consultation undertaken by the Commission in the last quarter of 2015 framed the questions in a way likely to bias respondents in favour of intervention. Consider two examples (emphasis added):

- Do you think that online platforms should ensure, as regards their own activities and those of the traders that use them, more transparency in relation to information in response to a search query by the user, in particular if the displayed results are sponsored or not?
- Should there be a mandatory requirement allowing non-personal data to be easily extracted and moved between comparable online services?

The inquiry was into whether platforms should be more strictly regulated, so phrasing questions neutrally would have been challenging. Nevertheless, it is difficult to think of contexts in which one wouldn't like more transparency and greater ease of data portability. There was a key omission in most questions, namely, the acknowledgement that policy interventions would have costs as well as benefits. Moreover, these costs – as with all costs in a competitive setting – would be passed on to users in the form of higher prices, reduced choice and/ or lower quality.

Similarly, whilst it is important to take the concerns of business users of platforms seriously, the Ecorys report shows that the top two sources of problems were technical issues and a lack of customer support, both of which are unrelated to the market power of platforms. Concerns around transparency and contractual practices ranked high, but fully 70 per cent of business respondents didn't disagree that platform terms and conditions are fair. Additionally, 89 per cent of respondents said that they had taken steps to solve the problems faced in dealing with platforms.

Surveys are liable to be interpreted to favour the interpreter's prejudices, but the picture that emerges from the above is not of a market in which users are routinely abused and have no avenues for redress. Rather, what we observe is a market where users are broadly happy, although they agree that things could always be better. Crucially, they have ways to make their discontent heard. This picture is consistent with rising numbers of platform users and an ever broader scope of platform services.

Do platforms have an incentive to abuse customers?

An economic analysis of monopolistic abuse requires deciding not just whether platforms have the *ability* to fleece business customers, but also whether they face the *incentive* to do so. My waiter could water down my wine thereby lowering his cost and raising his profit, but he has no incentive to do so because I'd sooner or later become aware of the racket and take my custom elsewhere. (Unless I found myself on, say, a Greek island where my repeat custom wasn't expected. Then the racket might be profitable, but even then, the waiter would eventually earn a reputation for dodgy practices.)

The same is true for platforms. Consider a search engine which ranks results in two ways: 1) by how much the owner of the link is willing to pay; 2) by how relevant the result is to the query. Note that relevance is a subjective, though scientific, concept: it may be gauged by the user's past browsing history and other users' previous clicks after the same query, but it is not permanent, immutable nor obvious. Indeed, this is how search engines compete with each other: by coming up with different sorting devices.

Paying customers have no reason to be afraid of abuse. They know the placements that they are bidding for. The structure of the online ad auctions is such that customers reveal their true valuations for the space (so-called 'Vickrey pricing'). Non-paying customers might worry about the methodology by which they are ranked, but if we judge the relevance to the user's query – her probability of clicking on the link – as a fair measure of where they should rank, then one is hard-pressed to come up with a scenario in which a competitive market couldn't deliver this outcome.

Is there market failure in platform markets?

Some object that the conditions of the competitive model don't prevail in P2B relationships. The objections usually relate to either the market power of platforms or the extent to which users are informed about their own preferences.

Market power

It is true that platform markets are characterised by a few players with large market shares, but this tells us little about competitive conditions because switching costs are low – by historical standards – and platforms (e.g. Amazon, eBay, Facebook and Google) compete amongst themselves for business customers. In a world in which users spend an increasing amount of time online, multi-homing across platforms and devices, the notion that businesses have to bargain with platform monopsonies is dubious.

A recent study of deals promotion platforms (e.g. Groupon) found that, because users (both consumers and merchants) multi-home, there was little difference between platforms in the deal terms they offered. The authors also found that unsuccessful merchants were likely to switch platforms for their next promotion, although this made little difference to sales. Similarly, reports suggest that many Uber drivers in the U.S. periodically (even daily) switch to the Lyft app. Increased consumer switching is also observable in online compared to physical news media. Theory suggests that, if consumers multi-home, advertisers will tend to single-home, but this is driven by expected revenue not multi-homing costs.

It's true that multi-homing costs vary by platform. Some developers will find it profitable to write apps for more than one platform; others won't. The decision will be made on the basis of the size and purchasing power of the customer base to which the app intends to cater, the size of the relevant platform, and the contractual terms attached to developing for one rather than a different platform. Apple operates stricter developer restrictions than Google Android, but its average user is also better off.

Imperfect information

The other line of argument posits that users are imperfectly informed and therefore unable to judge whether the results they're getting are the ones they actually would have wanted. This hypothesis is hard to test, because users will not know ex ante what results they would like, nor will they ever find out unless they're the same results given by the search engine. However, if results were consistently unsatisfactory one would expect an erosion of the platform's user base, especially over an extended period of time.

Moreover, this argument fails to account for the fact that markets may not be informationally efficient at any point in time, but they are dynamically efficient: user information improves over time as they accumulate experience and provide feedback. Indeed, the high hopes surrounding artificial intelligence in large part stem from the experience of steady improvement in platform performance as user data is obtained and processed.

Possible interventions

From the above, there are reasons to believe that P2B platform markets as they currently exist are less problematic than we may at first assume. But even if one believes there are important issues, the question is to establish what policy intervention, if any, would improve over the status quo.

An improvement would be a situation in which the risk of abuse is minimised, whilst the flexibility of platform-to-business (P2B) contracting and the dynamic character of internet markets are preserved. If the former comes at the expense of the latter, then it is a question of deciding what the scale of the problem is. If only a few platform customers are ever subject to or at risk of monopolistic abuse, then intervention probably isn't worthwhile.

The Commission has put forward four alternative proposals to address the perceived issues. One of them involves no action, so below we consider the other three.

Option 1: EU soft law action to spur industry-led intervention

This would focus intervention on statistical reporting about platform environments; giving business users more information about contractual terms and options for redress; and developing voluntary standards.

Structural or legal separation of platforms from 'auxiliary activities' is also mentioned. Presumably, this is motivated by perceived conflicts of interest when platforms compete with their users. However, such intervention is unwarranted by the existing evidence and would potentially damage innovation and the efficient operation of platforms, since it would affect their scale and scope.

Option 2: Targeted EU legislative instrument combined with industry-led action

Option 2 is more interventionist and includes different levels of regulation which go from requiring platforms to provide specific avenues for redress, to a 'minimum required level of transparency', to an independent mechanism for dispute resolution and bans on certain practices.

In the absence of more conclusive evidence that certain practices are irredeemably and consistently causing damage to business users without proper redress, all of the above would be heavy-handed. It is surprising that there is no consideration of the compliance costs that externally set standards of operation, transparency (including potentially about proprietary information) and dispute resolution would entail.

Option 3: EU legislative instrument providing detailed principles

This option is the most interventionist, as it would create an EU regulator for online platforms alongside a specific regulatory framework. We have on previous occasions discussed why platform-specific regulation is a bad idea: platforms serve different markets, many of which are regulated, and they have different business models. Bringing them under the same regulatory umbrella would be redundant and unsuitable.

Option 3 would also involve detailed prescriptive regulation of transparency, data access and other practices by platforms in their relationship with business.

Give P2B a chance

The status quo simply isn't dire enough to warrant most of the interventions proposed by the Commission in its impact assessment. Furthermore, market abuse can readily be addressed by ex post antitrust intervention, which (regulators agree) poses less of a threat to dynamic innovation than ex ante regulation. There may well be scope for more information provision and greater transparency from platforms on their contractual terms, but at this stage it is appropriate to give them the opportunity to craft standards which address the concerns raised in the Commission's surveys, whilst minimising the compliance and other costs that will inevitably be passed on to users.