

Bits – Internet Platforms: To Regulate or Not To Regulate?

Market Power and Internet Platforms

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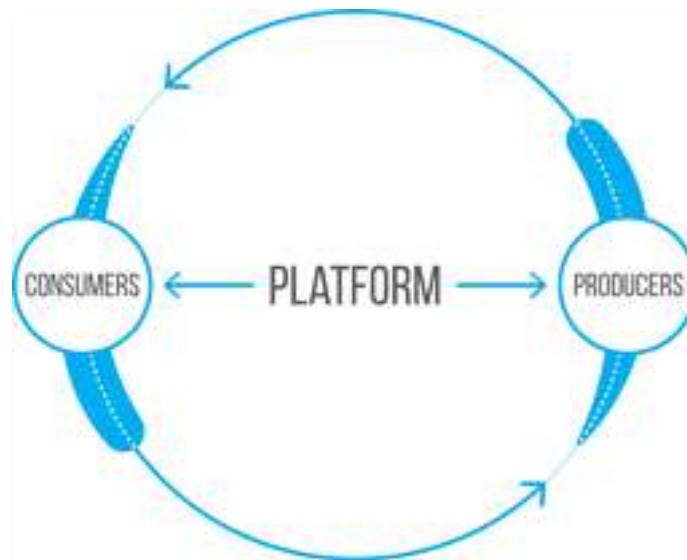
Brussels, July 16, 2015



Outline of the talk

- Internet platforms seen as multisided platforms (MSP)
 - Definition and typology
- Assessing market power for Internet platforms
 - Price(s) and cost(s)
 - Relevant market
 - Competitive benchmark
- (Cautious) conclusions
 - No answer but (hopefully) clear questions

Multisided Platforms

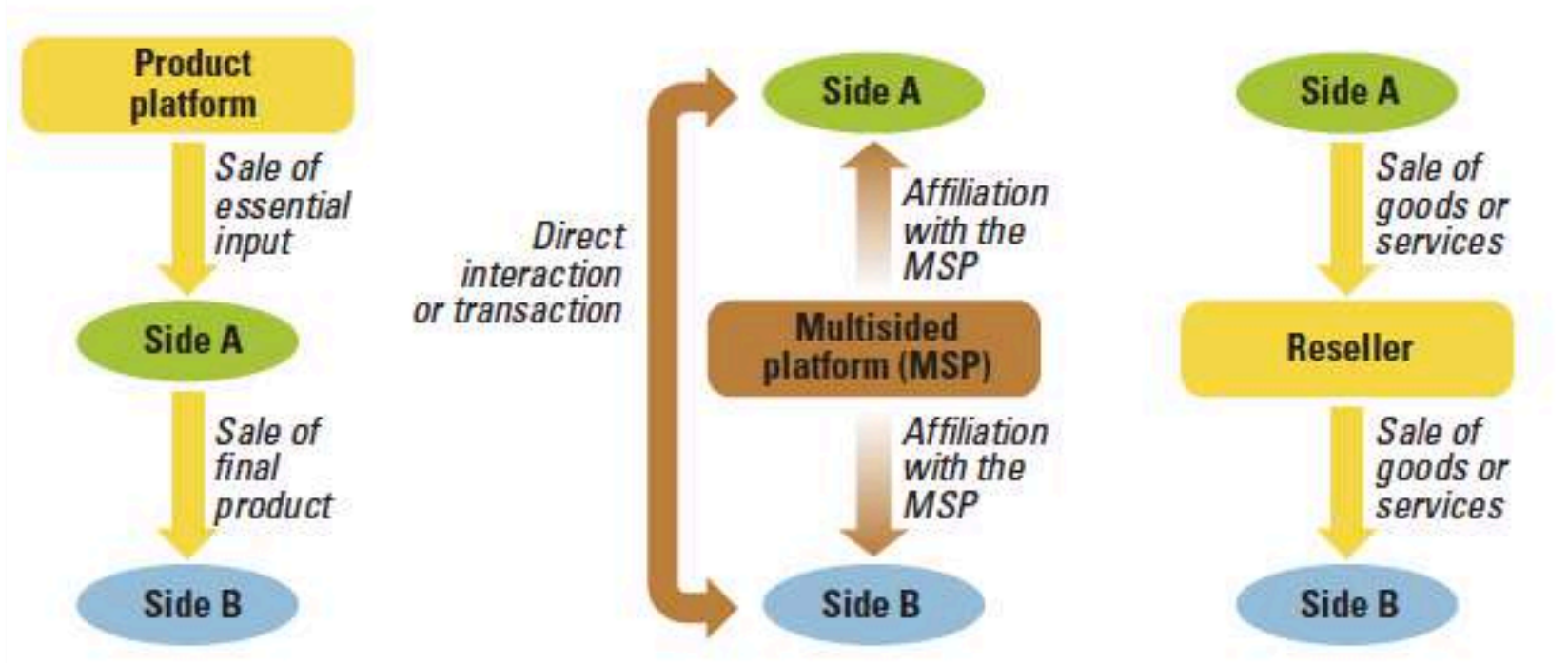


Multisided platforms: Definition (Evans, 2011)

- There exists a **business opportunity for an MSP** if
 - Distinct groups of customers wish to interact.
 - The interaction generates external effects.
 - “**Cross-side**” → A member of one group values more (or less) the interaction when the participation of *another group* increases.
 - “**Within-side**” → A member of one group values more (or less) the interaction when the participation of *her own group* increases.
 - An intermediary can facilitate interaction more efficiently than bilateral relationships between the members of the groups.
 - Transaction costs and free-riding problems make it difficult for members of distinct customer groups to internalize the externalities on their own.
 - Internet and digital technologies contribute to reduce transaction costs.

Multisided vs product platforms vs resellers

There are two key characteristics of a multisided platform: (1) each group of participants ("side") are customers of the MSP in some meaningful way, and (2) the MSP enables a direct interaction between the sides. Product platforms violate the first requirement: The ultimate customer is not a customer of the platform provider. Resellers violate the second requirement: There is no direct interaction between the sides.



Multisided platforms: Typology

- **Exchanges** → Help ‘buyers’ and ‘sellers’ search for feasible contracts and for the best prices.



- **Software platforms** → Allow applications developers and users to interact



Multisided platforms: Typology (2)

- **Matchmakers** → Help members of one group to find the right ‘match’ within another group



- **Advertising-supported media** → provide content to ‘viewers’ and sell their attention to advertisers



Multisided platforms: Typology (3)

- **Peer-to-peer marketplaces** → A.k.a. ‘Sharing economy’



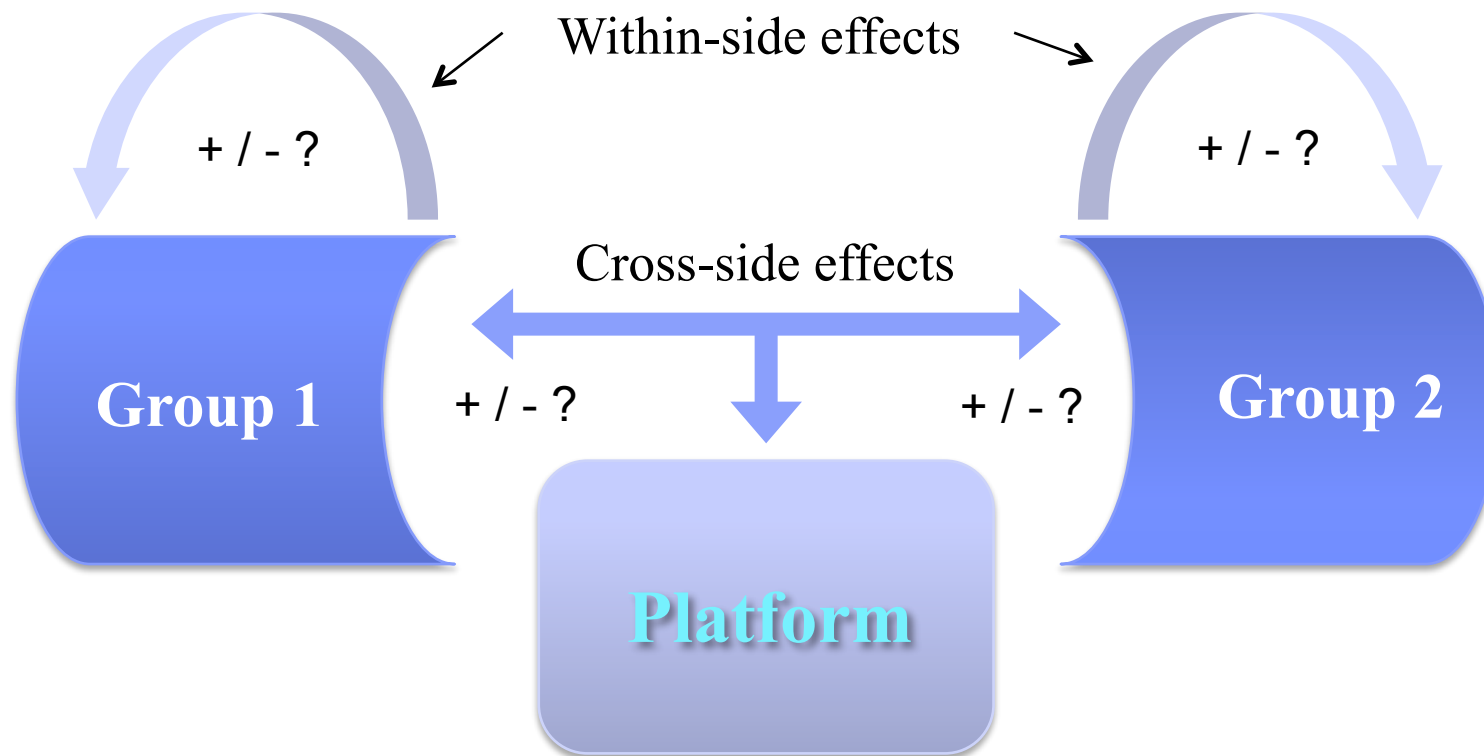
- **Crowdfunding platforms** → Link entrepreneurs to funders



- **Transaction systems** → provide a method for payment to buyers and sellers that are willing to use it







Identifying external effects

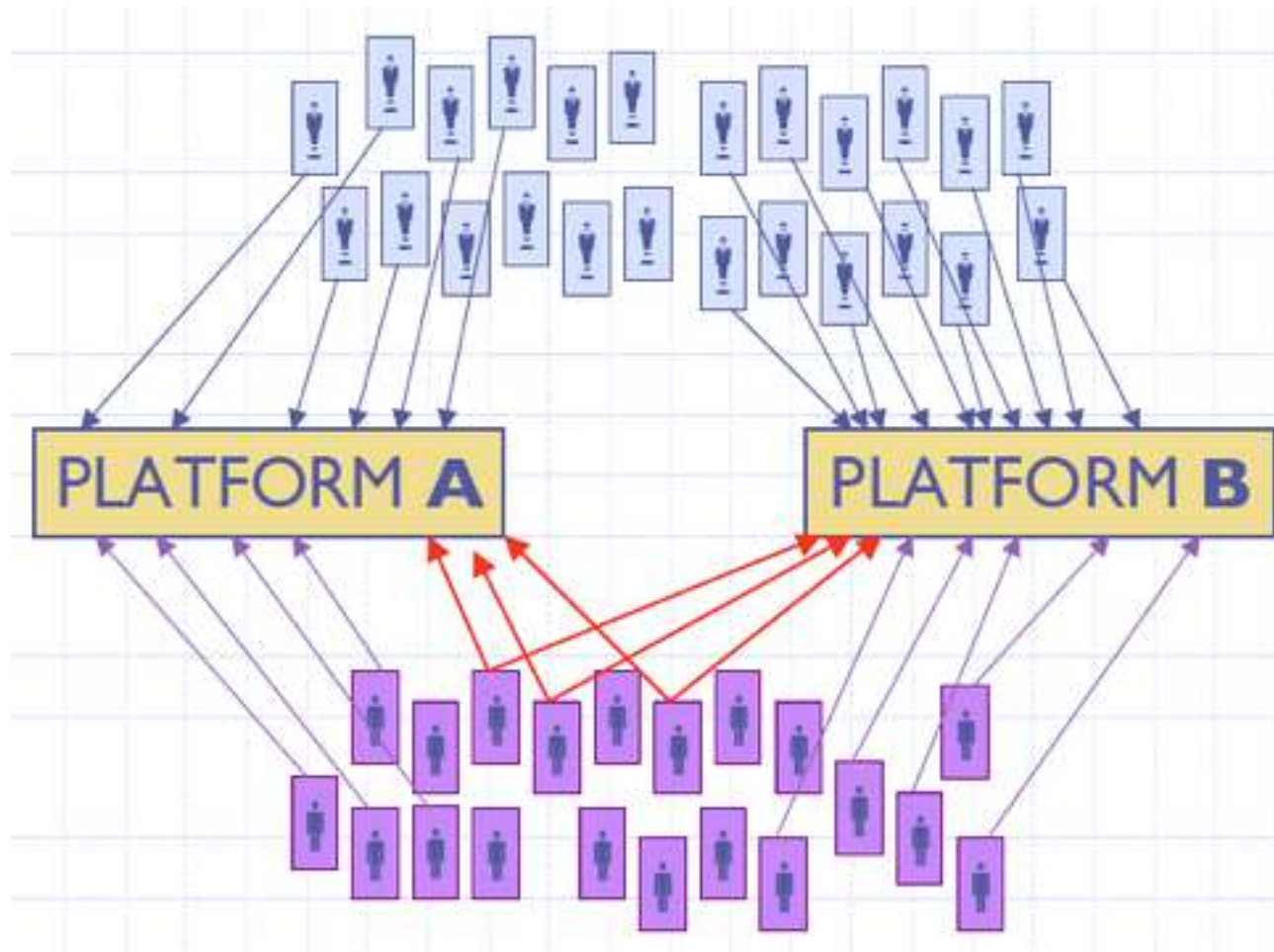


Identifying external effects (2)

- Some examples

	Sides	Cross-side	Within-side
	A. Game developers B. Users	A to B: + B to A: +	In A: - In B: +
	A. Readers B. Advertisers	A to B: + B to A: - (+?)	In A: / In B: -
	A. Women B. Men	A to B: + B to A: +	In A: / (-?) In B: / (-?)
	A. Merchants B. Consumers	A to B: + B to A: +	In A: - In B: /

Single- vs. multihoming



Intuition

- ✓ Platforms have a monopoly for access to singlehomers.
- ✓ Singlehomers are “courted”.
- ✓ Multihomers are “exploited”.

Assessing market power



Defining market power for MSPs

Market power

From Wikipedia, the free encyclopedia

In economics and particularly in industrial organization, **market power** is the ability of a firm to profitably raise the market price of a good or service over marginal cost. In perfectly competitive markets, market participants have no market power.

Which cost(s)?

Which benchmark?

Which market(s)?

Which price(s)?

Which price(s) and cost(s)?

- 2 types of “prices”
 - Membership fees → affect participation on the platform
 - Usage fees → affect usage of the platform
- Skewed pricing structure
 - Typically: one ‘money’ side and one ‘subsidy’ side
 - Often necessary to address the ‘chicken-and-egg problem’
 - Nightclub example → Which side to subsidize?



Or



Lower margin on the side where
the price-elasticity of participation is higher, and/or
the external effect generated on the other side is larger.

Which price(s) and cost(s)? (2)

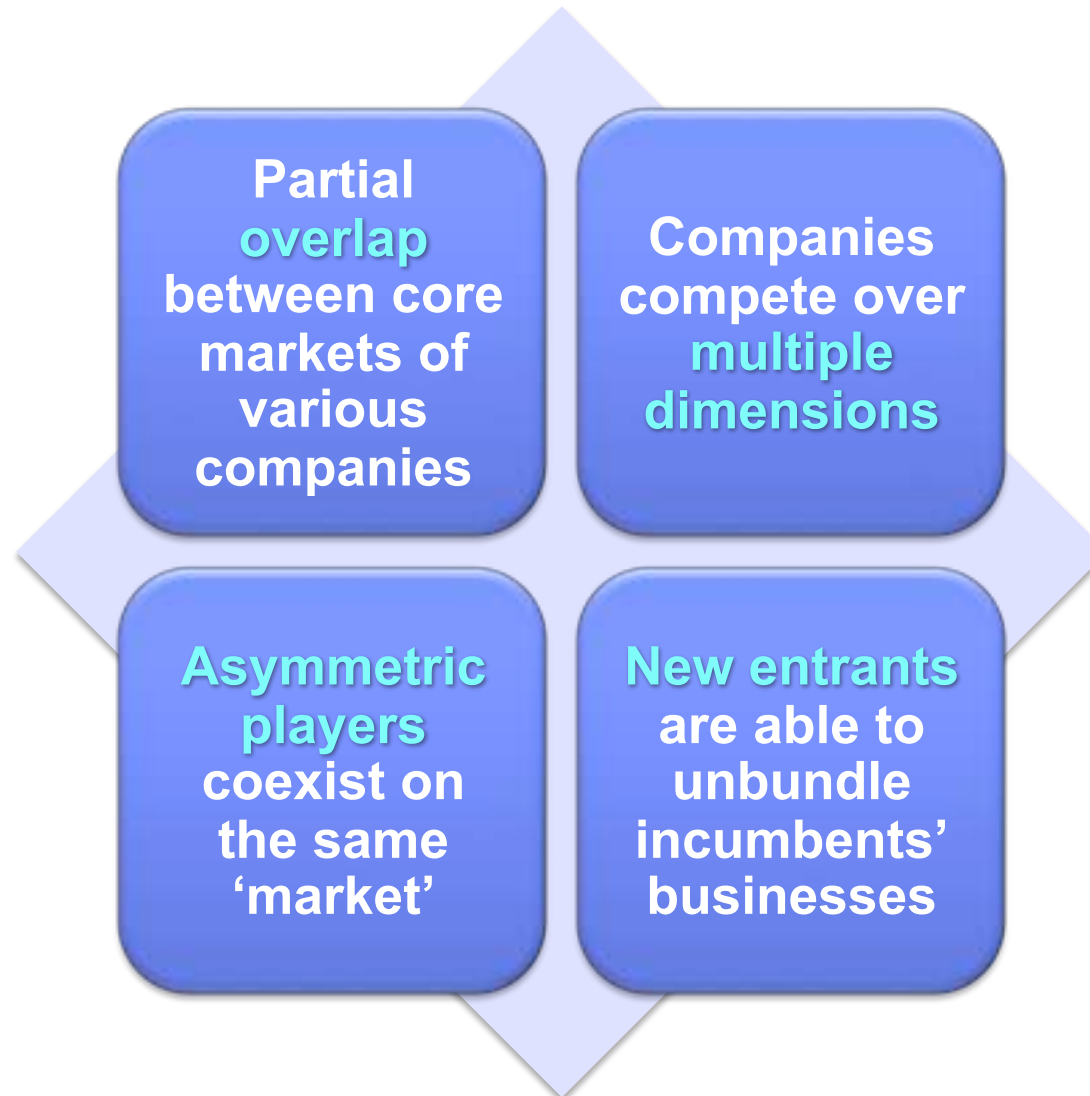
- **In general**

- The standard formula for profit-maximization (inverse-elasticity rule) must be adapted.
- ***Opportunity cost < marginal cost***
 - **Why?** Attracting an extra side-a user generates revenues on side b.

- **Main lesson**

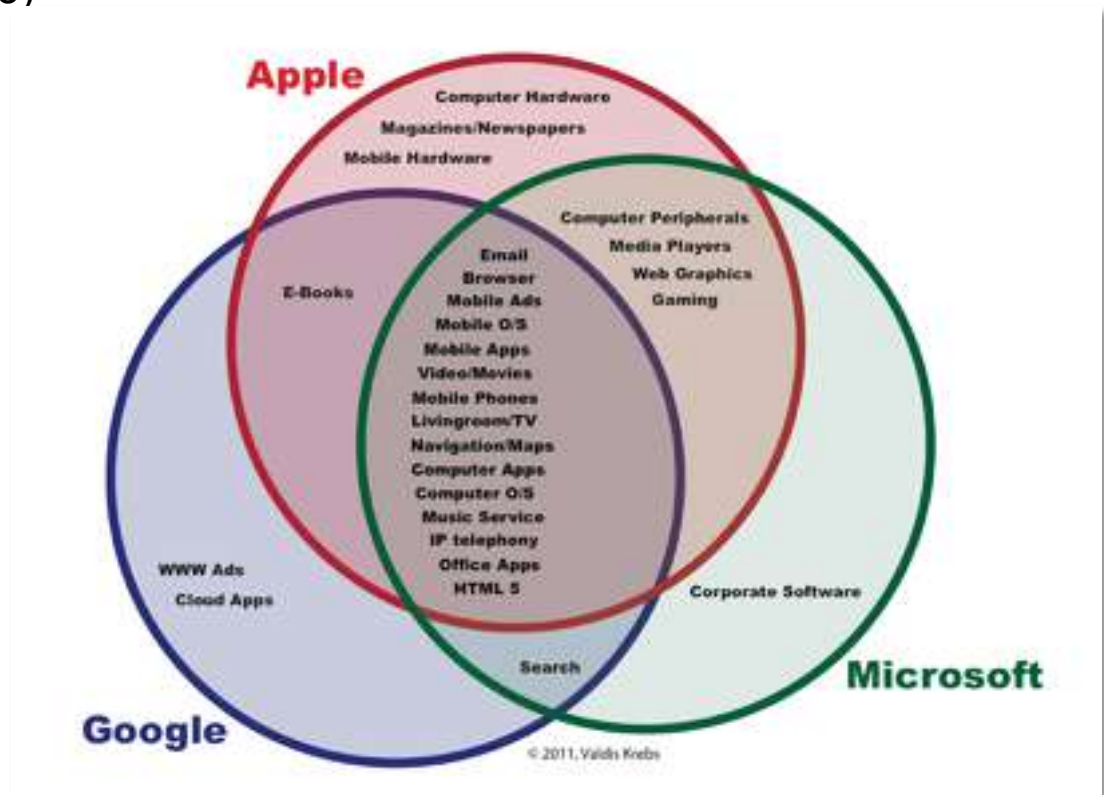
- **There is no way to allocate the increases in revenues from changes in prices to one side or the other; nor is there any way to allocate the costs.**

Which market(s)?



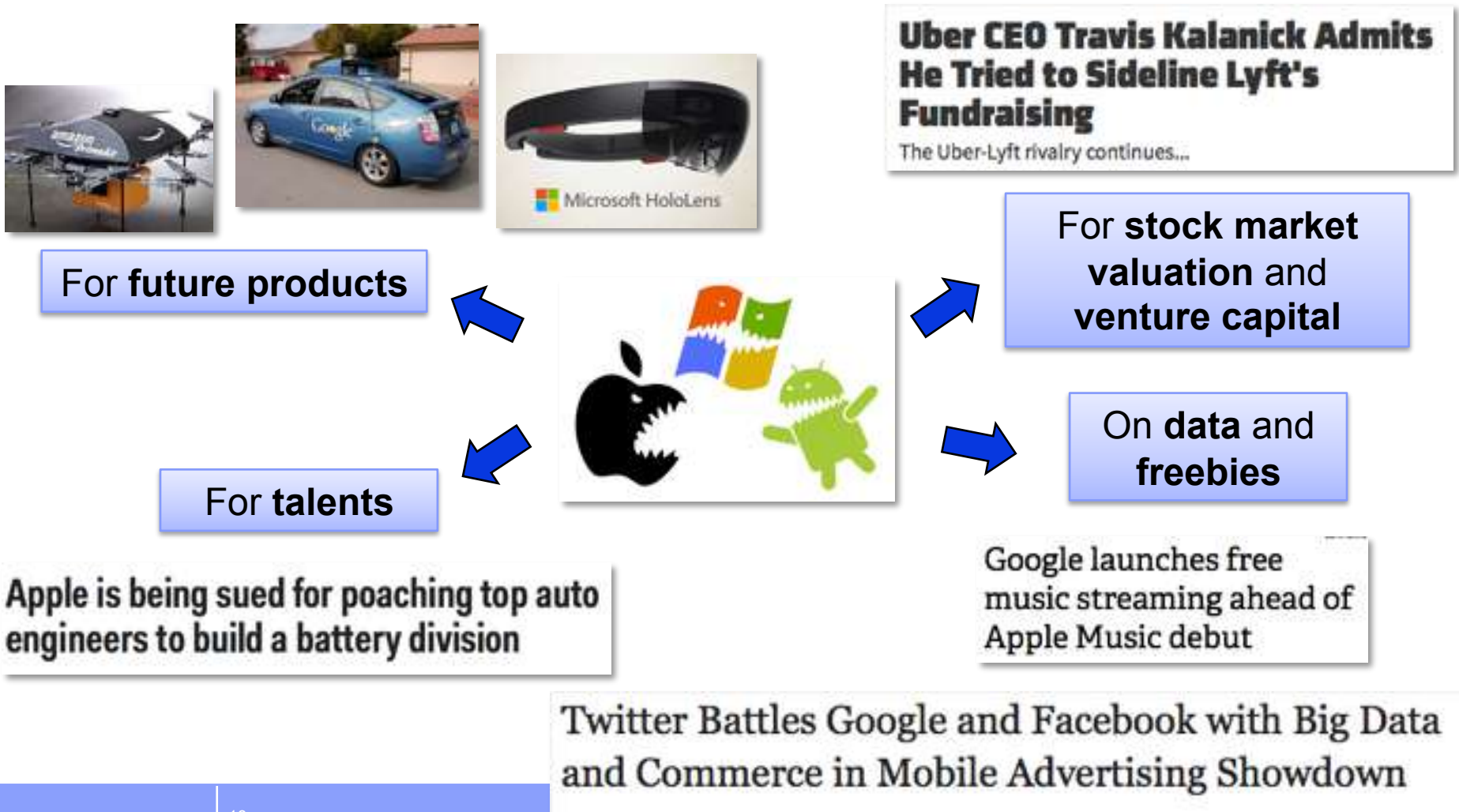
Which market(s)? (2)

- Companies with distinct core businesses **but with overlapping activities**
 - “**Moligopolists**” (Petit, 2015)
 - Monopolists exposed to cutthroat competition of large rivals outside of their relevant market
 - Technology oligopolists with entrenched market positions in distinct segments
 - Not all activities have a two-sided nature but many external effects are present.



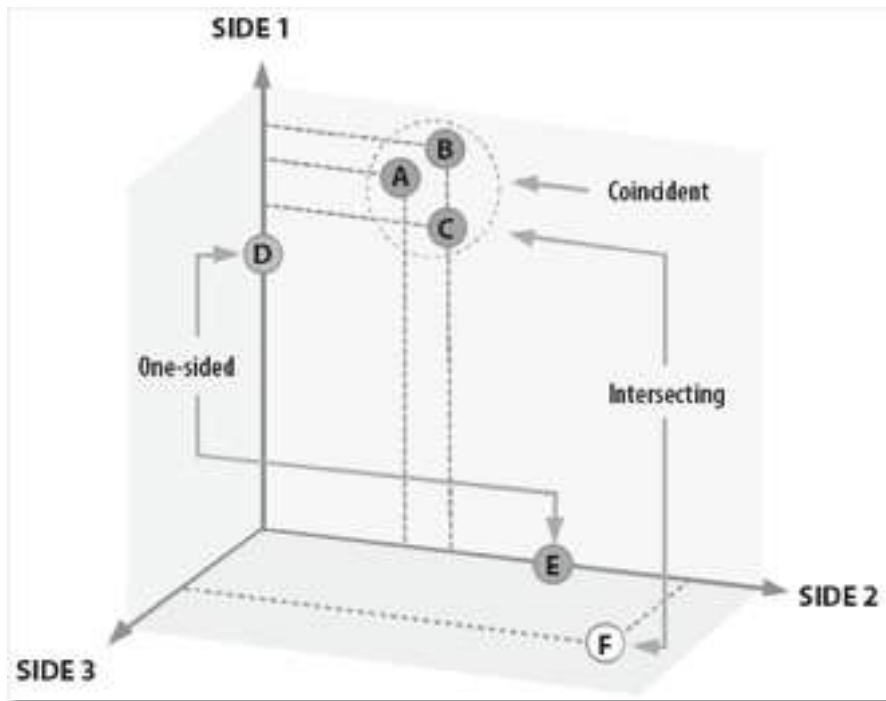
Which market(s)? (3)

- Multi-dimensional and unusual competition (Petit, 2015)



Which market(s)? (4)

- Several sources of **asymmetry** among competing companies
 - Different **levels of ‘multisidedness’**



	Coincident			One-sided		Intersecting
	A	B	C	D	E	F
SIDE 1	X	X	X	X		
SIDE 2	X	X	X		X	X
SIDE 3						X

Source: Evans, 2011, p. 25

Google fined £400,000 in France for making its Maps service free

Which market(s)? (5)

- Sources of asymmetry (cont'd)
 - Different **business models**
 - Music streaming platforms
 - Legal (Spotify) vs. illegal (Megaupload) or 'semi-legal' (Youtube)
 - Different split of revenues (Spotify vs. Tidal)
 - Different monetization strategies (freemium, subscription, ad-supported)
 - Lending-based crowdfunding
 - Prosper (auction mechanism) vs. Lending Club (pre-set rate mechanism)
 - MOOC platforms
 - Non-profit (EdX) vs. for-profit (Coursera)

Which market(s)? (6)

- Sources of asymmetry (cont'd)
 - Different **sizes** and **scopes**
 - French market for **reward-based crowdfunding**: Kickstarter (big entrant) vs. KissKissBankBank (local incumbent)
 - Different **regulatory frameworks**
 - **Ride-sharing services** (Uber, Lyft vs taxicab companies): Employment contracts, safety regulations, ...
 - Different **cost structures** and **qualities of service**
 - **Short-term accommodation**: Airbnb hosts don't face the same costs as hotels

Which market(s)? (7)

- **New entrants** (Taneja, 2015)
 - New MSPs start competing with incumbents on ‘traditional’ markets.
 - They quickly win market shares from leading businesses by decomposing markets into highly customized niches so that the incumbents cannot compete on scale alone.

Warby Parker Now Worth \$1.2 Billion, Focusing On Building More Brick-And-Mortar Stores

How LendingClub aims to end banking as we know it

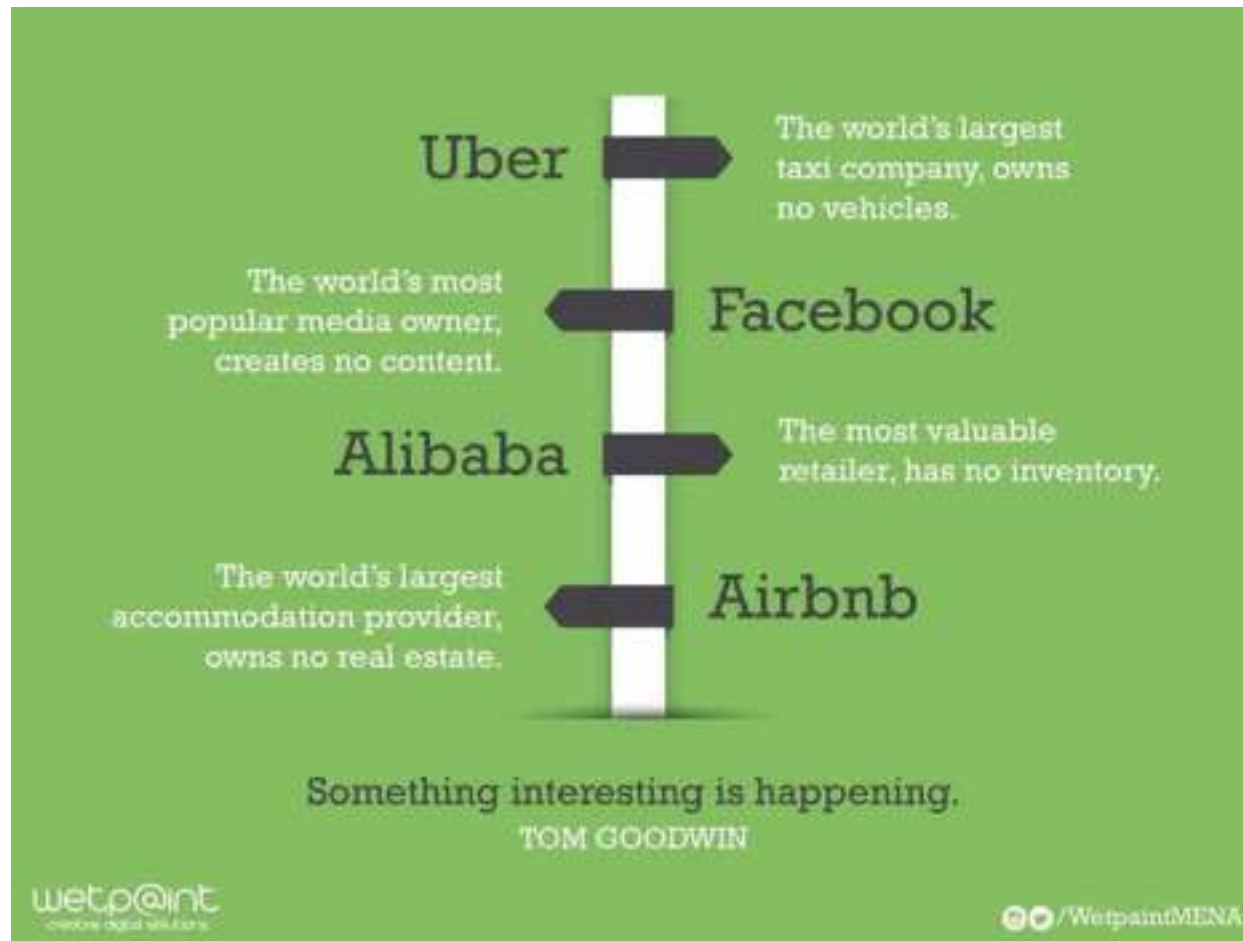
Why Taxis Can Never Compete With Uber

For many drivers and riders, the convenience that ride-sharing offers is simply too tough to pass up.

Watch out, hotels. Fast-growing Airbnb makes inroads with business travelers

Which market(s)? (8)

- New entrants and asymmetry with incumbents



Competitive benchmark?

One-sided market	Multisided market
Efficiency requires marginal-cost pricing	Efficiency is not achieved when prices equal marginal costs
Excessive prices (market power) and dumping (predatory prices) are deemed anti-competitive	Efficiency may require skewed prices, cross-subsidies, or direct subsidy
→ Forget one-sided logic when dealing with antitrust issues in multisided markets!	

Competitive benchmark (2)

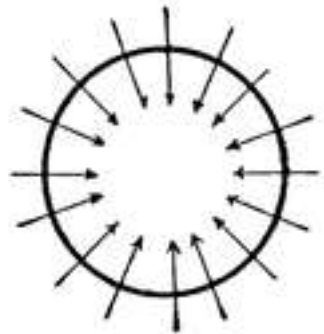
- **Competitive constraints must be examined on all sides**
 - When are prices predatory?
 - Analyzing pricing on just one side could lead to a false positive /negative as it may be profitable (and socially efficient) to charge less than marginal cost on a particular side.
 - One needs to examine whether prices have been lowered enough to make it unprofitable for competing platforms to operate at the margin.

Competitive benchmark (3)

- **Competition on both sides of a transaction can limit profits**
 - Take 2 competing platforms, with singlehoming on both sides.
 - Suppose weak competition on side A and intense competition on side B.
 - Ability to raise prices on side A will not lead to an increase in profits.
 - Why? Additional profits on side A will be competed away on side B.
- **Price competition among platforms can be fierce**
 - Especially if singlehoming on both sides
 - Nightclub example: One more woman (and so, more men) in nightclub A = one less women (and so, fewer men) in nightclub B
- **Remarks**
 - Different from multiproduct setting because platforms cannot stop serving side B without leaving the business entirely.
 - Multihoming on side B → competition ↓ → permits positive profits

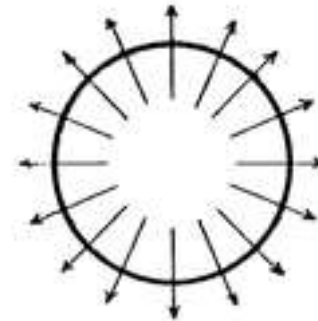
Competitive benchmark (4)

- Determinants of the number and relative size of competing platforms



Forces leading to **concentration**

Positive cross-side effects
Positive within-side effects
Scale economies



Forces leading to **coexistence of platforms**

Multihoming
Platform differentiation
Congestion

Competitive benchmark (5)

- **Consumer welfare criterion**
 - Large (dominant? ‘essential’?) platforms have advantages
 - Larger network effects
 - Interoperability and compatibility
 - But what about switching costs?
 - Integration of various services
 - But what if platform favors its own services at the expense of competitors’?
 - Competition for future products spurs innovation
 - Hard to argue against freebies...
- **Very dynamic environment**
 - Makes competition law notably hard to define

Competitive benchmark (6)

■ General lesson

- To be effective, regulation and antitrust assessment must be based on an accurate understanding of the way each market operates.
- In this respect, it is crucial to recognize the possible multisided aspects of a market
- Sticking to a one-sided logic may lead to erroneous decisions.

Summary and conclusion



(Cautious) conclusions

- **Internet platforms seen as Multisided platforms (MSPs)**
 - Create value by facilitating the interaction between distinct groups of customers who need their demand to be coordinated in some way.
- **Market power is delicate to define for MSPs**
 - Skewed pricing structure
 - No way to allocate costs across sides
 - No clear relevant market and competitive benchmark
- **With MSPs, firm size and market concentration are not synonymous with market power**
 - Naturally tendency for ‘winner-takes-all’ in platform markets
 - The winner is (most often) the best.
 - Consumers have many reasons to prefer large platforms.

(Cautious) conclusions (2)

- Some form of market power, however, exists
 - Not so much in terms of the ability to raise prices
 - But in terms of favoring its own products/services, or of entering more easily new market segments
- Any abuse of such (redefined) market power must be adequately remedied.
 - On a case-by-case basis
 - With a sound understanding of multisided aspects.

Background readings

- Belleflamme, P. and Peitz, M. (2010). *Industrial Organization. Markets and Strategies*. Cambridge: Cambridge University Press. **Chapter 22. Section 3.**
- Evans, D.S. and Schmalensee, R. (2013). *The Antitrust Analysis of Multi-Sided Platform Businesses*. NBER Working Paper No. 18783.
- Petit, N. (2015). *Antitrust and the Challenge of Policing “Moligopolists”*. Slide presentation.
- BLOG: www.IPdigIT.eu

