Two-sided Internet Markets and the Need to Assess Both Upstream and Downstream Impacts

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The Main Points

Internet platform operators accrue scale and positive network externalities, but also can achieve and sustain "winner take all" market dominance.

Government agencies, includes ones in the U.S, use flawed market assessments and may impose defective consumer safeguards when intermediaries serve two-sided markets. Emphasis on downstream impact without full investigation of upstream effects, often missing potential for substantial harm to competition and consumers, e.g., Google's domination of online advertising.

Too many false positives and negatives trigger over-regulation **and** under-regulation.

Heavy reliance on Chicago School economic analysis that primarily considers whether consumers accrue short term, welfare gains without longer term assessment.

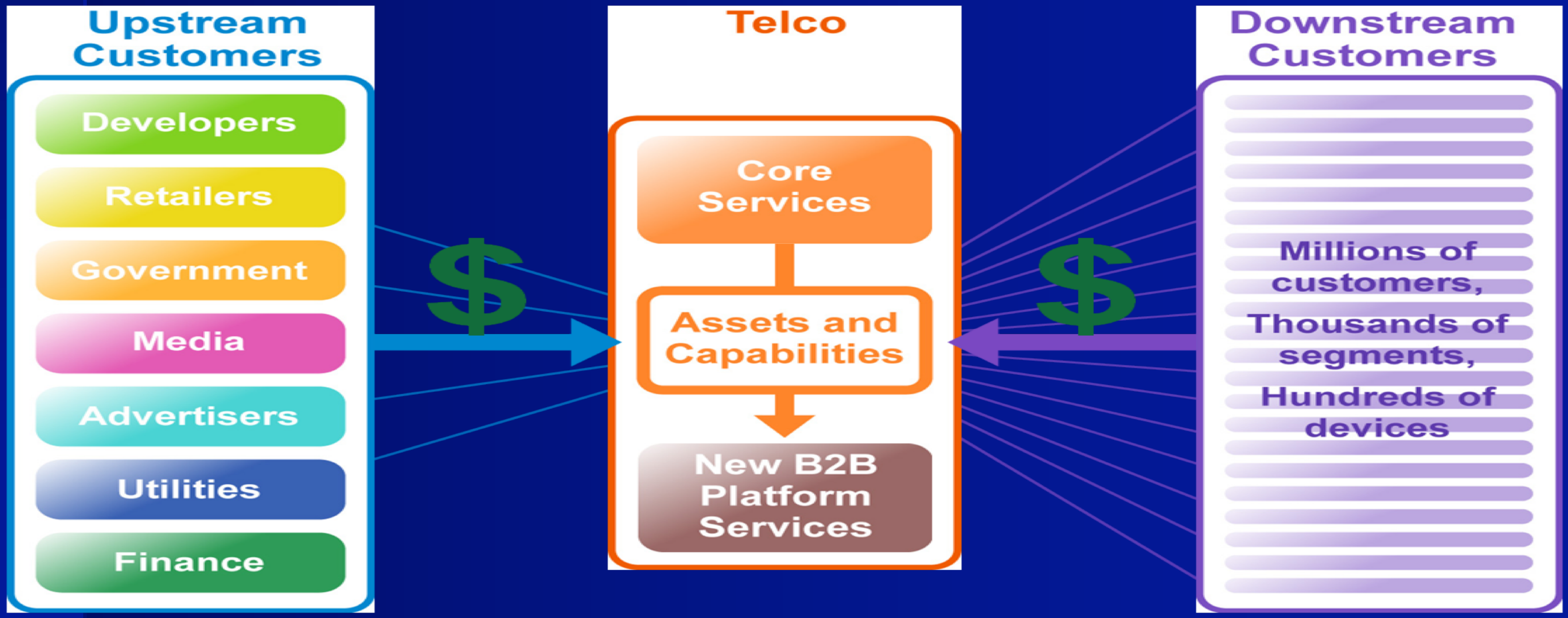
Preoccupation with downstream open access/network neutrality leaves little time and energy to address potential harm, particularly by upstream vendors coordinating and using data collected by broadband intermediaries, such as Amazon, Alibaba, Facebook, Google and other "unicorns."

Ohio v. American Express establishes a precedent supporting the need to assess market impacts on both sides of an intermediary's operations. Smarter oversight needed, not necessarily more regulation and expanded jurisdiction.

Growing Dominance of Internet Platform Intermediaries

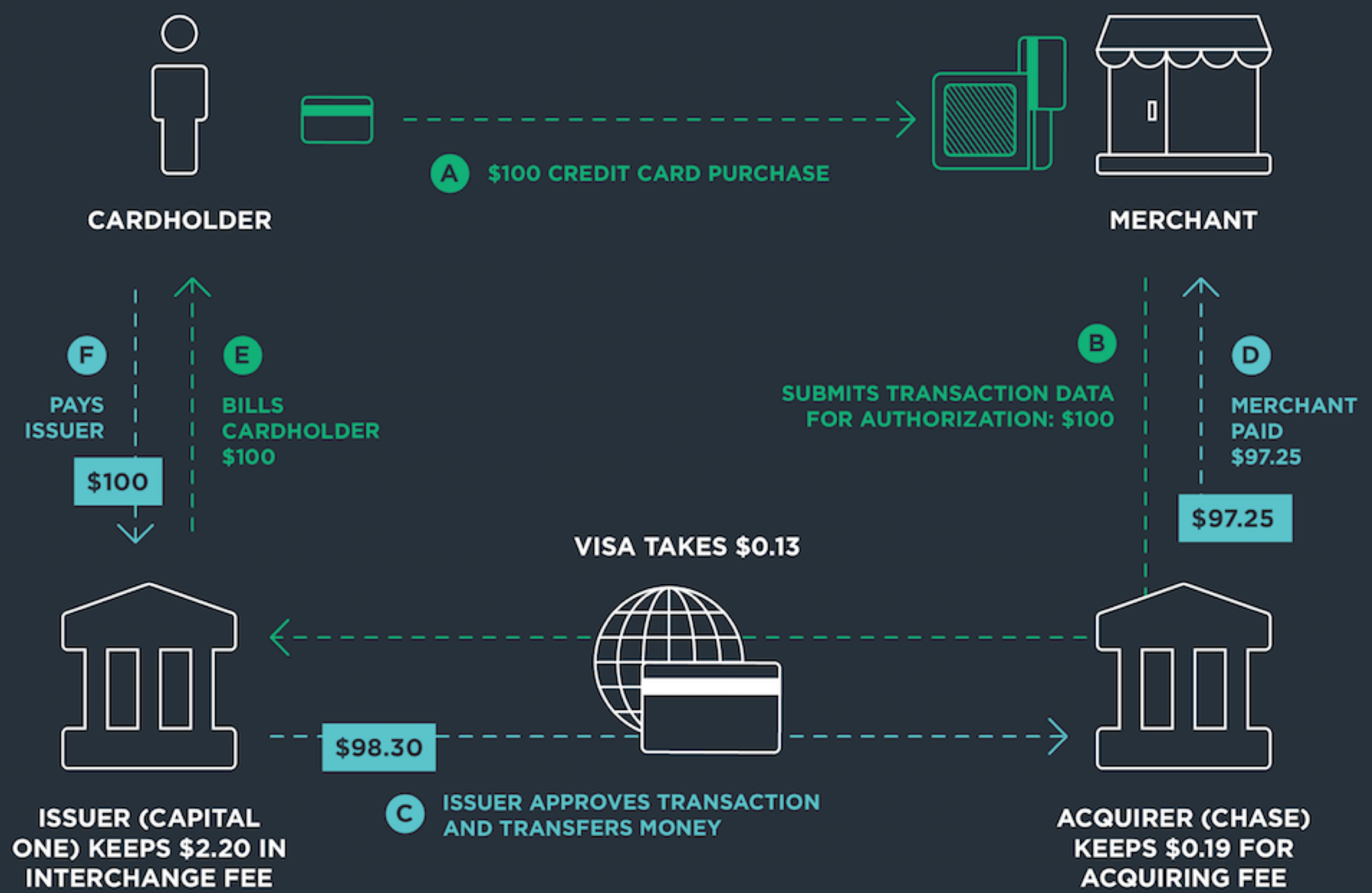
Internet Service Providers ("ISPs") operate as intermediaries in a double-sided market with retail, broadband subscribers downstream and other ISPs, content distributors and content creators upstream.

The Internet ecosystem supports powerful platform operators who can capture large market share by exploiting scale economies, network externalities and high switching costs/barriers to market entry.



Source: STL Partners, http://www.stlpartners.com/articles/EB_six-key-telco-2-opportunities_Summary

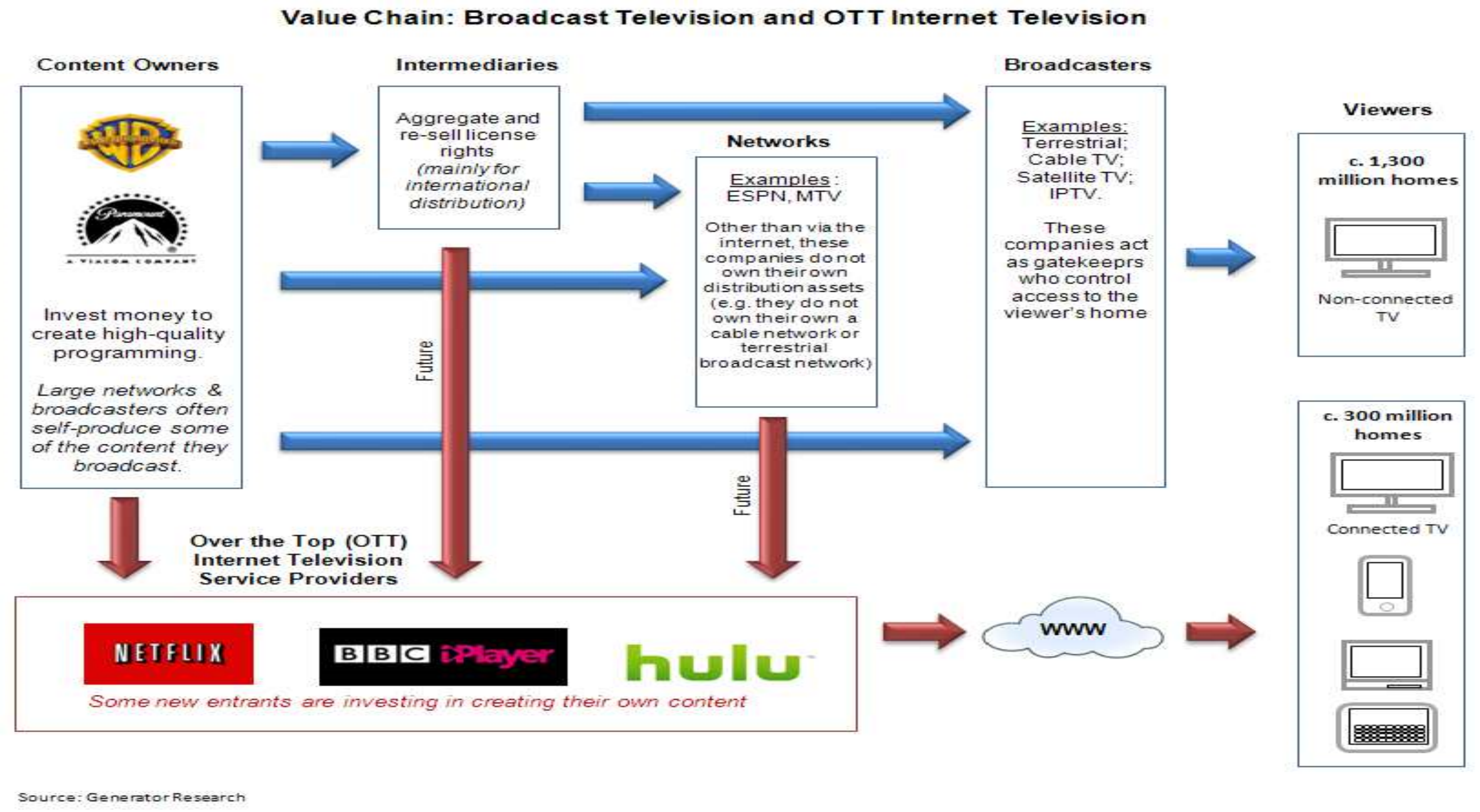
Legacy Platform Model—Credit Cards



Source: Chelsea Allison, The Primary Players in Payments Processing, Fin; https://fin.plaid.com/articles/major-players-in-payment-processing

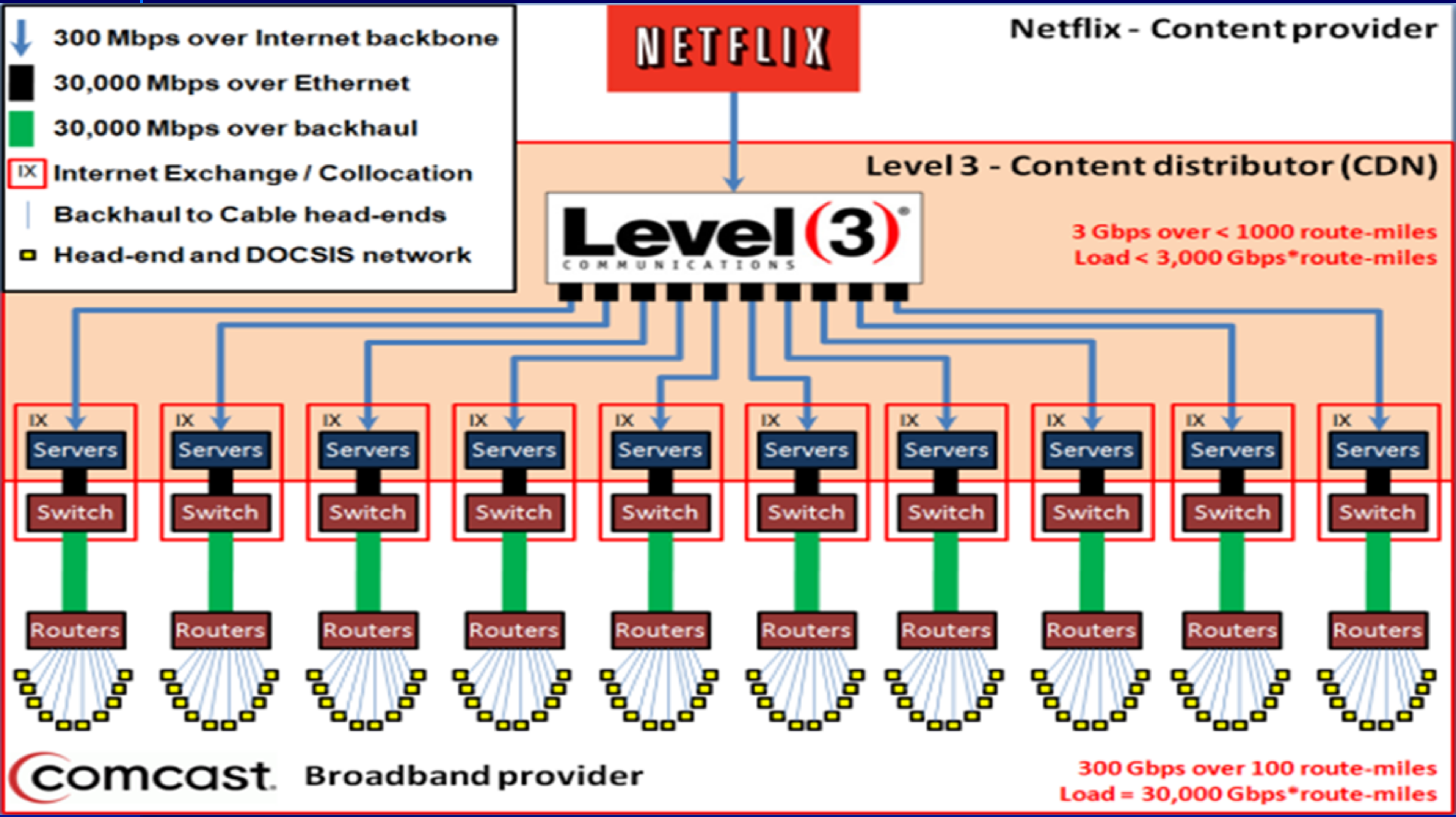
Major Types of Internet Platforms

Internet platform operators have evolved from, and adopted tactics of, previous intermediaries such as credit card issuers and broadcasters.



Types of Internet Platforms

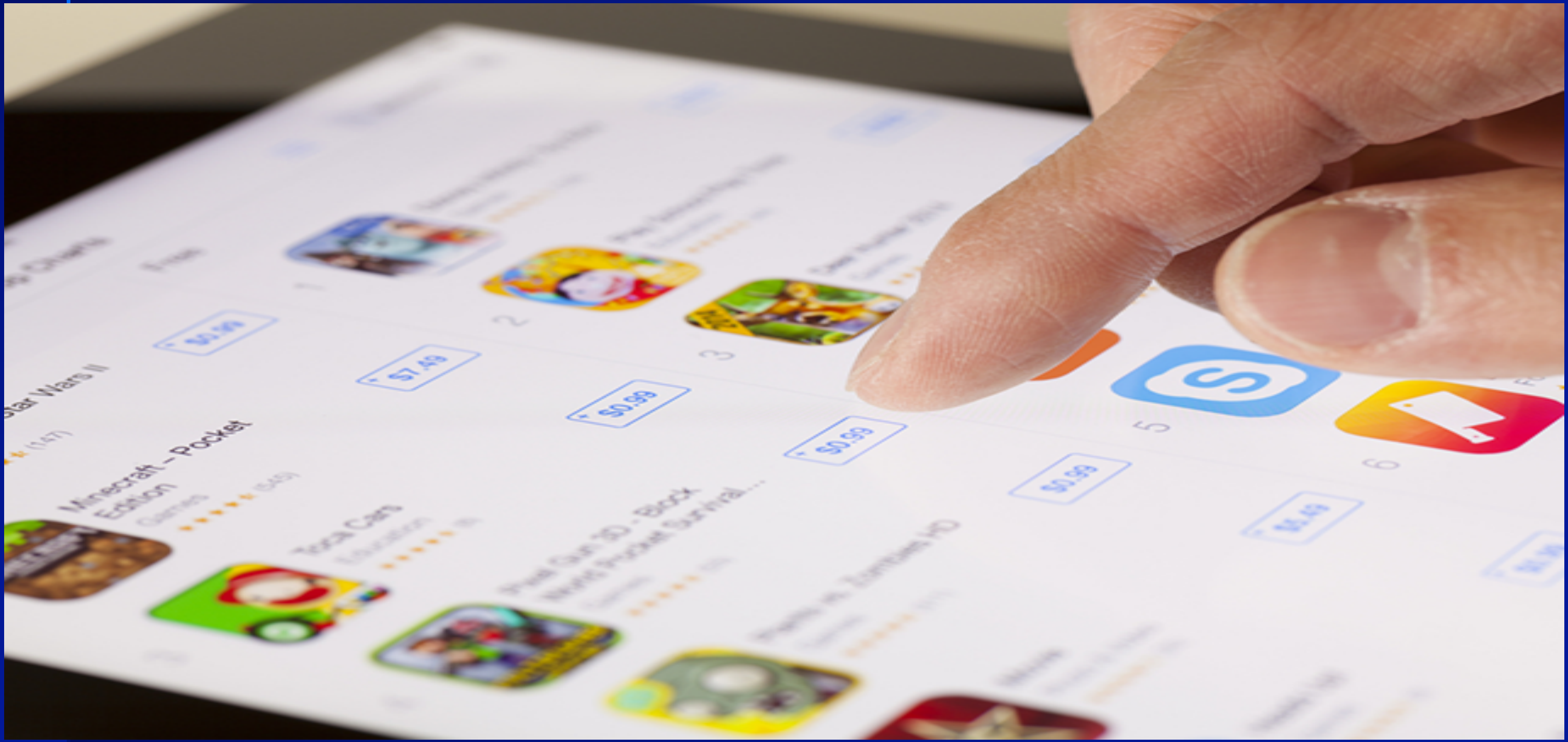
ISPs establish a platform between upstream sources and distributors of content and end users, i.e., subscribers of "retail" broadband access service.



Source: George Ou, SiliconAngle, https://siliconangle.com/blog/2010/12/14/division-of-labor-between-broadband-and-cdn/

Types of Internet Platforms

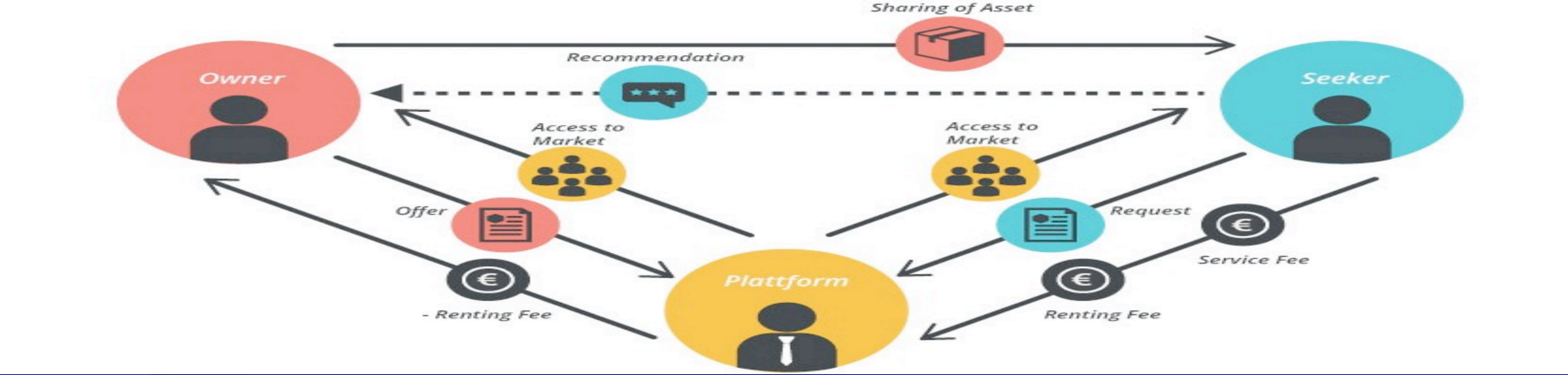
Smartphone operating system packagers, such as Apple and Google, erect a platform for applications available only through an intermediary's store.



Types of Internet Platforms

Various specific application and service intermediaries, e.g., Facebook in social networking, Google in web search; PayPal in electronic payments; Amazon in e-commerce and Uber in automotive transport.

Source SEOAgency, http://www.seoquotes.com.sg/google-display-network/



Source: European Parliament and Business Model Toolboxx, http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/593510/EPRS_BRI(2016)593510_EN.pdf

Consumer Benefits from Two-Sided Markets

Digital broadband platform operators can quickly accrue scale economies and efficiency gains by attracting large numbers of users and spreading costs over a global base.

Broadband platforms also can generate positive networking externalities, because their overall value to subscribers increases as the number of participants grows.

When intermediaries reach a critical mass of popularity, non-users see the advantages in joining the bandwagon which further enhances the comparative attractiveness of a particular platform operator even when other, “multi-homing” options exist.

Competitive necessity, more efficient operations & willingness to underprice to acquire shelf-space and market share can result in lower priced products and services, because two sided-platform operators can calibrate how much to charge each side.

Downstream consumers often benefit from intermediary conferred subsidies, e.g., rebates on top of no-fee credit cards.

Free-rider opportunities remain plentiful.

Consumer Costs from Two-Sided Markets

Consumers may suffer the loss of competition when bricks and mortar, local vendors shut down as well as the broader harms from increased unemployment, reduced incomes and greater risk and uncertainty in the Gig Economy.

Consumers may have to pay more for goods and services when platform operators can more accurately assess their price sensitivity through data collection and analytics.

Intermediaries can use dynamic pricing to maximize profits; many consumers hate "surge pricing" regardless of its efficiency and offsetting price reductions in off-peak, low demand conditions.

Intermediaries defray the cost of subsidies to end users with expansive data analytics that generate new revenue streams, e.g., auctioning advertisement placements.

Consumers may not fully appreciate the value they permit intermediaries to capture from privacy intrusions through mining consumer behavior, including web site visits and searches, where subscribers use their handsets and the topics of their emails and posts.

Subscriber Data Value and Lock-in Cost Missing in the Cost/Benefit Analysis

The existence of other service options does not guarantee that market leaders face significant competition and the discipline imposed by multi-homing.

Multi-billion dollar unicorn valuations show several “winner take all” global and national industry segments.

Positive network externalities favor additional subscribers joining the bandwagon.

Massive subscriber populations generate big data that help the unicorns capture the lion’s share of advertising revenue making it possible to fine-tune their data analysis internally and by acquiring existing, or potential competitors.

Many subscribers do not read their service agreements, nor do many understand the scope and value of what they permit intermediaries to acquire, process and sell.

AT&T provided a window on such value when it offered reduced surveillance for a monthly $29 payment from wireline broadband subscribers. The company faced significant pushback, but this did not prompt less intrusive data mining, or discounts.

Insights from Ohio v. American Express Co.

Embracing recent academic literature on two-sided markets, the conservative majority of the Supreme Court endorsed assessing both sides to consider whether positive impacts on credit card users, e.g., rebates and enhanced travel services, offset a lower court's finding that "anti-steering" contractual language constituted a vertical restraint on trade.

American Express contracts with vendors prohibit efforts to steer consumers to use other credit hard with lower "swipe fees." A single-market analysis would detect harm to credit card competition with higher consumer costs. However, a two-sided market analysis would identify offsetting consumer benefits (at least to Amex card users).

The Amex case creates a new precedent that can help lower courts avoid false positives, i.e., finding consumer and competitive harms that are offset by countervailing benefits.

Does the case also support avoiding false negatives, where a one-side market analysis would identify ample consumer and competitive benefits, but assessing the other side would show significant harms?

For many Internet-based platforms, impact assessment focuses primarily on downstream consumer impact where plenty of benefits exist. The now endorsed two-sided assessment would detect ample harm to competition and consumers, e.g., privacy invasion, lack of transparency, unauthorized data mining and commodification, questionable price discrimination, election meddling, "fake news" reduced consumer surplus and welfare.

Conclusions and Recommendations

Consumers and governments may not fully understand the tradeoffs when digital, broadband intermediaries dominate many market segments including first and last mile content carriage, smartphone and computer operating systems and a variety of content and applications market segments.

Some Chicago School assumptions about how market work have become less certain, e.g., Amazon's long term willingness to forego profits to acquire market share and more "shelf space."

It has become increasingly clear that consumers have to contribute more value, than what they might infer from widespread promotion of "free" and subsidized access. If the Amex case provides a way to prevent a false positive, then arguably it also supports prevention of false negatives when upstream adverse impacts are assessed.

To achieve greater clarity on the potential for beneficial and harm impact, courts and government agencies should examine platform operations on both upstream and downstream market sides.

Conclusions and Recommendations (cont.)

Internet-mediated platforms often have impacts on both market sides as well having inter-relationships between actions of upstream ventures and downstream consumers.

Just as platform intermediary operation affects both downstream and upstream users, so too can market success in one market generate unrivaled opportunities to extend market power elsewhere, e.g., Facebook and Google dominate news dissemination without employing any reporters.

A more holistic examination of impacts, without placing a premium on short term consumer benefits, would generate a more accurate assessment of the mixed impacts generated by platform intermediaries.