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**Regulatory approaches to foster
investment and business opportunities
for digital services**

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Part 1: How digital platforms impact economic regulation



Digital services are provided by platforms

- Platforms make economic sense because they substantially decrease transaction costs between two distinct groups of customers
- There are no formal definitions of a two-sided market or platform.
- But digital platforms have some special characteristics related to two-sidedness: price structure and that the demand from one group of customer depends on the demand from the group in the other side
- Increasingly economic literature refers to **two-sided platforms** (not two-sided markets) in order to make a distinction between the platform and the relevant market, or markets, in which the platform operates.



Examples of online and physical platforms

| | | | |
|------------------------------|--|--|---|
| <p>Online Search Engines</p> | <ul style="list-style-type: none">▪ Search services▪ E-mail▪ Targeted advertising | | <p>A user enters keywords or key phrases into a search engine and receives a list of Web content results in the form of websites, images, videos or other online data</p> |
| <p>Online Applications</p> | <ul style="list-style-type: none">▪ Social networks▪ Voice services▪ E-commerce▪ Dating | | <p>Means of communication, shopping online or finding a match for dating</p> |
| <p>Physical platforms</p> | <ul style="list-style-type: none">▪ Bars▪ Merchants▪ Supermarkets▪ Publishers | | <p>Actual places for shopping, trading, socialising or reading the news</p> |



Two-sided platforms display network effects

Cross-group effects

Users experience a higher value if there are more participants on the other side of the platform
(e.g. to allow them to use a payment mechanism)

Users experience a lower value if there are more participants on the other side of the platform
(e.g. they may dislike advertising)

Within-group effects

Users experience a higher value if there are more participants on the same side of the platform
(e.g. they like all their friends to be on the same social media platform)

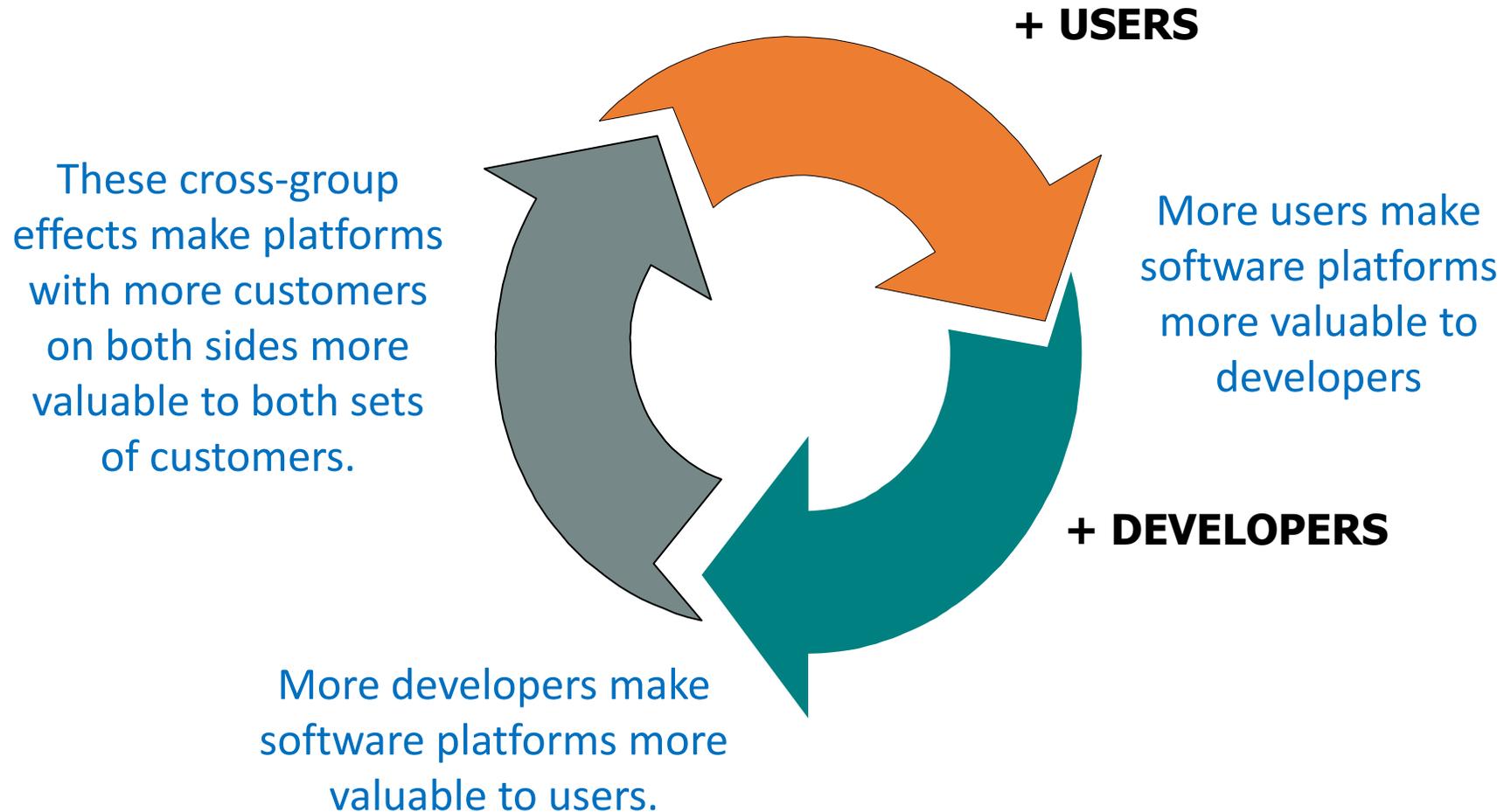
Users experience a lower value if there are more participants on the same side of the platform
(e.g. bidders for these goods on internet auction websites experience more competition)

Positive

Negative



Positive cross-group effects leads to larger and fewer competing platforms





Is excessive market concentration a problem?

| | Global market share April 2018 | Business activity |
|----------|-----------------------------------|------------------------|
| Google | 90% | Search |
| Facebook | 66% | Social media |
| Apple | 45% | Smartphone web traffic |
| Amazon | 37% | Online retail |

Source: The Economist 30th June 2018, "Fixing the Internet", based on data from Global Stats Counter



Two-sided platforms introduce new challenges for regulators and competition authorities

- Ex-ante regulation has typically worked on a) defining markets, b) determining dominance within those markets.
 - Two-sided platforms makes both of these tasks more difficult.
- Competition authorities has typically worked on identifying anti-competitive behaviour from dominant suppliers (e.g. predatory pricing) and imposing appropriate remedies.
 - With two-sided platforms it is hard to tell the difference between social-optimal pricing and pricing that has the intention or effect of limiting competition.



One or two markets?

- The correct choice depends on the type of platform: transactional or non-transactional.
- If there is no transactional across the platform two (interrelated) markets should be defined. But in two-sided transactional platforms only one market should be defined.
- A key reason for defining two separate markets in non-transactional platforms is the possibility that another product competes on one side of the platform but not on the other side.
- However for a transactional platform a one-to-one match must occur between two different groups on each side and therefore a firm operates in a single market or not at all: the product is the transaction.



Example: Media markets

- Consider that TV might be a substitute for printed newspapers for an advertiser but not for a reader of printed newspapers who is also a TV viewer, as for instance a person may like to read his newspaper on the metro on his way to work and rather watch TV at home in the evening.
- In this case reading printed newspapers and watching TV are complementary. In both cases there is no observable transaction.
- Therefore one can say there is a market for consumers of media in one side and a market for advertisers in the other side of the non-transactional platform. Each platform may compete or not with other similar platforms.
- However, if we consider an online version of the newspaper where you can click on ads and make purchases – now there is a two-sided transactional market, with cross-group externalities, so a single media market should be defined.



Can the SSNIP test be used?

- The SSNIP test is the standard approach to market definition – looking at the impact on profitability of a Small but Significant Non-transient Increase in Prices
 - Which price? Given that in a two-sided market the hypothetical monopolist sets (at least) two prices, which price should he be thought of as raising?
 - Profitability? Should we look at what happens to profits on only one side or on both sides of the market?
 - Feedbacks? Given that in a two-sided market there are indirect network externalities, should we take into account also (all?) feedbacks from one side of the market to the other?
 - How do we deal with products which are competing on one-side of the market but not on the other-side?



Principles for applying the SSNIP Test

- For two-sided transactional platforms one should check the profitability **of an increase in the price level** (that is, the sum of the prices paid for the transaction by the two parties).
- For two-sided non-transactional platforms one should check the profitability (considering both sides) of a **price increase on each side separately**.
- Ideally, one should allow the hypothetical monopolist to adjust optimally the price structure.



Market power is less about market share

- It's common for platforms with strong cross-platform network effects, as well as networks with pronounced direct network effects, to show high levels of concentration.
- Multi-sided platforms often provide one of their products for free or at a subsidized price. In these cases it is not possible to calculate a value-based market share.
- Profitability is an appealing measure of market power because it assesses the extent to which the platform has been able to earn more than a competitive rate of return.
- However rates of return vary over time, and it is well known that in digital platforms profits may not show up for a long time.



It is hard to prove anti-competitive practice

- Predatory prices can be hard to detect:
 - Predation can be successful without triggering exit.
 - There are non-predatory reasons to price below cost and market may tip to monopoly even absent predation.
- A platform may engage in two-sided anti-competitive predatory pricing if it charges below marginal costs overall (across both sides of the platform).
- Network effects mean that it may still be possible to recover losses.
- Price structure can also be used in a predatory fashion:
 - Mobile service providers and choice of on-net and off-net prices.
 - Asymmetric media competition (e.g. subscriber-supported versus advertising-supported business models).



Summary

- Two-sided markets (platforms) exhibit a tendency towards concentration
- At some (hard to define) point concentration will be harmful to competition and the long-term interest of consumers
- Traditional market analysis is difficult in two-sided markets:
 - Which price is considered for SSNIP test (to help define the market)?
 - Dominance has to be assessed on balance of probability across both sides of the market
 - Danger of false outcomes and difficulty in determining appropriate and proportionate remedies creates a tendency to avoid ex-ante intervention.
- Ex-post regulation also suffers from inappropriate remedies – fines may be the only available remedy ... but may be next to useless.
- Perhaps the future involves tighter rules around M&A so as to allow competitive and independent platforms and apps to develop.



Part 2: Selected European cases on regulation of digital platforms



The EU has imposed substantial fines

- Google was fined EUR 2.4bn for discriminating against rivals in comparison-shopping (2017).
- Google's EUR 4.3bn fine for forcing all Google-play services to be pre-loaded on smartphones (2018)
- According to EC, these actions “deny rivals the chance to innovate and compete on merits” and “deny customers the benefits of effective competition”.
- But EC also says “it is Google's responsibility to bring the infringement to an end”.



Recommendations and advice to Governments

- Unlocking digital competition, Digital Competition Expert Panel, March 2019 (The Furman Report), UK Government
- “Competition Policy for the Digital Era”, Jacques Crémer, Yves-Alexandre de Montjoye, Heike Schweitzer, a report to the European Commission, 2019

<https://www.gov.uk/government/publications/unlocking-digital-competition-report-of-the-digital-competition-expert-panel>

<https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf>



Key Furman Report recommendations (i)

- Creating a **new digital markets unit** (either independent or as a function of an existing authority/regulator) with specific powers
 - to set a code of conduct for companies with “strategic market status”;
 - on data mobility and open standards; and
 - to secure access to non-personal anonymised data.



Key Furman Report recommendations (ii)

- Adapting the **merger control rules** so that the Competition and Markets Authority (CMA) can “better stop digital mergers that are likely to damage future competition, innovation and consumer choice”.
- An obligation on digital companies that have been designated with a strategic market status to make the CMA aware of all intended acquisitions, and
- The CMA’s assessment taking account of the scale as well as the likelihood of harm.



Digital mergers

- Furman Report: “Over the last 10 years the 5 largest firms have made over 400 acquisitions globally. None has been blocked and very few have had conditions attached to approval, in the UK or elsewhere, or even been scrutinised by competition authorities.”
- Examples:
 - Facebook’s acquisition of Instagram and WhatsApp (businesses that have given a platform a stronger position in its current market)
 - Google’s acquisition of DoubleClick, the advertising technology business, and of YouTube (businesses that have given a platform a strong position in a related market)



Key Furman Report recommendations (iii)

- Strengthening regulator's **competition enforcement powers** so that breaches can be dealt with more quickly and easily, adjusting also the standard of judicial review for antitrust infringements and use of interim powers.
- Monitoring of personalised pricing: where companies use their data-driven algorithms to set prices according to the individual's willingness to pay. Suggests government to monitor the use of artificial intelligence and protect vulnerable consumers



Conclusions

- A differentiated approach to large platforms imposing a code of conduct
- Reversing the burden of proof
- Competition enforcement should be targeted at specific harms based on a thorough analysis of the market and less on market definition on a case by case analysis
- Reinforced merger regime used to address potential competition problems
- Switching costs and data accessibility: better control of personal data.



Thank You

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