The Internet - Challenges for Competition Policy

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Structure of the Presentation

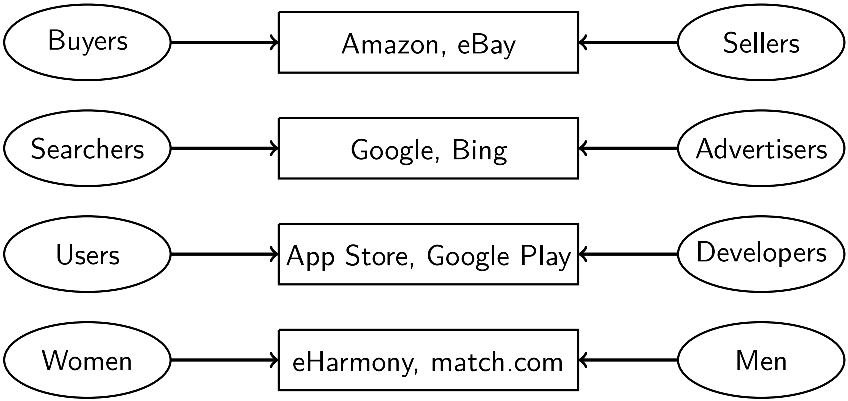
- Characteristics of mergers between Internet platforms

- Leveraging of market power

- Effects of targeting

Characteristics of Internet Markets

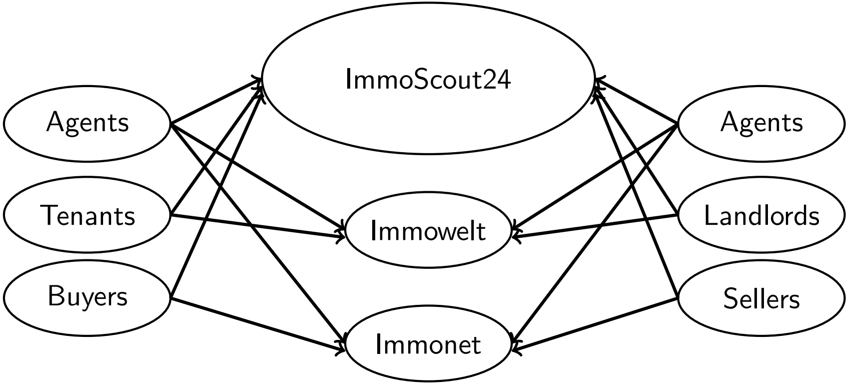
Most markets in the Internet are characterized by strong cross-group network effects



What are the implications for merger control?

Example: Housing and Rental Market

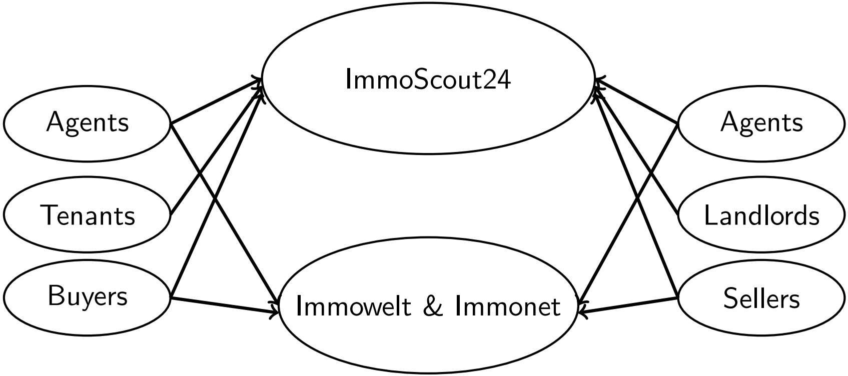
Online housing and rental market in Germany



Merger between the second and third-largest platform

Example: Housing and Rental Market

Three platforms control more than 75% of the online market.



Concentration has increased a lot

Impact on Competition

- Merger was approved by the Bundeskartellamt
- The two sides of the market cannot be considered separately (integrated analysis);
  even more so as buyers are not charged by platforms
- Decision stated that competition can even increase with the merger

Question: What are the specifics of this market?

Impact on Competition

- Due to the strong indirect network effects, *tipping* of the market becomes an issue
- Danger of tipping gets reduced if two relatively similar platforms compete compared to one big and two small platforms
- Second-largest platform becomes a closer competitor and may intensifies competition ('catch-up merger')
- *Multi-homing* also reduces the probability of tipping
- Evidence that mergers in two-sided markets do not lead to higher prices: Chandra and Collard-Wexler (2009)

Mergers Involving a Dominant Platform

- Often mergers involve Internet giants
- Since 2005, Facebook acquired more than 55 companies
  Most prominent merger: Facebook and WhatsApp for around 19 Billion Dollars
- Since the same time, Google acquired more than 170 companies
  Among those are YouTube or DoubleClick
- Many of the companies that were gobbled up by Facebook, Google or Microsoft had a technology advantage but were much smaller

Problems for Competition Policy

- These industries are highly innovative
- Is market dominance good for innovation?
- Potential problem: New York Times in May 2006

  In some niches of the software business, Google is casting the same sort of shadow over Silicon Valley that Microsoft once did. "You've got people who don't even feel they can launch a product for fear that Google will get in."

Why does Acquisition Occur so Often?

- Advertising is usually the main revenue source in the Internet
- Culture in the Internet that users obtain content for free;
  Users are often unwilling to pay

→ Business models centers around advertising

- Internet giants have much better data about consumers due to their size and history

→ They can exploit innovations in a more successful way due to larger revenue creation

Does this Hamper Innovation?

- Partly yes because dominant firms get bigger and their leading position gets harder to attack
- In addition, often innovation can be easily 'copied' by dominant firms
- BUT countervailing effect:

  Small innovators benefit from dominant firms as they are likely to be bought at a larger price ('innovation for buyout')
- Problem is more complex (e.g, Cabral, 2016)

Leveraging of Market Power

- In September 2013, Google announced that users need to create a Google+ account to comment on YouTube videos
- There was no technological need for this.
  BUT Google+ has failed to become a serious competitor to Facebook or Twitter; requiring such an account would mean a boost for Google+
- Due to a lot of criticism, Google split up Google+ and YouTube in July 2015

Tying of Products

- Particular example of leveraging market power:
  Through *tying*, a firm with market power for one good uses this market power to gain higher profits for another product, in which there is competition (Whinston, 1990; Carlton and Waldman, 2002; Nalebuff, 2004)

- Other examples:
  - Preferential treatment of additional services such as Google Finance, Google Images, or Google News in the search results of Google's search engine through prominent placement
  - Google required Yelp to agree that Google Places presents Yelp user's business reviews if Yelp wanted to stay in Google's search index

Antitrust Assessment

- Practice of tying anticompetitive as it leads to inefficiencies in the market of the tied good
- Practice has been used and prosecuted before (e.g., Microsoft tied its Media Player to the operating system Windows)
- In two-sided markets, *tying* can be used on both sides of the market; users and companies
- With the acquisition of new services big Internet firms can use this tying on more products

$\Rightarrow$ Problem may become more pronounced in the future

Targeting

- Targeting can have many different forms
    - Geo-targeting
    - Search advertising
    - Targeted ads
- Keyword advertising (mainly done on search engines) is one of the most prominent and effective form (e.g., Google AdWords)
- Companies can bid for many combinations of key words

Targeting

- Evans (2008):

  Bid to get the third slot for "luxury hotels London": $3.04

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Pros and Cons of Targeting

Targeting has many advantages:

+ Advertisements are more effective
+ Per-click pricing allows platform to charge advertisers only for users who are potentially interested in the product
+ Advertising is less of a nuisance to users
+ Targeting allows companies with niche products to advertise ("long-tail" of advertising; Anderson, 1992)

Pros and Cons of Targeting

However, targeting may also have disadvantages:

- Privacy issues

  To allow for targeting, companies need data from consumers (e.g., Google checks the mails sent via Gmail, looking for keywords to target users with paid ads).

- Higher product price

  Since consumers provide information about their preference, companies can extract more consumer surplus (de Cornière and de Nijs, 2016)

- Higher product prices due to per-click fees

  Per-click fees increase the marginal costs of selling products, thereby inducing double-marginalization (Dellarocas, 2012)

Consequences for Antitrust Policy

- Targeting can cement a dominant firm's position because it makes data even more valuable

$\Rightarrow$ Acquisition of smaller firms becomes more likely

- New business models can occur, i.e., platforms whose main business is to collect data

$\Rightarrow$ This might bring about new challenges or competition policy

Summary

- Mergers between Internet platforms are more complex to assess than mergers in a one-sided market
- Due to large cross-group effects, danger of market tipping and ways to counter this need to be taken into account
- Acquisitions allow big companies to practice anticompetitive tying
- Targeting has many advantages but can also cement the dominant position of an Internet giant