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CONCURRENCES LAW & ECONOMICS WEBINARS
Tipping in digital platform markets

Webinar - 21 September 2020*

Webinar organised by Concurrences, in partnership with Cleary Gottlieb, Compass Lexecon, Facebook and Orrick.

James Tierney

James Tierney (Partner, Orrick) opened the discussion by defining tipping and explaining its effects: the disproportionate selection by customers of the firm' product and the emergence of the firm as a de facto standard.

> **"THE MARKET IS UNLIKELY TO SELF-CORRECT AND SELF-REGULATE, EVEN IF A BETTER PRODUCT EMERGES."**
> **JAMES TIERNEY**

When market tips, the winner takes all. Market power then allows the firm to price above competitive levels or engage in other anti-competitive behaviour. That power can be durable. The market is unlikely to self-correct and self-regulate, even if a better product emerges. Mr Tierney then invited the panellists to focus on the characteristics of tipping markets and the public policy implications of market tipping. He stressed that digital transformation is spreading across the most traditional industry segments, which Google's acquisition of Nest, a manufacturer of digital thermostats, indicates, as well as the evolution of AmEx or JP Morgan Chase's business models to leverage network effects using data analytics and connected services.

David Sevy

David Sevy (Executive Vice President, Compass Lexecon) started his intervention by reminding that digital markets and online platforms are not all similar. They each offer different services; they have different business models. However, those markets and platforms share common features. Most digital markets are multi-sided markets on which different groups of users congregate around platforms. Platforms are matchmakers facilitating relationships between those groups of users, who create and transact through platforms. Network effects are another prevalent

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characteristic of online platforms: the value created for users on one side of the platform relates to the presence and activity of other users on the same side and/or on another side of the platform. Different sorts of externalities result from those intra-group or cross-group network effects. Mr Sevy further stressed that whilst the presence of different user groups on the platform enhances the value of the usage of that platform for all users, value creation is not necessarily symmetric between user groups. This may result in asymmetric pricing by the platform and possibly a "free" side – notwithstanding the interpretation of data provided by users on this "free" side as a price to access the platform.

David Sevy then explained why some markets tip and what triggers tipping: a combination of various factors, including strong network externalities, a large dataset and an effective matching technology, and extreme scale and scope economies permitted by the sharing and redeployability of assets (IT infrastructure, hardware, etc.).

"TIPPING IS USUALLY DURABLE DUE TO A SELF-REINFORCING MECHANISM."
DAVID SEVY

Mr Sevy specified that tipping is usually durable due to a self-reinforcing mechanism (sometimes paired with impediments to multihoming): the next generation of users will patronise the same platform as the previous generations of users because of the direct benefits of network externalities and indirect benefits of scale and scope economies. This creates barriers to switching platforms because different users would need to coordinate their decision to switch to a different platform. This explains why disruption of incumbent platforms can be rare despite innovation. Mr Sevy then discussed the concerns that winners in tipped markets could engage in exploitative abuses or exclusionary conduct, e.g. through envelopment strategies by multi-sided platforms leading to sequential market tipping.

Marco Iansiti

Marco Iansiti (Professor, Harvard Business School) based his remarks on the findings presented in his book titled *Competing in the Age of AI.* After decades of investment in information technology, digital networks and artificial intelli-intelligence, the way companies emerge, organise and grow is changing in a fundamental fashion. Some companies are now built on a digital core: many of the task traditionally implemented by managers and other people through business processes are done by software, algorithms and AI. As a result, those companies are immensely scalable.

"DIGITAL NETWORKS AND ARTIFICIAL INTELLIGENCE, THE WAY COMPANIES EMERGE, ORGANISE AND GROW IS CHANGING IN A FUNDAMENTAL FASHION."
MARCO IANSITI

Another consequence relates to scope, not only scale since those companies with software core can develop platform-like capability. They also accumulate data and process it to grow. Mr Iansiti exemplified his remarks by examining operators on the payment market. Then, Marco Iansiti explained that companies have been developing interfaces and thus resemble platforms. He then commented on the fact that many of these companies are still dealing with highly competitive markets since switching costs are low and multihoming is high.

Finally, he focused on the challenges in regulating these organisations with a digital scale, scope and learning. The issue is broader than the scope of antitrust; it concerns security and privacy, algorithmic bias and discrimination through an algorithm. Regulation must be innovative given the recent changes in the corporate structure. Regulation should motivate companies to adopt and implement ethical solutions. Community is key; it has been instrumental in enabling real-life solutions to competition issues over the years and a driving force of the software industry.

Nicolas Petit

Nicolas Petit (Professor, European University Institute) examined the distinction between tipped markets and untipped markets. He first stressed that focus should be placed on tipped markets rather than tipping market. According to him, antitrust policymakers should not go after tipping markets because tipping is an efficient process: fierce competition takes place during the tipping phase, and it removes fragmentation and duplication. A finding that tipping is objectionable from an antitrust endpoint requires a theory or a model to show that two conditions are met: first, that tipping to an inefficient product or service is an empirical regularity and, second, that it is excessively costly to reverse or correct tipping by lowering market processes.

"ANTITRUST POLICYMAKERS SHOULD NOT GO AFTER TIPPING MARKETS BECAUSE TIPPING IS AN EFFICIENT PROCESS."
NICOLAS PETIT

Nicolas Petit made a plea in favour of focusing antitrust resources on markets that have tipped already when a stable equilibrium has been reached with certainty. In such a situation, price cuts and innovation by rivals is not enough to compete with the tipped product or service. He noted that the European Commission has defined tipped markets as markets in which there is a complete elimination of competition.

With tipping markets, the challenges revolve around understanding the organisational and managerial complexity underpinning the capabilities of firms. With tipped markets, behavioural performance-driven indicators lead to less false positives. Finally, Professor Petit outlined difficulties in relating to the definition of markets and the notion of digital output. Is it substitute output or does that include complimentary product output?

Antonio Nicita

Antonio Nicita (Commissioner, Italian Communications Regulatory Authority) emphasised that the risk of false-positive is significant. He noted that the approach adopted by Vice-President Vestager, who is seeking comments on a new competition tool to allow for early intervention when markets are reaching a tipping point, is raising questions in terms of antitrust but also regulation. Regulation is needed, aside from antitrust.

"REGULATION IS NEEDED, ASIDE FROM ANTITRUST."
ANTONIO NICITA

Looking at tipping from a regulatory point of view, Mr Nicita observed that focus has been placed on the supply side rather than on the demand side. He noted that regulatory authorities should push for interoperability: if the standard is open and recognisable, then it is efficient in terms of complementarity of investments.

However, network effects are central; it justifies looking at the demand side. Barriers to entry are driven by the demand, whose behaviour does not only depend on network effects. The demand also bears exit costs. Tipping is coming from the demand side. The Digital Service Act serves regulation: although the matching process may be efficient, it raises issues in terms of pluralism. Regulation should not be on the supply side; it should be based on deframing, increasing awareness of consumers, increasing transparency, forbidding some forms of advertising, etc.

Thomas Graf

Thomas Graf (Partner, Cleary Gottlieb Steen & Hamilton) raised the question of whether antitrust rules are insufficient to address tipping. He observed that antitrust law does not require waiting until a market is tipped to intervene. The legal test focuses on the likelihood of restrictive effects. Tipping is an extreme form of restrictive effect. Supporters of *ex ante* regulation sometimes claim that recent antitrust decisions have not resulted in changes in the relevant markets.

Mr Graf suggested that the fact that, even once the firm complies with the antitrust decision, no change takes place in the relevant market may be due to the fact that the conduct that was challenged was not restrictive in the first place. The counterfactual should be non-restrictive. Also, assuming that antitrust is not efficient in addressing tipping, other tools than ex ante regulation could be useful, such as the interim measures. *Ex ante* regulation could also take different forms, depending on the objective to achieve. If the objective is to prevent likely harmful conduct by prohibiting that conduct without evidence of harm in each individual case, the applicable legal principles should be framed. Particular conduct should only be considered as likely to cause harm if there is sufficient evidence that the conduct will typically cause harm and that it does not have any countervailing pro-competitive benefits.

"OTHER TOOLS THAN *EX ANTE* REGULATION COULD BE USEFUL, SUCH AS THE INTERIM MEASURES."
THOMAS GRAF

Another potential solution would be to provide for a duty to investigate by the European Commission of certain types of gatekeeper conduct when complaints are filled. At the moment, the Commission has prosecutorial discretion and follow an informal process to decide whether they want to allocate resources and to investigate a case.

Questions and Answers

A panellist asked whether there are justifications for agencies not to go after companies which, in spite of their sustained market position continue to innovate. Nicola Petit stressed that R&D expenditures should not be used as a justification of competition conduct and as a defence against antitrust liability. However, the sizable investment in innovation is denoting the degree of uncertainty in the relevant markets. Determining the right level of innovation for the competition is obviously difficult but not impossible. Professor Petit referred to the *Microsoft browser* case.

In response to a question about the specific tests or antitrust tools that could be developed for the purpose of market definition in the context of multisite platforms, Thomas Graf stated that the same basic principles of market definition apply, regardless of the type of markets. He stressed the importance of not focusing on market definition. Looking only at the defined market results in adopting a binary approach which may be problematic, especially when vertically integrated companies compete with non-vertically integrated companies.

To a question on the consideration of switching costs for the purpose of determining the right point of intervention, Marco Iansiti observed that switching costs are very low for all users. However, the analysis of switching costs must be much more precise and consider multihoming. Antonio Nicita also insisted on the need to consider exit costs. He notes that some switching costs are durable; he mentioned frictions generated by login passwords and subscriptions. ■