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Subcommittee on Antitrust, Commercial, and Administrative Law

On

"Online Platforms and Market Power Part 2:
Innovation and Entrepreneurship"

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Framing:

I attach as one element of my testimony a report entitled "Committee for the Study of Digital Platforms: Market Structure and Antitrust Subcommittee." The report was finalized last month and is the result of work by a committee that I chaired for the University of Chicago Booth School of Business's Stigler Center on Regulation. The report will provide more details, more explanation, and useful citations for the points I will make in my live testimony.

Remarks:

Digital platforms combine economies of scale, low marginal costs, economies of scope through data and an installed base of users, network effects, multi-sidedness, and sometimes a global reach. All of these attributes together tend to generate concentrated markets, or market structures containing few firms. With the addition of inertial (or "sticky") consumers these markets feature high entry barriers which make it difficult for new firms to enter the market to create competition.

The harms from insufficient competition appear in prices that are higher than competitive prices, quality that is lower than competitive quality, and less innovation than consumers would benefit from in competitive markets. Prices for advertising may have markups; consumer prices may be marked up from a negative price to a zero price (free). Quality may be degraded through additional advertising, reductions in privacy, or addictive and exploitative content. Reductions in innovation occur because the inventive to move both faster and more creatively is generated by an entrant or competitor – and they are not present in the market. The incumbent firm, perhaps while spending money on R&D and innovation, is not spending as much, or achieving as much, as it would in the presence of competitors who threaten to take away its customers with a more innovative product.

The remedies to these harms are both antitrust enforcement and regulatory actions; these are complements in generating and protecting more competition in the digital sector. Improved antitrust enforcement could protect nascent or potential competitors from being purchased by the entrenched incumbent and could defend them from anticompetitive exclusionary conduct. A digital regulator could break down entry barriers to new entry by establishing, for example, open standards for micropayments, personal identities, and data portability. A regulator could mandate that consumers can control their own data, or that interoperability be established in a particular sector, both of which could allow entrants to easily attract consumers.

Innovation and entrepreneurship are strongly affected by antitrust enforcement. A venture capitalist has little incentive to invest in an innovative startup that will implicitly or explicitly compete head-on with an entrenched platform if it will be subject to anticompetitive exclusion. A VC might want to invest if the resulting business could create a strong enough threat of increased competition that the platform feared losing its monopoly rents. In that case the platform might agree to purchase the entrant instead - for a share of those monopoly rents. Such mergers lessen competition. Reforming merger review to take into account the competitive power of nascent threats to the platform, and accepting the uncertainties that such assessments necessarily involve, could benefit consumers by preventing mergers that lessen innovation.

There is an argument that acquisition of a competing entrant by a dominant platform is the reason the entrepreneur was funded in the first place, so acquisitions must be a stimulant to innovation. First, note that these mergers occur when the entrant has a business that is very similar to the incumbent's; it competes with the platform either now or in the future, and that is why the entrant is a threat and worth purchasing. The acquisition is thus stimulating entry into the same activity as the existing platform, which may not require much innovation. Secondly, if antitrust enforcement were to strengthen, while the incumbent would have a harder time buying the entrant because merger law would be tougher, *it would also have a harder time excluding the entrant* because antitrust enforcement would be protecting the entrant. Thus, the entrant could earn returns for its investors by taking share from the incumbent and gaining share for itself. This stream of profits would stimulate innovation.

If an entrepreneur develops a complement to the platform, rather than a substitute, the merger may not lessen competition but instead create a better product that benefits consumers. It can be difficult to determine at an early stage whether an entrant is a complement or a substitute to the entrenched platform. Even more importantly, the platform may realize that the entrant is a complement today but a likely substitute – a competitor – in the future. This will lead the platform to attempt to acquire the entrant at a time when it is both difficult for the enforcement authorities to understand that future competition is threatened, and to prove it under the current antitrust regime.