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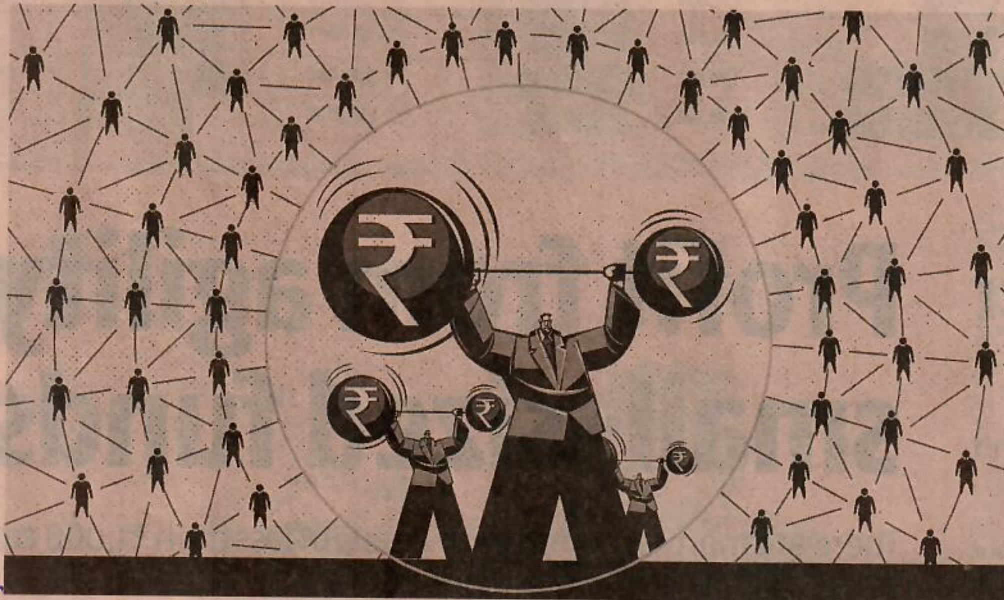

Market power in the new economy

It is a cause for concern if sheer financial might is the tool through which market dominance is achieved

We worry about rent-seeking behaviour in the old economy, and revere high-tech entrepreneurs. However, some high-tech companies have tried to obtain monopoly power through "network effects". Once such a position is established, supernormal profits are produced at the expense of consumers. Some entrepreneurs and their financiers have taken to large-scale discounting in order to obtain a head start in capturing network effects. We need to broaden our concept of predatory pricing in competition law to grapple with these situations. This will require new work at the Competition Commission of India (CCI) and ultimately, new thinking about the Competition Act.

Innovation is the foundation of economic progress. While we normally revere technology companies for their disruptive innovations and the efficiencies that they create, we must recognise that some technology-driven businesses' real revenue channels are through the acquisition and abuse of market power. This is examined in a recent paper by Smriti Parsheera, Avirup Bose and myself (http://goo.gl/4TO1EF).

SNAKES & LADDERS

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High-tech industries suffer from the possibility of market power through three channels. Sometimes there is a high fixed cost and near-zero marginal cost, through which it becomes impossible to challenge incumbents. In other situations, there are network effects where the gains to users of a system are proportional to the number of users of the system. As an example, buyers are likely to go to ebay.in as sellers go to ebay.in, and vice versa. Once ebay.in is established, it is impossible to challenge. A third route to the acquisition of market power is like Google search, where the large number of existing users makes possible the best-quality analysis of data about user behaviour, which makes Google the best search engine.

People from a technology background take pride in identifying opportunities to set up network effects. My ears go red when I hear tech entrepreneurs and their financiers talk about these opportunities and ways to capture them. Many entrepreneurs and their financiers have lunged for a strong position in industries with network effects. If a head start cannot be obtained through technological innovation, they are willing to subsidise users to artificially induce the network.

Tech companies and their backers have burned large sums of money to create or buoy network effects. The global taxi company Uber made losses of $1.27 billion in the first half of 2016, where it was giving out money to drivers and passengers aiming to create conditions where both sides of the market would solely use their platform. Money has become the raw material. The "innovation" is to spend money to achieve market power and then raise prices so as to earn supernormal prices forever. Similar issues are seen with some other e-commerce "platform" industries.

These phenomena are problematic from the viewpoint of economic policy. Market power is a problem, regardless of whether it involves paan-chewing old men in old economy firms or latte-guzzling techies in new economy firms. The very thing that technologists and private equity investors intend to capture — market power — is the thing that economists and competition policy thinkers aim to keep out of reach.

It is one thing for a company to get to a leadership position owing to technological innovation. There is merit in the Schumpeterian argument that it may make sense for society to accept supernormal profits by some firms for some time as this creates incentives to innovate. Yet, it is a cause for concern if sheer financial might is the tool through which the leadership position is achieved. Such strategies for obtaining market power actually create incentives to underinvest in building the best product. What matters is financial muscle, not intellectual muscle.

A novel dimension of this problem is the early evidence about cartels of investors who engage in strategic behaviour and choose which company will live and die. The computer programming for the Uber app is pretty trivial; the question now is about finding billions of dollars to subsidise users. As the winning component moves from intellectual capability to financial resources, the gains from high-tech companies are increasingly shifting away from inventors to investors.

How should we think about these questions in Indian public policy? The first element is to bring this full knowledge about network effects and the new economy into the analysis of competition and consumer protection at the CCI.

The second element is to think about the possibility of recoupment. Discounts to consumers are pro-consumer when they have no impact upon market power in the future. But when discounts are a tool for achieving market power, and are being given with the hope of recoupment in the future, they need to be viewed differently.

The third element is to act on Internet time. Conventional CCI notions of predatory pricing are based on the slow evolution of market power in the old economy. The CCI needs to work faster on disposing of these cases. A voluntary settlement process needs to be developed through which interventions can take place early enough to head off these problems at an incipient stage.

The fourth element is to emphasise interoperability. There is limited opportunity for market power in industries like email as there is full interoperability. A new player can always come in, no matter how small she is, as the entire existing market is addressable through a standardised system of protocols and regulators ensure that incumbents do not choke off new players.

Requiring interoperability and open access should be a pro-competitive lever for the CCI, and all regulators in India. As an example, the Ratan Watal committee on payments has emphasised open access and interoperability at the three levels of (a) the RTGS system, (b) payment switches such as NPCI and (c) consumer payment systems such as UPI. This would reverse the present RBI approach, by which payment regulation actually prohibits interoperability between digital wallets and bank accounts, and has created the opportunity for some players like Paytm to engage in the strategy of large losses.

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