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Regulating technology companies

Taming the beasts

[FEATURE-LENGTH ARTICLE PUBLISHED 5/28/2016 IN RESPONSE TO ANDY'S LETTER TO THE EDITOR]

BRUSSELS AND PARIS

European governments are not alone in wondering how to deal with digital giants

TALK to Axelle Lemaire, a French secretary of state in charge of all things digital, and one topic quickly comes up: online platforms of the kind operated by tech giants such as Facebook, Google and Uber. "France is very open to them," she insists, "but consumers have to be protected."

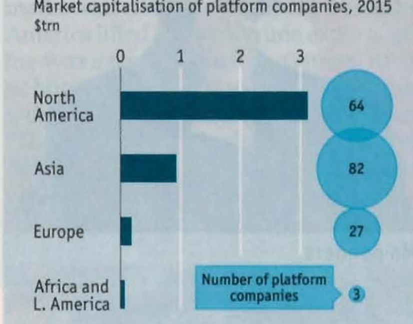
Ms Lemaire's words will soon be put into action. The French parliament is about to pass a law, sponsored by her, which will create the principle of *loyauté des plateformes*, best translated as platform fairness. Once it takes effect, operators of online marketplaces will, among other things, be required to signal when an offer is given prominence because the operator has struck a deal with the firm in question, as opposed to it being the best available.

In Brussels, too, the regulation of platforms is on the agenda. On May 25th the European Commission announced plans for how it intends to deal with such services. Its proposals cover everything from what tech firms should do to rid their digital properties of objectionable content, such as hate speech, to whether users can move data they have accumulated on one platform to another.

Here we go again, many will say. As usual, Europe is putting regulation above innovation, and being protectionist to boot, since most platforms are either American or Asian (see chart). European firms earned only about 5% of the profits of the 50 biggest listed platforms, which

Platform four

Market capitalisation of platform companies, 2015



Source: Global Platform Survey, CGE

reached a total of $1.6 trillion in the past four years; more than 80% ended up in America. The commission has been going after American tech firms for a while, say critics—it will soon decide how to punish Google for abusing its dominance in internet search, for example. This week's plan fits a pattern.

But it is not only Europe that is suffering from growing platform anxiety. Although worries vary, politicians and regulators around the world are waking up to the power of these online matchmakers, whose role is to bring together different groups—advertisers and consumers in the case of Facebook and Google, merchants and buyers in the case of Amazon, drivers and passengers in the case of Uber. Platforms exhibit what is known as "network effects": the bigger the number of one kind of customer, the more attractive these services are for the other sort, and vice versa.

Facebook, the world's biggest social network, symbolises the rise of global platforms. It now boasts over 1.65 billion active users a month worldwide—more than the population of China. On average, they spend about 50 minutes per day on the site and the other two big services Facebook owns, Instagram and WhatsApp. For many of its users, the social network is not only useful for connecting with friends and relatives but also an important news source.

Platforms have also started to emerge in other sectors. Industrial machines and their products are packed with sensors and connected to the internet, digitising the real world and creating opportunities for matchmakers to connect manufacturers with suppliers. (This is where the EU sees a chance to close the gap with America.)

If Europe, predictably, is reacting to the rise of platforms through the rule book, America's response also fits a stereotype. Regulators have largely given the country's platforms free rein—which may not be unconnected to the fact that they are now fervent lobbyists. In 2013, for instance, the Federal Trade Commission (FTC), which had been scrutinising Google, decided to take no action. But private actors are flexing their muscles.

The platlash

Platform operators have faced a barrage of class-action suits from private litigants. Last month Uber, a taxi-hailing service, settled one brought by drivers, promising no longer to kick them off its app without warning or recourse. After pressure from consumer groups, Google announced on May 11th that it would ban adverts for payday lenders, which are widely viewed as ▸▸

exploiting their customers.

The debate about the power of platforms has grown more heated thanks to reports this month that Facebook employees have kept news topics on issues close to conservatives' hearts away from prominent display. Many, on both right and left, have called for Facebook, which denies the allegations, to be reined in. When a group of conservatives recently met Mark Zuckerberg, the firm's boss, some demanded that it should have a more politically diverse workforce and take into consideration the impact on businesses when it changes the algorithm that decides if their Facebook page is shown in people's newsfeeds.

Now the regulatory winds may be shifting. The FTC seems to be having second thoughts: it is not only looking again into Google's search business, but is investigating whether the firm abuses its dominance in mobile operating systems. Whoever is elected president in November is unlikely to ignore the question of platforms. "If I become president, oh do they have problems," Donald Trump has said of Amazon, accusing it of evading taxes.

The mood is changing in Asia too, albeit more slowly. In recent years the size of Naver, a web portal in South Korea, has prompted debate about whether it should be regulated. After an investigation by the country's watchdogs, the firm has agreed, among other things, to help smaller online firms sell their wares.

The Chinese government is making life harder for platforms—and not just big Western ones, many of which are banned in the country or kept out by its Great Firewall. Alibaba, Baidu, Tencent and other big Chinese internet firms already know what is expected of them when it comes to keeping their services free of politically sensitive content. But other concerns are also increasingly to the fore: earlier this year Baidu got into hot water after the death of a student who said he had received misleading information on a cancer treatment from the company's search engine. The government may seek even greater control over online-video platforms by insisting on taking minority equity stakes.

The European Commission's plans don't go that far but some proposals could end up being very interventionist (the details are still being worked out). For instance, the commission intends to create a "level playing field" for conventional telecoms carriers and firms that offer communication services over the internet, such as messaging apps. The question is whether levelling the field would involve lightening the regulatory burden on incumbents, such as the requirement to offer universal service, or applying such rules to newcomers. If the commission's intentions for on-demand video services, such as Netflix, are any guide, the newcomers are likely to face new responsibilities: it wants to ensure that 20% of content is European.

In most other respects, however, the plans are a far cry from the fiery rhetoric in late 2014, when the European Parliament passed a resolution for Google to be broken up. In fact, they are notable as much for what they do not say as what they do. They do not, for instance, seek to make platforms responsible for illegal activities on their properties. Such "platform liability" would hurt small (mostly European) ones more than big (mostly American) ones, because there are economies of scale in policing this sort of thing. Instead, the commission is betting mainly on self-regulation to keep platforms clean (although it says it might take "additional measures" should such voluntary efforts fall short).

Another notable absence is a plan to apply new competition rules across all types of platform. Last year France and Germany, in particular, had demanded such "horizontal legislation" to strengthen the rights of smaller businesses that have come to rely on platforms—for instance, to keep platforms from imposing unfair terms and conditions or changing them unilaterally. But given the diversity of platforms, the commission has opted to stick with existing competition law and look at problems on a case-by-case basis. (In a nod to more interventionist member states, however, it plans to revisit the question next year).

The most interesting questions concern how platforms collect data from users and connected devices. These help firms improve services and target ads. But they can also be a source of market power—something antitrust experts have only now started looking into. "Exclusive access to multiple sources of user data may confer an

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Alibaba

Under scrutiny

SHANGHAI

American regulators are investigating China's e-commerce giant

"WE HAVE from time to time been subject to PRC and foreign government inquiries and investigations." So declared form 20-F, a regulatory filing submitted by Alibaba, China's biggest e-commerce firm, to America's Securities and Exchange Commission (SEC) on May 24th. It is tempting to dismiss this as boilerplate language. All foreign firms listed in America (Alibaba trades on the New York Stock Exchange) are required to file this document regularly. In fact, it is not inconsequential. The filing revealed that Alibaba is the target of an ongoing SEC investigation into its accounting practices. The company's shares fell sharply after the news became public.

The SEC appears to have three areas of concern. It wants to know more about the Cainiao Network, a logistics joint venture worth $7.7 billion in which Alibaba has a 47% stake. The agency also wants data on "Singles' Day", an annual marketing promotion that last year apparently generated $14.3 billion in gross merchandise value (GMV) on one day. As GMV is not a recognised term in GAAP, the accounting standard used in America, the SEC may be digging into this claim.


Ma ponders

Most intriguingly, the American regulator is also scrutinising how the company has handled its many related-party transactions. Jack Ma, the firm's founder, caused outrage when he unilaterally spun off AliPay, Alibaba's lucrative online-payments arm, in 2011 into an entity that he controlled. That business, now known as Ant Financial Services Group, is valued at $60 billion and is heading for a public flotation.

Where will this SEC action lead? It could be a routine inspection of the sort most public companies can expect from time to time. Alibaba certainly denies any wrongdoing, noting that it is cooperating with the authorities and voluntarily disclosing the fact that it is under investigation. But if the regulators do uncover evidence of real misconduct, things could get nasty for China's most celebrated firm.

The only certainty, argues Vasu Muthyala of Kobre & Kim, a law firm, is that Chinese firms face greater scrutiny. Mr Muthyala, a former prosecutor who previously served at the SEC, says: "As Chinese business looks west for new capital, customers and business partners, there will inevitably be an increase in interest from American regulators."

unmatchable advantage," warns an influential report by a committee in Britain's House of Lords. Germany's competition authority is investigating whether Facebook has abused its dominance to impose weak privacy rules on users.

Sensibly, given how little is known about the mechanics of data markets, the commission intends to take only limited steps. For instance, it wants online firms to give users the option to log in using government-issued IDS rather than credentials provided by big platforms. This could make it harder for these to track users as they move around the internet, limiting their ability to scoop up data from sites belonging to others. Another proposal is to make it easier, for both consumers and businesses, to transfer data if they want to switch platforms.

Regulators still have much to learn about how to deal with platforms. But they have no choice but to get more expert. As Martin Bailey, who heads the commission's efforts to create a single digital market, told the Lords committee: "There is hardly an area of economic and, arguably, social interaction these days that is left untouched by platforms in some way." That is true far beyond the borders of Europe. ■

Oil-price reporting

Striking it rich

A niche business straddling journalism and oil is proving surprisingly lucrative

TWO lines of business have stood out of late for their inability to make money: journalism and oil. So when it emerged on May 23rd that Argus Media, a British firm that reports global commodities prices, is to be sold to an American investment firm for $1.4 billion, it aroused a variety of emotions. One was surprise. "Data about oil markets now seem to be worth more than oil itself," exclaimed one executive of a commodities exchange. Another, in the words of an employee at S&P Global Platts, Argus's main rival, was "jealousy". The sale has turned some of Argus's 750 scribblers, a quarter of whom are said to own shares or options, into millionaires.

Argus began in 1970 as a newsletter reporting on petroleum-product prices in the Netherlands. General Atlantic, which is buying out the family of Jan Nasmyth, its late founder, has made the most aggressive move so far in an industry that is fast consolidating. Its leaders, Platts and Argus, are battling for dominance over reporting prices of the most widely used oil benchmarks, such as Dated Brent and West Texas Intermediate (WTI), against which billions of dollars-worth of oil are priced each day.

The benchmarks are used by oil companies, oil-producing countries, derivatives traders and others to decide at what level they should price hundreds of different grades of oil. Their providers make money by selling subscriptions to their information; the more prominent the benchmark, the more subscribers it generates.

In recent years, Platts has made the running in the oil markets with its Brent assessment, based on four grades of North Sea crude, which is used as a reference for petrol prices stretching from Europe to Asia. WTI, which sets the price of different grades of oil traded in the Americas, is assessed at a landlocked hub in Oklahoma and has not got the same global reach.

General Atlantic says its interest in Argus grew after 2009, when big producers like Saudi Arabia began using its sour-crude index rather than a rival from Platts to price imports into the United States—an indication that Platts's leadership of the market was not impregnable. In December America lifted a ban on crude exports, giving WTI a new lease of life. General Atlantic hopes Argus's WTI physical assessment will become an international rival to Brent. "The battleground is global," says Adrian Binks, who will remain Argus's boss after over 30 years leading the company.

Asia is a further bone of contention as trade flows have shifted east. Platts's long-established Dubai benchmark, used to price Middle Eastern crude bound for Asia, has been whipped around in the past year by aggressive trading from two big Chinese oil firms, Unipec and China Oil. India's Reliance is also muscling in, and there is a vigorous new source of demand from China's so-called "teapot" refiners, recently permitted to import oil. Big oil traders like Royal Dutch Shell, long used to calling the shots on Brent crude, have complained about undue Chinese influence on prices in Asia. Platts says it has addressed the problem by adding crudes to make the benchmark more liquid this year.

There are also calls for stronger regulation as the industry consolidates. "There's a huge tension between the economic value of these businesses—both to their shareholders and the broader economy—and the lack of oversight provided by host governments," says Owain Johnson, managing director of the Dubai Mercantile Exchange (DME).

The companies argue that they are media outlets covering physical commodities, and should not be regulated like futures markets such as the Chicago Mercantile Exchange, where WTI futures are traded, or the DME. Though their benchmarks carry enormous weight, they are gathered by journalists who sit in newsrooms, watching screens and contacting traders by phone and instant messenger. They say they police themselves based on principles set by the International Organisation of Securities Commissions in 2012.

They may be partially reassured that General Atlantic, an investor in Airbnb and Uber, disrupters of hotel and taxi services respectively, understands the importance of trying to keep regulators at bay. In the meantime, it has created a rare species at Argus: the rich and happy journalist. ■

Keeping a close eye on the barrels