



Rumbling Regulation October 9th, 2020

The big tech story of this week was the report by the US Congress into the market positions and business practices of big tech, notably Amazon, Google, Apple, Facebook (“AGAF”). Microsoft, the villain of the 1990’s and 2000’s was relatively unscathed.

Background

On June 3, 2019, the House of Representatives Judiciary Committee announced a bipartisan investigation into competition in digital markets. The purpose of the investigation was to (1) document competition problems in digital markets; (2) examine whether dominant firms are engaging in anti-competitive conduct; and (3) assess whether existing antitrust laws, competition policies, and current enforcement levels are adequate to address these issues.

According to the report, as part of a top-to-bottom review of the market, the Subcommittee examined the dominance of Amazon, Apple, Facebook, and Google, and their business practices to determine how their power affects the economy and democracy of the US .

After the 16-month probe, the House Democrats released their 450 page report* on the competitive practices at Apple, Amazon, Facebook and Google.

Listening to the US Congressional Hearing earlier this week, the report has clearly lost its bipartisan origins and turned into another political squabble. Immediately, the Republicans started distancing themselves from the report and many of its recommendations.

Superficially, analysing the references to each company in the report, Facebook was mentioned 946 times, Apple 1285, Amazon, 1866, Google, 1964 and Microsoft 74 times.

Recommendations of the Report

The conclusion of the report is that all four companies (AGAF) enjoy in the words of the Committee, “monopoly power.”

The report starts off by stating:

“They not only wield tremendous power, but they also abuse it by charging exorbitant fees, imposing oppressive contract terms, and extracting valuable data from the people and businesses that rely on them...Whether through self-preferencing, predatory pricing, or exclusionary conduct, the dominant platforms have exploited their power in order to become even more dominant.”



To put it simply, companies that once were scrappy, underdog start-ups that challenged the status quo have become the kinds of monopolies we last saw in the era of oil barons and railroad tycoons...The effects of this significant and durable market power are costly. The Subcommittee's series of hearings produced significant evidence that these firms wield their dominance in ways that erode entrepreneurship, degrade Americans' privacy online, and undermine the vibrancy of the free and diverse press. The result is less innovation, fewer choices for consumers, and a weakened democracy".

The report outlines various changes to combat that, including:

- 1) forcing these companies to be broken up or
- 2) imposing business structures that make different lines of business functionally separate from the parent company. This implies government oversight of the different functional units.
- 3) and/or prohibiting dominant platforms from entering adjacent lines of business.

For example, this could include a scenario such as forcing Google to divest and separate from YouTube, or Facebook doing the same with Instagram and WhatsApp or Apple splitting off the App Store. It could also mean putting rules in place that takes management of say Amazon's marketplace policies and enforcement of such policies out of Amazon's hands affectively making Amazon compete as an equal on its own platform.

Part of the problem is that there are fundamental differences between the different companies. As Microsoft's founder and ex-CEO, Steve Ballmer commented, "putting them all together makes good theatre but not good policy."

Interestingly enough, just last week, Facebook introduced greater integration and interoperability between Facebook, Messenger, Instagram, and WhatsApp.

The report recommends that any acquisition by a dominant platform should be presumed anti-competitive unless the merging parties could show that the transaction was necessary for serving the public interest. This will send shockwaves through the entire global start-up community as the most efficient exit for many start-ups is to be acquired. AGAF being excluded from the list of potential buyers will reduce competition among suitable acquirors substantially.

Other recommendations include the ho-hum ones we have seen time and time again, e.g. dominant platforms should be prohibited from preferencing their own services instead making them offer equal terms for equal products and services.



A more controversial recommendation, showing lack of fundamental understanding about the underlying working of these services is the recommendation; requiring dominant firms to make their services compatible with competitors and allowing users to transfer their information easily.

A simplistic analogy would be to require a unifying global language with all the challenges of teaching everyone this new language and translating all that has already existed in the prior dominant languages to this new language. It's even more impractical to agree on a uniform data model in the tech world than in the world of human languages. Unintended consequences will be that such a unified model would also increase cyber security and national security risks.

A noteworthy problem is that despite the involvement of dozens of experts, the fundamental differences between the rapidly evolving business models of internet companies and old bricks and mortars seems to be ignored. The ideological philosophies of the report look to be rooted in views about old style monopolies with inappropriate references to the Railroad Robber Barons, Standard Oil and AT&T.

“As a charter of economic liberty, the antitrust laws are the backbone of open and fair markets. When confronted by powerful monopolies over the past century—be it the railroad tycoons and oil barons or Ma Bell and Microsoft—Congress has acted to ensure that no dominant firm captures and ideological.”

As Google says, “competition is just a click away.” You cannot compare that situation to a telecom monopoly or a railway monopoly. Moreover, you risk deterring these companies from making infrastructure investments, badly needed for the US to compete effectively against countries like, China, South Korea, Japan, and Singapore to name a few.

it is exceptionally difficult to make the case that any of these companies are causing consumer harm. It is also noteworthy that these companies are amongst the most popular in the U.S. The reason these companies have power is because so many customers choose to use them.



Source: Jose van Dijk, https://www.acm.nl/sites/default/files/documents/2018-05/presentation-jose-van-dijk-acm-conference-2018_0.pdf

Reactions from the Tech Companies

Amazon, Apple, and Google have responded subsequently and of course they all disagree with the report.

Amazon said in a blog post : “Misguided interventions in the free market would kill off independent retailers and punish consumers by forcing small businesses out of popular online stores, raising prices, and reducing consumer choice and convenience. ... these flawed regulatory ideas rely on the false narrative that Amazon’s interests are not aligned with those of the thousands of small and medium-sized businesses thriving as sellers in our store. The opposite is true: Amazon and sellers complement each other, and together we create a better customer experience than either could create alone.”

Apple said that it “vehemently disagrees with the conclusions reached in the house report and claim that it doesn't have dominant market share in any categories of its business.”

Google states that “its free products like Search, Maps and Gmail help millions of Americans and they have invested billions of dollars in research and development to build and improve them”.They disagree with the report, which they believe feature outdated and inaccurate allegations from commercial rivals about Search and other services².



Google continues to state: “Google has long championed the importance of data portability and open mobile platforms; we are arguing a case before the Supreme Court tomorrow for the important principle of software interoperability; and we have urged Congress to pass comprehensive federal privacy legislation. We look forward to engaging with Congress on these and other issues moving forward.”

Facebook has not made any official comments about the report.

Summary

It is of course important to constrain the power of any company which is abusing its position. Constraining the power of the tech mega caps, though, probably needs new laws that start with Internet assumptions. The threat of the laws would themselves be a deterrence for the companies.

The regulatory overhang is likely to limit the valuation multiples of the companies as it did for Microsoft during 2003-2010 period. All the companies have a long-term focus with little concern for maximizing near-term profitability. The regulatory overhang is likely to further support management’s focus on the long-term, with little incentive for the companies to show significantly improving profitability and risk irking regulators.

Apple has been a leader in Environmental, Social and Governance policies (ESG) while Google, Microsoft, and Amazon have been fast followers. The companies are likely to continue to invest in their ESG initiatives as matters of principle but also to counter allegations of self-serving monopolistic behaviour directed at them by governments and regulators.

We expect the regulatory noise to rumble on in every jurisdiction. At the same time, we believe Apple, Amazon, Google, and Microsoft are well-placed to navigate the regulation. All the companies have studied the challenges which Microsoft faced throughout the 2000’s when it had to abide by the US Department of Justice, Consent Decree. The transformation of Google into Alphabet in 2015, was no doubt partially driven by a strategy to avoid cross-subsidisation allegations as Google branched into diverse markets.

The irony is that regulation tends to harm smaller companies more than the larger ones as we saw with General Data Protection Regulation in Europe.

There is also strong resistance to “breaking up” any of these companies, especially as they have been critical in keeping the economy functioning during the recent pandemic and they are the leading US warriors in the battle against Chinese tech dominance.

*https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf



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