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Perceptions versus Reality

Regulating Digital Platforms

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SUMMARY

Digital platforms, also known as “online intermediation services,” are increasingly important for European businesses, bringing wide-ranging benefits to both individual consumers and to the participating companies. More and more new platforms are arising – in areas such as manufacturing and healthcare.

Not surprisingly, as digital platforms have become more numerous and significant, they have come under the scrutiny of regulators. In particular, the European Commission has been examining the perception that European business users are being treated unfairly by digital platforms. The result was a recently proposed new regulation “promoting fairness and transparency for business users of online intermediation services.”¹

In this paper, we first analyze the economic and commercial constraints facing digital platforms. In particular, we focus on two economic imperatives: First, platforms have a strong incentive to maintain user trust. Second, platforms have a strong incentive to keep

transaction-related costs under control.

Using this analytic framework, we examine six perceptions of platform unfairness in light of the reality of transactions-based costs and user trust. We show how these perceptions, in some cases, correctly identify platform behavior, but misunderstand the reasoning behind the behavior. Other perceptions misunderstand the economic incentives of platforms. In particular, the perceptions of business users often don’t account for the competitive and reputation reality facing the platforms. It makes no business sense for platforms to act in a way to reduce user trust and drive away business users, since businesses can easily belong to multiple platform ecosystems and shift between them.

For each perception, we also consider the associated remedy outlined in the proposed regulation. Given our analytic framework, we discuss the plusses and minuses of the different aspects of the proposed regulation.



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INTRODUCTION

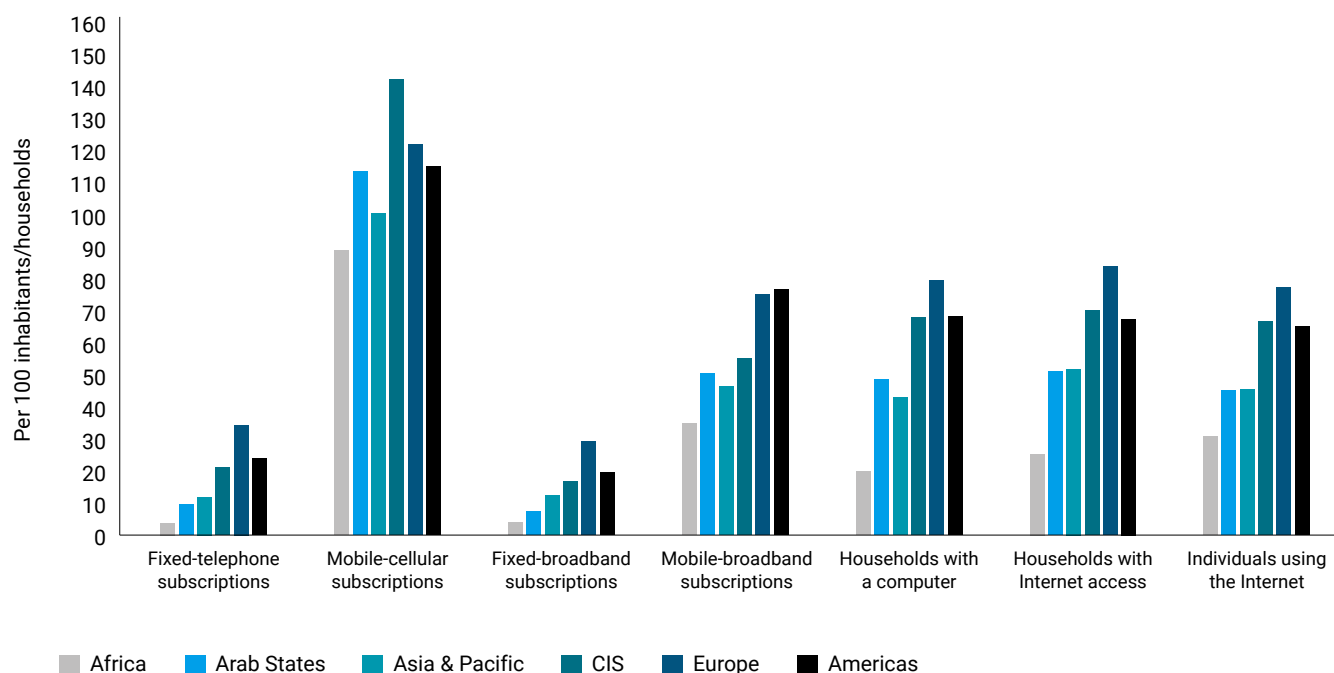
Europeans are keen to engage digitally, as illustrated by relative smart phone and Internet penetration rates (Figure 1).

European businesses show increasing shares of turnover realized from electronic sales, and many European SMEs use social media and other platforms as part of their business processes.

Our 2017 research shows that Europe boasts 1.89 million app economy jobs – more than the 1.73 million app economy jobs in the United States.²

The United Kingdom and Germany both have more than 300,000 app economy jobs, followed by France and the Netherlands. Many EU member states also rank high in various technology/ICT readiness indices.³

FIGURE 1: ICT penetration levels by geographic region, 2016*



Notes: * Includes ITU estimates. | Source: ITU, *Measuring the Information Society*, 2016.

The next step is to turn this digital investment into growth. Perhaps the most important example has been the movement toward a Digital Single Market. By “tearing down regulatory walls” the European Commission argued that the Digital Single Market “could contribute €415 billion per year to [the European] economy and create hundreds of thousands of new jobs.”⁴

As we will see in Section 2, digital platforms are important contributors to expanding the market for European suppliers of goods and services, stimulating and accelerating innovation, and improving growth, efficiency and productivity more generally.⁵

The main impacts from digital platforms occur through two channels: (1) the impact on the size and functioning of markets and trade/

commerce, and (2) the impact on the tradability of services.⁶

Digital platforms are important contributors to expanding the market for European suppliers of goods and services, stimulating and accelerating innovation, and improving growth, efficiency and productivity more generally.⁵

However, a number of concerns have been raised by business users about their treatment by digital platforms (European Commission, 2016a,b). As a result, the Commission announced, in its Communication on online platforms of 25 May 2016, it is carrying out “a targeted fact-finding exercise on B2B practices in the online platforms environment.”⁷

This fact-finding exercise included comprehensive surveys of European businesses using platforms, to identify their areas of concern. The results of these surveys and other elements of the fact-finding exercise are summarized in the report commissioned by the European Commission, “Business-to-Business Relations in the Online Platform Environment” (Ecorys, 2017, which we will refer to as the OPE report).⁸

This report formed the evidentiary basis for the recently proposed regulation “promoting fairness and transparency for business users of online intermediation services.”

Six distinct perceptions of unfair trading practices emerged from the European Commission study. We report these perceptions in Table 1, along with the corresponding remedy from the proposed new regulation.

The purpose of this paper is to take a step back and analyze whether the perception of unfair treatment is justified given the economic and commercial constraints faced by the platforms. This is not an easy task. We have a well-developed sense of what’s fair or unfair in ordinary transactions between two individual businesses.

But digital platforms are a new type of market institution in which the platform is making large investments and taking risks, and bringing potential buyers and sellers together on a large scale. As a result, perceptions of unfairness may often not correspond to reality.

To show this, in Section 2 of this report, we start by discussing the nature of platforms, and why they matter. We examine the definition of platforms, the benefits, and who the major players are. Note that, to keep the scope of this paper manageable, we are not discussing the impact of privacy law or competition law on

platforms. These are important issues that have received much analysis elsewhere.

In Section 3 we identify the two major economic and commercial constraints faced by platforms: the need to hold down transaction-related costs, and the need to maintain user trust, where “users” refers to business users. Transaction-related costs are costs like fraud monitoring, which rise with the number of transactions. Given the vast number of transactions facilitated by many platforms, holding down such costs is an economic must. Similarly, maintaining user trust is essential to keep business users from shifting to other platforms or other sales channels.

These two imperatives drive many of the policies adopted by platforms. For example, the need to hold down transaction-related costs may make some types of conventional business practices unwieldy or uneconomical. One such practice: In one-on-one business transactions, it’s normal for the two parties to negotiate the terms of a contract. But negotiating individual terms and conditions with individual business participants is not possible when a single platform is facilitating millions of transactions. In some sense, the network effects can generate higher costs.

Using this analytic framework, in Section 4 we examine the six perceptions of platform unfairness, and the corresponding proposed remedies, in light of the reality of transactions-based costs and user trust. We show how these perceptions, in some cases, correctly identify platform behavior, but misunderstand the reasoning behind the behavior. Other perceptions misunderstand the economic incentives of platforms. In particular, the perceptions of business users often don’t account for the competitive and reputation

reality facing the platforms. It makes no business sense for platforms to act in a way to reduce user trust and drive away business users, since businesses can easily belong to

multiple platform ecosystems and shift between them. Finally, in Section 5, we summarize our conclusions about the proposed regulation for online intermediation services.

TABLE 1: Perceptions of Unfair Practices Expressed by Business Users and the Realities of Online Platforms

PERCEPTION 1	PERCEPTION 2
<p>Platforms abuse their power by setting uniform “Terms and conditions” of participation, and changing them at will.</p> <p>Reality The complaint is that platforms are “unilaterally dictating” terms and conditions. However, allowing individual negotiation of terms and conditions would drive up transaction-related costs, raising the price that platforms would have to charge. At the same time, individual negotiation would likely erode user trust – especially for small business users who would be worried about having to match the legal resources of larger companies.</p> <p>Proposed Regulation Terms and conditions should be clear and unambiguous. Changes should require 15 days notice.</p>	<p>Platforms treat business participants unfairly by not revealing the details of their search or ranking methodologies.</p> <p>Reality The problem is that giving out more information on the search and ranking methodologies has an ambiguous impact on user trust, while potentially increasing transaction-related costs. Yes, more information helps business users present themselves, but it also gives an advantage to opportunistic sellers who manipulate the rankings. That raises transaction monitoring costs – potentially making the platform less affordable.</p> <p>Proposed Regulation Platforms would have to reveal main parameters of their ranking and search algorithms.</p>

PERCEPTION 3

Platforms treat business participants unfairly by sometimes removing their products or services without adequate warning.

Reality

Giving more warning before removing products or services would have an ambiguous impact on user trust while increasing transaction-related costs. Businesses that are making an honest mistake would benefit, but so would businesses selling fraudulent, illegal, and inappropriate product, services, and content. Moreover, platforms are private enterprises that should be able to choose which business users can participate.

Proposed Regulation

The terms and conditions would have to specify the “objective grounds” for suspension or termination decisions. Business participants would need to be informed of the specific facts and reasons for the removal of their products or services, or their suspension or termination.

PERCEPTION 4

Platforms act to give their own products or services an unfair advantage.

Reality

Platforms would lose their users’ trust if they were perceived to unfairly favor their own products and services, thereby undercutting business users.

Proposed Regulation

Platforms would have to include in their terms and conditions a description of any “differentiated treatment” given to their own goods and services.

PERCEPTION 5

Platforms deny businesses data on their own customers and transactions to get an unfair advantage.

Reality

Providing businesses with more data on customers has an ambiguous effect on user trust. Moreover, some platforms' refusal to share data is the result of existing EU regulations to protect consumers and business users under privacy, competition or other regulations.

Proposed Regulation

Terms and conditions should describe the access of business users to data provided by business users or consumers.

PERCEPTION 6

Business users of platforms don't have good ways to register their complaints and problems.

Reality

Platforms that don't provide effective redress procedures risk losing user trust. However, many of the complaints about redress procedures really reflect other misperceptions about the economic and commercial environment platforms face.

Proposed Regulation

Platforms must have an effective internal redress system, which mandates appeals to an outside mediator if requested by the user.

WHAT ARE DIGITAL PLATFORMS AND WHY DO THEY MATTER?

The Nature of Platforms

Digital platforms are very diverse, both in nature and "geography." Their potential is shaped by access, which is, in turn, determined by network availability, accessibility and affordability; the skills to use (both on the consumer and business side) and build them (technical side); and the business, innovation and regulatory environment by which they are governed.

There is no single (legal) comprehensive "one-size-fits-all" definition of platforms, or even an agreed-on terminology. The proposed regulation defines an "online intermediation service" as meeting the following key requirement:

...they allow business users to offer goods or services to consumers, with a view to facilitating the initiating of direct transactions between those business users and consumers, irrespective of where those transactions are ultimately concluded.

That definition covers an extraordinarily wide range of business operations. Indeed, platforms can take on different forms based on the types of content or services traded, as well as the different actors involved in transactions that are facilitated by the platforms (platform companies themselves, businesses, individuals). Ecommerce marketplaces, social media networks, mobile application stores, and online advertising networks, among others, are all platforms under this definition.

The Benefits of Platforms

Digital platforms have the potential to act as important drivers of European growth, and help small and medium European companies grow to scale (see, for example, Garces-Tolon, 2017; eBay, 2017a,b, 2015; Melin et al., 2016; Oxera, 2015). The European Commission is committed to seizing the benefits digital technologies can bring the European economy,⁹ and acknowledges that innovation and platform companies play an important role in this process. It also states that "the future Internet cannot succeed without trust of users in online platforms, and without online platforms respecting all applicable legislation and the legitimate interests of consumers and other users...Platforms bring a new dimension to more traditional models of firms, especially to SMEs."¹⁰

The European Commission identifies two main benefits platforms bring businesses, and which they argue are also the main drivers of business growth: (1) cost reduction (such as transaction costs and search and information costs), and (2) the promotion of business opportunities (including through an expansion of market access, both segments and geographic areas, and an offering of business support services that might otherwise not be affordable, such as tax and legal support, the provision of business and customer data, export guidance).

The Commission argues that platforms contribute to productivity and competition and are "powerful engines of growth," notably by enabling small companies to achieve the benefits of digital technologies, facilitating

market entry, and driving the creation of so-called “unicorn” startups, considered to be strong and highly valued companies. “The EU’s strategic objective is to set the optimal innovation environment to create, attract, retain and grow new online platform innovators within Europe, while at the same time creating a regulatory framework that respects the legitimate interests of consumers and other users” (European Commission, 2016a). Platforms are also seen as potentially playing an important role in supporting growth and innovation in the Digital Single Market and alleviating some of the challenges it faces (for example, by reducing market fragmentation and facilitating scaling-up for both established market players and new entrants).

The Commission further acknowledges a range of potential benefits, including that platforms may facilitate employment, education and knowledge sharing; contribute to innovation and speed up time to market; increase consumer choice, improving competitiveness of industry and enhancing consumer welfare; and offer the potential to enhance citizens’ participation in society and democracy, facilitating access to information – in particular, for younger generations and across borders (European Commission 2016b). In addition, the so-called “collaborative economy platforms” are thought to contribute to better resource allocation and more sustainable consumption patterns.

One channel through which the economy can derive benefits from digital platforms is through the transfer of intangible capital, from the rest of the world to Europe, and between European countries. Intangible capital includes the investment in research and development, software and market research necessary to

construct and maintain a well-functioning digital platform.¹¹ For example, the software needs to be tested, maintained, and upgraded. The platforms need to keep investing in cybersecurity in the face of ever-more intense threats. Fraud has to be policed. These transfers of intangible capital to Europe, like intellectual assets more generally, are difficult to capture and quantify and are largely mismeasured or absent from the official economic statistics (Mandel 2015, Mandel 2017a), and from any discussion about the benefits from platforms.

The Commission acknowledges that platforms face a number of challenges in Europe that potentially limit their growth and impact, including a fragmented EU market, policy, legal and regulatory uncertainty, restrictions on data flows, a lack of financing for promoting existing innovation, and a lack of digital entrepreneurship skills.

While the Commission clearly sees the potential benefits from platforms in Europe, it argues that a number of concerns have also been raised, such as concerns about the collection and treatment of data, consumer protection, and the role of platforms in fighting illegal content. There are also a number of specific concerns related to B2B interactions on platforms – which are the focus of this paper.

Who Are the Main Players?

The nationality of digital platforms is not directly connected to the perception/reality evidence gap. However, it is relevant to note that the global platform space so far has few European-based platforms. New platforms are emerging everywhere, and certainly some global platforms have originated in Europe, (e.g, Skyscanner and BlaBlaCar). However, most have originated in the U.S. and Asia. For example, Evans and

Gawers (2016) report that, in their study of the rise of the platform enterprise, only 27 out of the total 176 platforms studied (i.e., 15 percent) were European, accounting for just over 4 percent of market value. The study categorizes online platforms in transaction, innovation, investment and integrated platforms. Europe is underrepresented in the two categories that attract the most value – namely, “integrated platforms” (no European platforms) and “innovation platforms” (one European platform).

ECONOMIC AND COMMERCIAL CONSTRAINTS FACING PLATFORMS

In the simplest sense, platforms provide broad economic benefits because they can connect large numbers of potential sellers, no matter how small, with large numbers of potential buyers at a low cost. This can change “local” markets into “regional,” “national” and even “global” markets.

For example, a mobile application store potentially gives app developers in one country access to a very large market of potential users across national borders. Similarly, a “ride-hailing” platform gives individual drivers access to more potential passengers across a region, while passengers have access to more potential drivers. A “food delivery” platform gives individual restaurants access to more potential eaters across a region, rather than being restricted to just local customers.

It is clear from basic economics that platforms improve overall social welfare by making markets more “inclusive.” That is, usually selling and buying opportunities are truncated by such factors as distance and borders. That’s especially true for small businesses. Platforms

tend to shift both the supply and demand curves to the right, and increase the amount of economic activity and social welfare.

This can be seen very clearly for any particular platform. Consider, again, the food delivery platform. From the perspective of the restaurants, each establishment gets access to more potential customers than before. This allows restaurants with a better quality-price tradeoff to expand their sales. Indeed, some restaurants may specialize in sales outside their local area. On the other side, customers have access to more choices. Moreover, their local restaurant may be forced to improve in order to compete, thus even increasing their local choices. Customers may eat out more locally or order from new restaurants, thus creating more jobs.

From this perspective, we have new direct evidence on the employment benefits of ecommerce platforms in the United States. On the one hand, from the second quarter of 2015 to the second quarter of 2017, ecommerce created roughly 240,000 new jobs in electronic shopping companies and fulfillment centers, spread around the country. That’s far greater than the roughly 120,000 jobs lost in brick-and-mortar retail over the same stretch. Moreover, the ecommerce fulfillment center jobs pay about 30 percent more than brick-and-mortar jobs.¹²

But, maintaining a platform poses economic and commercial challenges. The first issue is scale, in a surprising way. As the number of buyers and sellers on the platform increases, the network effect sends the number of potential transactions soaring.

How Fast Can Transaction Costs Rise?

If not kept under control, transactions costs on a platform can rise very quickly. For example, if we assume that all buyers have access to all sellers, then the

Number of potential transactions = number of buyers x number of sellers

Consequently, if you double the number of buyers on a platform, and double the number of sellers, the number of potential commercial transactions goes up by a factor of 4. If we increase the number of buyers and sellers on the platform by a factor of 10, then the number of potential commercial transactions that need to be monitored goes up by 100 times.

As the number of business users on leading platforms goes up into the millions, so do the pressures on platforms to control transaction-related costs.

This rapid increase in the number of potential transactions drives platform benefits. Bigger scale means more sales.

But, as the number of potential transactions rises, so do, potentially, the essential transaction-related costs such as monitoring for fraud, keeping track of gaming of search and ranking, responding to complaints, and providing individual business support (see box). Each of these is potentially quite expensive, on a transaction basis. Fraud, for example, takes many different forms – payment fraud, click fraud, misleading or false reviews, malware. Each of these has to be monitored and dealt with.

Platforms have to do a delicate balancing act. They have to keep these transaction-related costs under control, because they can rise very rapidly as the platforms expand. On the other hand, if the platform skimps on transaction-related costs, it risks losing the trust of its business users. User trust is very important: If business users don't feel like they are getting a fair shake, they can move to competing platforms, set up their own websites, or shift to other sales channels.

Platforms have to treat their business users fairly. A company that loses the trust of its business users can find its business base eroding very fast. For example, app developers who lose trust in a particular mobile application store can prioritize their efforts and develop apps first for competing app stores. Drivers who feel they are being treated badly by one ride-hailing platform can choose to drive for alternative companies. And ecommerce sellers typically are selling through multiple channels, and they can choose to take all or part of their business elsewhere.

This threat of "exit" is very real. Market share and selling patterns can shift remarkably quickly. Consider the case of Etsy, the New York-based ecommerce platform that calls itself the "global marketplace for unique and creative goods."¹³ Etsy describes itself this way:

Our mission is to Keep Commerce Human.

Etsy is a very successful platform, with 1.9 million sellers. However, in recent years, Etsy lost the trust of a key group of its sellers. These were the makers of handmade goods who were upset that Etsy was unfairly allowing the sale of mass-produced items at a much lower price.¹⁴

The result of this lost trust? Sellers began setting up their own websites and going to alternative platforms.¹⁵ The CEO was replaced, and Etsy put in new policies to regain trust with its sellers.¹⁶ A renewed focus on “trust and reliability” helped revenue growth accelerate in late 2017 with revenues up by a strong 21% for the full year.

This feedback mechanism, and other similar cases, operated without any need for government regulation. This is the hidden truth of platform economics: When business user trust is broken, it's like trying to cross the ocean in a leaky boat. Things look good on the surface, but the boat will sink unless it's patched quickly.

As a result, successful platforms have a strong incentive to simultaneously control transaction-related costs while retaining business user trust. That doesn't mean they get the balancing

right all the time, but there's a powerful market feedback mechanism in place to ensure that they try.

PERCEPTIONS OF UNFAIR PRACTICES AND THE REALITY ABOUT ONLINE PLATFORMS' BUSINESS MODELS

The analysis of the previous section provides the framework for our discussion of perceived "unfair practices." Recall that the European Commission's fact-finding process, and the resulting OPE study, identified six main areas of concern, or reports of perceived "unfair practices." We will see that each of these perceptions of unfairness arises out of not fully understanding the balancing act between controlling transaction-related costs and maintaining user trust. We will then examine the proposed remedies in light of these perceptions and realities.

PERCEPTION 1

Platforms abuse their power by setting uniform “Terms and conditions” of participation.

Reality

The complaint is that platforms are “unilaterally dictating” terms and conditions. However, allowing individual negotiation of terms and conditions would drive up transaction-related costs, raising the price that platforms would have to charge. At the same time, individual negotiation would likely erode user trust of especially for small business users who would be worried about being taken advantage of.

Proposed Regulation

Terms and conditions should be clear and unambiguous. Changes should require 15 days notice.

Some business users surveyed in the OPE study felt that the inability for individual users to negotiate terms and conditions – leaving them with a “take it or leave it” attitude from the platforms – was unfair. However, key benefits of digital platforms include precisely the economies of scale that come from standardization, and the large absolute scale with, in some cases, millions of users. The nature of such online platforms with up to millions of users in many different geographic locations – providing the desired scale and coverage users get from being on a platform – means individually negotiable terms and conditions are generally not feasible or realistic.

To put it a different way, if “terms and conditions” were to be open to negotiation, that would have to apply to all business participants in order to be fair. Millions of individual negotiations would greatly increase transaction-related costs.

At the same time, allowing “terms and conditions” to be negotiated by each business user would likely erode user trust – not increase it. In a two-sided market where the digital platform is serving as an intermediary between buyers and sellers, buyers on platforms want standardization when they deal with sellers. Individualized terms and conditions would weigh against that. Second, individualized terms and conditions are likely to favor larger users with greater legal and other resources than smaller users.

For that reason, it makes sense that the proposed regulation does not require individualized terms and conditions. It does, however, require 15 days notice, which responds to user complaints about the frequency of changes to the terms and conditions, and the lack of time to adequately respond to them. For example, follow-up, and more in-depth, interviews the OPE study conducted with business user respondents

found that *“Business users of online platforms for ecommerce (trade in goods) experience frequent (i.e, several times a year) and sudden changes to the terms and conditions (T&C) of use. While business users do get notified of the projected changes by email or messages, in most cases, there is not enough time provided to comprehend what exactly is going to be changed and to react to it. In some cases, the time of the notice is enough to react to slight changes, but not to big issues.”*

Nonetheless, according to the OPE report, platforms are aware of this complaint and trying to find the right balance between controlling transaction costs and maintaining user trust. “E-commerce platforms are aware of the

difference in capacity that different business users can dedicate to examining changes to T&C. Therefore, whenever changes to T&C are planned, many platforms try to communicate them to their business users and notify them in advance. For example, one major e-commerce platform sends out emails and messages to the business users in advance and follows up with a reminder before the changes actually take place.” Other platforms offer users a grace period between the time when the changes in T&C are announced and when they are enforced. Either the 15 day notice imposed by the proposed regulation or a comparable grace period would be sufficient.

PERCEPTION 2

Platforms treat business participants unfairly by not revealing the details of their search or ranking methodologies.

Reality

The problem is that giving out more information on the search and ranking methodologies has an ambiguous impact on user trust, while potentially increasing transaction-related costs. Yes, more information helps business users present themselves, but it also gives an advantage to opportunistic sellers who manipulate the rankings. That raises transaction-monitoring costs – potentially making the platform less affordable.

Proposed Regulation

Platforms would have to reveal main parameters of their ranking and search algorithms.

Rankings and comparisons of products and services have always been with us. Newspapers have always run reviews of restaurants and films. Specialty organizations, such as Consumer Reports in the United States and Stiftung Warentest in Germany, have for many

years tested and ranked consumer products. The New York Times and Der Spiegel have long published bestseller lists.

In that context, real-time search and ranking done by many platforms is nothing new.

However, the broad issue here is a general perceived lack of transparency: Business users are confused about how platforms' search functions work and what kind of variables feed the algorithms that are used to determine what products are placed where on the ranking or featured products lists. And, of course, they desire more information to achieve a higher ranking.

Some types of businesses seem to have more issues than others. For examples, the OPE study found that *"business users of OTA¹⁷ platforms report more difficulties with search and ranking algorithm than businesses trading online in goods. The ranking on such platforms changes very fast, sometimes in the course of one hour, with no apparent reason, so that businesses have no means to react."*

It would seem to be a simple task for platforms to more clearly specify their search and ranking algorithm. But there are two issues. First, the search algorithm is an important part of the platform's business model and considered intellectual property and a trade secret.

But, more important, increasing visibility into the algorithm has an ambiguous effect on user trust. Making the search or ranking algorithm completely transparent would give the advantage to sellers who are clever enough to "game" the system, rather than those sellers who are best at serving customers. If a business

knows that having precisely 10 good reviews will put their product at the top of the ranking list, then they will focus their attention on getting those 10 reviews, in any way possible – including cheating.

The gaming problem can be seen clearly in the case of book bestseller lists. Generally speaking, "bulk" purchases are not counted as part of the rankings. But clearly it's much easier for a publisher or author to manipulate rankings if they know the precise threshold of what counts as a bulk purchase.

That single-minded focus on gaming the system is not what's best for buyers. Indeed, for a digital platform to be successful, it has to balance out the needs of sellers and the needs of buyers.

At the extreme, making the search and ranking algorithms fully transparent would force more monitoring and investigation of individual transactions to make sure the rankings are not being manipulated to the detriment of buyers. In the end, that is likely to drive up platform costs.

The proposed regulation would provide users with the general parameters of ranking and search algorithms. The question is whether this can be done without requiring platforms to provide the sort of details that would enable the algorithms to be gamed.

PERCEPTION 3

Platforms treat business participants unfairly by sometimes removing their products or services without adequate warning.

Reality

Giving more warning before removing products or services would have an ambiguous impact on user trust, while increasing transaction-related costs. Businesses that are making an honest mistake would benefit, but so would businesses selling fraudulent, illegal, and inappropriate product, services, and content.

Proposed Regulation

The terms and conditions would have to specify the “objective grounds” for suspension or termination decisions. Business participants would need to be informed of the specific facts and reasons for the removal of their products or services, or their suspension or termination.

Here’s the problem: Giving more warning before removing products or services would have an ambiguous impact on user trust, while increasing transaction-related costs.

The OPE study revealed that business users sometimes find the information provided by the platform upon delisting or suspension too limited. The OPE study found that most complaints in this area were related to ecommerce and app store platforms. For example, *“regarding delisting of apps, business users of one major platform characterized the information provided as being too limited. Typically, the notification contains a referral to a section of the terms and conditions (usually on content and privacy), without a more specific description of the violation and no reference to a specific provision in T&C.”*

It’s important here to distinguish between two main, but quite different, scenarios for delisting of products and services. One is the case where a business user does not meet the platform’s minimum standards for functionality, and the other is delisting because of breach of

conditions. In the former case, business users are usually notified by the platform that they will be delisted unless their performance improves.

However, delisting because of breach of conditions is usually with shorter notice. Such breaches include platforms’ legal obligations (e.g., regarding hate speech or the sale of illegal items), intellectual property rights (IPR), or fraud and consumer safety. Some platforms tend to act quickly to start the delisting process when they receive an IPR infringement claim, due to the liability of platforms under the E-commerce Directive. When this happens, business users of that platform worry about the scope for abuse – notably that this may be used as an instrument between competing companies. However, this is not a platform-specific issue, but rather reflects the current state-of-the-art in terms of dealing with intellectual property infringement.

This issue was already raised for Perception 2, but it bears repeating. Too much transparency gives an advantage to sellers who are trying to game the system, with the result of hurting other participants on the platform. The OPE

study reported that, *“platforms indicated the need to reduce the amount of information provided in specific cases, in particular in cases of attempted fraud. Detailed information is withheld not to give developers insight into the detection system, which would allow more sophisticated attempts to circumvent the detection system.”* Fraud can destroy user trust very quickly.

Finding the right balance between algorithmic fraud protection and human intervention is very dynamic, and hard to regulate across the whole range of platforms. A hotel booking platform, which potentially suffers from positive and negative fraudulent reviews, has a very different

set of issues than an ecommerce platform, where a big issue may be non-delivery of goods. Indeed, best practices in this area are more likely to arise from market competition rather than top-down regulation.

The proposed regulation requires platforms to specify the “objective grounds” for suspension or termination decisions in the terms and conditions. Given the fast-moving and dynamic nature of online intermediation services, this likely creates too much room for new and innovative types of fraud or inappropriate behavior – especially when combined with the requirement of 15-day notice of changes.

PERCEPTION 4

Platforms act to give their own products or services an unfair advantage.

Reality

Platforms would lose their users’ trust if they were perceived to unfairly favor their own products and services, and undercut business users.

Proposed Regulation

Platforms would have to include in their terms and conditions a description of any “differentiated treatment” given to their own goods and services.

This perception of unfairness is perhaps the most interesting. Two-sided markets are economically beneficial precisely because they benefit buyers, sellers, and the platform itself. Does allowing platforms to sell their own products and services on the platform increase or reduce economic benefits?

We note first that a successful platform has a strong incentive to attract buyers and sellers to get economies of scale. A platform that loses

the trust of its business users will quickly find itself on a downward spiral.

From this perspective, the OPE study mentions only two cases of where business users mentioned during interviews that they thought a platform used its platform ownership to gain an advantage over business users.

What about app store platforms? According to business users, the favoring is not done by altering search and ranking results, but by such

indirect means as featuring a platform's own apps in a promoted or featured list. However, the report noted that:

No specific cases of a platform being in competition with business users and using its platform ownership to gain an advantage over business users were mentioned during the interviews with business users of app platforms.¹⁸

Second, platforms want their business users to be successful. For this reason, some platforms go out of their way to offer business participants the same capabilities as the platform's own products. One example is Amazon, which gives third-party sellers access to Amazon's advanced logistics and fulfillment systems.¹⁹ This access is very important: As we have written elsewhere (Mandel 2017b), the ability of ecommerce fulfillment centers to sort and deliver small batches of goods has the potential to create a large number of jobs and help revive manufacturing. App storeowners such as Apple and Google regularly list apps that compete with their own products.

Third, platforms want their buyers to value their use of the platform. That means giving them the best products and/or services possible, whether they come from the platform operator or from other business users.

Finally, internal competition on the platform is potentially a very important force for raising living standards and boosting productivity. Recent research from the OECD has focused attention on the importance of knowledge diffusion from "frontier firms" to other businesses. (Andrews et al, 2016). To the extent that platforms are run by "frontier firms," their participation as active sellers can help stimulate that knowledge transfer.

The regulation strikes a middle ground by requiring the platform to announce if they are giving their own goods and services "differentiated" treatment, but not banning it. The question is how detailed the description needs to be.

PERCEPTION 5

Platforms deny businesses data on their own customers and transactions to get an unfair advantage.

Reality

Providing businesses with more data on customers has an ambiguous effect on user trust. Moreover, some of platforms' refusal to share data is the result of existing EU regulations to protect consumers and business users under privacy, competition or other regulations.

Proposed Regulation

Terms and conditions should describe the access of business users to data provided by business users or consumers.

Platforms obviously have access to some data about their business users and customers – platforms couldn't function without it. Platforms provide business users with the information they consider is necessary for business users to make sure transactions can take place. Such information can include addresses required for delivery of products, or payment information required for reservations.

Business users may complain that the inability to access certain kinds of data impedes their capacity to analyze trends and the market they operate in; improve their business model, strategy and performance; and to increase satisfaction delivered to customers.

However, maintaining user trust requires that this information, and other information on transactions, be strictly compartmentalized. Business users are less likely to participate in a platform if they fear that data on their transactions is being provided to potential competitors.

Platforms may choose to share information about the performance of the business user itself, like its turnover realized on the platform, but not about that of other business users.

In some cases, data transfer may be restricted to comply with government regulations. For example, data that would reveal information about pricing strategies adopted by different business users could be in violation of competition regulations.

But, even in the absence of government regulations, user trust requires drawing boundaries around the provision of data. The broader question is, then: what type of data should be provided and what type should be controlled? It is important to bear in mind that the group of business users most platforms engage with is very heterogeneous and ranges from one-person users/companies that may have little understanding of legal issues or platform business models, to very large companies with legal and business analytics departments fully resourced to exploit information to the maximum.

So what's important is that the boundaries around data be applicable to everyone. For example, the interviews discussed in the OPE study report that, in the case of ecommerce platforms, for example, *"The main wish from business users in ecommerce is to obtain access to email addresses of clients so they can communicate directly with them."* This seems innocuous in the case of a small business that wants to deepen its relationship with its customers. But the same rule applied to a very large company with many customers turns the platform into simply a massive email-harvesting operation. That's not an acceptable outcome.

Once again, the proposed regulation opts for a middle ground by mandating transparency, but not creating extra requirements for provision of data. In the end, competition between platforms will mandate the provision of data.

PERCEPTION 6

Business users of platforms don't have good ways to register their complaints and problems and get redress.

Reality

Platforms that don't provide effective redress procedures risk losing user trust. However, many of the complaints about redress procedures really reflect other misperceptions about the economic and commercial environment platforms face.

Proposed Regulation

Platforms must have an effective internal redress system, which mandates appeals to an outside mediator if requested by the user.

Setting up an effective yet efficient complaint and redress system is not easy. On the one hand, business users will look for other channels if they feel their concerns are not being heard. This is the need to maintain user trust.

On the other hand, the number of complaints will typically rise with the number of transactions, even if the odds of any particular transaction – generating a complaint are very low. As noted in Section 3, the number of transactions grow faster than the number of buyers and sellers because of the network effect. Thus, the scope and cost of the redress procedures potentially grows very fast as well – even if the platform is relatively complaint free.

To deal with this issue of transaction-related costs, platforms have attempted to automate the initial stages of complaint response. In some cases, these redress and appeal mechanisms – even if they operate well in a technical sense – may be unsatisfying and frustrating to users if they can be accessed only via email, without the possibility of a direct human contact and a named responsible case handler.

It is reasonable to note that the handling of complaints has improved over time. Automation has improved, and digital platforms have been hiring more workers to deal with complaints. Indeed, many digital platform companies have been experiencing rapid job growth precisely for this reason.

Finally, strengthening of redress procedures for business users on platforms could make it harder to protect against new types of fraud and malfeasance. Once again, this could undercut user trust.

The question is whether mediation, as provided for in the proposed regulation, is the most effective avenue for redress. On the one hand, it provides an alternative to the court system. On the other hand, developing an effective and knowledgeable set of mediators will be expensive and take time. Moreover, mandatory mediation has the potential to drag out the resolution process – especially in the case of users accused of committing fraud. It may be that improved redress procedures lessen the need for mediators.

CONCLUSIONS

Participation in digital platforms provides enormous benefits for European business users. However, given the newness of digital platforms, their economic and commercial constraints have not yet been clearly understood. In particular, some of their policies have been perceived as being potentially unfair to European business users.

In this paper we directly address those perceptions, of unfairness – putting them in a broader context of the need to maintain user trust and control transaction-related costs. We show how these perceptions in some cases, correctly identify platform behavior, but misunderstand the reasoning behind the behavior. Other perceptions misunderstand the economic incentives of platforms. In particular, the perceptions of business users often don't account for the competitive and reputation reality facing the platforms. It makes no business sense for platforms to act in a way to reduce user trust and drive away business users, since businesses can easily belong to multiple platform ecosystems and shift between them.

To put it another way, some practices perceived to be unfair are a direct result of the very nature of platform businesses and business models, which is what makes them attractive to users in the first place (for example, for most platforms network effects are very important, meaning that the more users there are on a platform, the better it is for each user. As a result, some platforms have millions of users, which, in turn, means that individual negotiations of terms and conditions, for example, is not possible).

Given this analysis, what is the role of government intervention in reducing perceptions of unfairness? The analysis in this paper shows

that, in many cases, potential government interventions might have the opposite effect intended. For example, releasing more detailed information about search and ranking criteria might increase the effort devoted to gaming the system rather than providing products and services customers want. User trust could fall rather than rise.

The other issue is the impact of government intervention on innovation and entry of new platforms. We have noted that platforms continually need to balance out user trust and transaction-related costs. New platforms – say, in the healthcare or manufacturing areas – will have to find that balance as well. If government rules impose new requirements on platforms, it may be difficult for innovative models to get traction. The implication is that the barriers to entry for new and innovative platforms may be increased, so there would be less competition in the future rather than more.

For that reason, the proposed regulation has taken a pragmatic approach to regulating platforms. There are some potential problems – notably the demand that platforms specify their “objective” reasons for suspending or terminating users. Given the fast-moving and dynamic nature of online intermediation services, this likely creates too much room for new and innovative types of fraud or inappropriate behavior, especially when combined with the requirement of 15-day notice of changes.

Nevertheless, rather than opting for detailed rules, in most cases, the proposed regulation relies heavily on transparency that can cover a wide variety of situations. That's important, given the heterogeneity in the types of platforms

and their business models, and in the context of very rapid technological change, which means existing platforms rapidly evolve and new ones regularly emerge. In addition, in the absence of clarity on legislative targets, or a legally exclusive definition of online platforms, any regulation could potentially blindly impact all types of platforms and the entire online ecosystem. As the potential areas of intervention might seek to include obligations for fundamental elements of platform business models, this could create a huge burden and likely negative direct or indirect side effects (e.g., platforms choosing not to serve business users in certain geographic areas or market segments to avoid new legislation, which, in turn, would have negative impacts on European business users). It may also introduce more rigidity, which will make it more difficult for platforms, a highly dynamic market, to continue adapting to consumer needs. It would also hamper the European Commission's objective to stimulate and grow the digital economy and create positive externalities from the creation of a Digital Single Market.

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- 4 https://ec.europa.eu/commission/priorities/digital-single-market_en
- 5 The Commission argues that platforms drive innovation, facilitate social interactions, and are powerful engines of growth. Important impacts from digital technologies occur when they reduce market frictions, trade and information costs; open up markets (providing companies access to a much larger market than when only trading "physically" and locally); and create new markets (see, for example, World Bank, 2016).
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