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The Dangers of Platform Monopolies

Predatory business development practices could cause risks for the platform ecosystem.

Platform businesses, such as Amazon, Google and Facebook, have come to dominate their respective markets. They have generated massive network effects by facilitating exchanges with technology. As these platforms get more popular, their user value increases, leading to a virtuous cycle where the entire market coalesces around them.

Their success has benefited consumers, with both low prices and access to more data-driven services. But this has also resulted in winner-take-all dynamics, making them powerful monopolies and preventing new entrants from coming in and attracting the market away from the dominant platforms.

While users have come to coalesce around these platforms because their needs are being well-served, their powerful network effects risk guaranteeing their winner-take-all position. In their initial days, these platforms rapidly gained user acceptance by providing value to them. Their benevolence is increasingly looking like dominance. While they have enabled interactions and opened up markets, increasing efficiency for customers and vendors alike, they are attracting scrutiny. Data has become currency and they have a monopoly on it.

Predator platforms

This has led to predatory business practices in the form of terms and conditions that platforms impose on the ecosystem. As platforms gain dominance, they often demand "preferred customer" clauses from their ecosystem partners. This essentially means that the partner must offer to the platform the best possible terms and prices it gives anyone. Amazon, for example, may require some of its sellers to provide it with the best prices that they bestow on any online channel. As the share of commerce originating from the dominant platform increases, ecosystem partners are more likely to work with such a clause. This poses a range of problems.

First, when a platform starts to dominate the market, it can raise the fees it charges sellers. A dominant platform can do so without the fear of destroying the network effect. An up-and-coming platform is less likely to do so. Sellers aren't left with much choice in such cases. They can try shifting their business to an alternate platform by offering even lower prices. But because of the "preferred customer" clause, it is an extremely difficult decision that strengthens the dominant platform's winner-take-all position. If sellers have to pay for access to the market, they may also be forced to contend with higher fees levied by the platform.

Platforms often bait and switch in this manner. They attract the ecosystem with lower fees and deeper incentives when network effects are low. As the ecosystem builds around the platform, network effects increase and the platform starts moving towards winner-take-all. The dominant platform can work against the interests of its partners without fear of destroying the network effect.

Taking out the competition

New entrants face near insurmountable hurdles in such an ecosystem. Consider a new platform that launches and wants to attract partners by offering them better economic terms than the dominant platform. These could involve lower selling fees or other subsidies like free promotions. These terms, in turn, may encourage sellers to reduce prices on the new platform. In such a case, the dominant platform can once again leverage the preferred customer clause and force sellers to offer the same lower prices. However, it is under no obligation to give sellers the better economics they enjoy on the new platform. As a result, sellers are hesitant to join the new platform because any price reduction on it, when mirrored on the dominant platform, would translate to lower margins for them. Thus sellers go on with the dominant platform and the new platform never takes off.

As we learn from the above scenarios, a dominant platform may achieve winner-take-all market share by serving the ecosystem well, but it often holds on to this advantage despite working against the interests of the ecosystem. It achieves this purely through negotiating favourable contracts. As dominant platforms continue to thrive, their monopoly is reinforced through these predatory contracts. While sellers feel squeezed, consumers may continue to benefit from better prices. This wards off scrutiny by regulators who are often looking for predatory pricing on the consumer side as evidence of antitrust practices. This is the dark side of winner-take-all platforms.

The much loved upstart that gains network effects by managing incentives across the ecosystem loses its benevolent streak as its power increases. This may take many different forms. Amazon, for example, often uses its platform's data to determine which product lines to get into; eventually it outperforms the merchants who were doing well with those products. Twitter, likewise, has repeatedly changed policies to work against the ecosystem. A recent example saw Twitter pushing live streaming service Meerkat off the platform after acquiring its competitor, Periscope.

It is natural for companies threatened by the behaviour of platforms to fight back by seizing on evidence that the new models cause economic harm. As we move towards the platform economy, regulators will have to look beyond consumer pricing to ensure power balance and regulate monopolists. For platforms, it will be important to remain transparent and aim to keep favourable conditions in place for both sides of the market to be sustainable.

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