Digital jungles, where foul-play is easy to mask

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Modern digital businesses have created immense welfare for the consumers. Alas, they have also given significant headache to regulators.

Regulatory bodies in countries around the world are on the lookout for the infringements on fair competition. If competition in any of the industries under their jurisdiction is unfair (according to their judgment), they have the power to mandate restoring fair practices with several strong means (including hefty fines and company breakups).

The current wave of digital transformation has created a new reality. The competitive advantage in today's business is based on the mastery of a small (and diminishing) set of practices (e.g. social, mobile, data, cloud, IoT and few others). Injection of these practices in standard industries gives birth to new leaders.

Being a leader in any of those practices gives sizable advantage to a given company over competitors in large number of industries. As a consequence, few big companies have entered and come to dominate large spectrum of industries. In multiple cases this trend has gone further than anyone could imagine just few years ago. As an example, consider that Apple now competes with Swiss luxury watchmakers.

This practice has resulted into GAFA (the leaders in the field: Google, Apple, Facebook, Amazon) and few other companies having large product ecosystems of (not necessarily inter-related) products. The take off of complex, integrated, connected products (like smartphones and smartwatches) has accelerated this trend.

This has given regulators a substantial work. Multiple business lines within a company give the opportunity of cross-subsidization. This is the practice where a company uses its dominant position on one market to gain the competitive advantage in another market. This is an unfair practice. Famous cases brought against Microsoft in the US and in Europe are such examples from the realm of digital business.

This practice is particularly hard to detect and prosecute when companies operate large ecosystems. Ecosystem operators have opportunities to bundle products and services together. However, if those bundled products are from different markets, the practice might be illegal. When bundled products command comparable market shares on respective markets, the practice cannot be called cross-subsidization. However, when the leader on one market is bundled with the laggard in another market, and the power of the market leader is used to promote the laggard – the practice becomes illegal.

Google, the champion of digital businesses, has experimented with similar behavior. It has attempted to popularize its troubled social network business (Google+) with the help of the popularity of its video business (YouTube) – it has obliged customers to merge their corresponding accounts. As a result, if one wants to comment on a YouTube video, she has to create a Google+ account even if she is happy with just Facebook.

This practice has gone unnoticed by competition authorities. However, after long preparations, and heated discussions in separate EU states, on April 15, EU has announced that it has sent an official statement of objections to Google referring to unfair practices in several lines of business.

Google, of course, maintains that it has not violated any anti-trust laws in EU (or elsewhere). In their two statements in response to the European commission (statement 1, statement 2), Google argues that their practices have created large benefits to consumers and points to the “Thriving competition online”.

However, given the company’s business model, it has incentives and (ample) opportunities to engage into borderline or anti-trust violating actions. This is why competition authorities have to continue closely monitoring digital ecosystem operators.

Let’s discuss incentives first. The matter is quite simple here – any company has an incentive to increase its profits. The only thing preventing them from violating the laws is business ethics (besides the fear of sanctions, of course).

In this respect Google says it is an ethical company. It just wants to catalog the world data, and not to be evil. However, Marissa Mayer, then VP of the company, stated openly in 2007 that “[Google] has monetary incentive drive people to pages with adds on them”. In other words – to rig their search algorithm. This was when Google’s business had only one leg – advertising. Now that the company has grown many more legs, other businesses might be using the same tactics undetected. Even though Mayer left Google (and leads Yahoo now), there are no signs that something has fundamentally changed in Google in this respect.

In order to comprehend the opportunities that Google has for anti-trust violations look at the role it plays in today’s economy. Google runs the universal information aggregation tool. As a result it provides information on which companies the economy trusts. Coming up at the top of search result list is supposed to mean that **the company is the best** *(i.e.* the most popular).

However, instead it rather means that **the company will be the best**. Much depends on the actual algorithm used by Google in rankings. This is a unique, and very large power.

Google’s rankings are based on the PageRank algorithm, which lies in the public knowledge domain. However, the actually algorithm used contains a “secret sauce” which constitutes Google’s business secret.

This is where people (and authorities) have problems with Google. Without knowing the algorithm it is impossible to detect whether Google ranks pages fairly (what it’s supposed to do) or gives an unfair advantage to its own products (e.g. maps, YouTube, and a number of other services that it provides by now).

European officials have demanded Google make the actual algorithm public. Not surprisingly, Google does not want to do this. It maintains competition is fair and giving out the “secret sauce” will give its competitors an unfair advantage (getting hands on “secret sauce” without sharing the development costs). Google claims that its consumers will switch to alternative services, as competitors will be able to deliver the same quality.

But if the competitor had the same quality service, why would anybody switch away from Google?

Establishing itself as the leader in ethical practices will help the company not only to keep current consumer base, but also to increase the chances to attracting new generations of consumers. It’s hard to beat the combination of quality, network effects and ethical behavior.

Ultimately, it might be more beneficial to position as an ethical company instead of spending resources on further masking already questionable actions. After all, regulators’ and competition authorities’ toolbox will (with some lag) adjust to the new, digital reality.