Examining Startup Investors' Thoughts On Big Tech's Power

By **Jennifer Oliver** (May 1, 2020)


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On Feb. 12, the U.S. Department of Justice's Antitrust Division held its first Public Workshop on Venture Capital and Antitrust at Stanford University's Paul Brest Hall.

The DOJ hoped to learn from the VC community about the future of disruptive innovation, whether current firms' dominance is so great that they can restrict competition and access to essential inputs, and how the VC community evaluates the strategic value of a transaction that might inform the DOJ about whether a transaction is premised on creating value for consumers versus preventing competition.

This article highlights the key takeaways from this discussion, exploring how innovation and competition in the startup tech sector is likely to evolve. If nothing else, the discussion made clear that a broad range of behavior in Silicon Valley, and elsewhere, may be stifling innovation and is making it difficult for startups to thrive. This ultimately harms consumers as well.

The Panels

Kill Zones

The first panel at the venture capital roundtable included a robust discussion of "kill zones" — areas and industries in which acquirors are scooping up innovative startups to eliminate potential competitors. At least some panelists agreed that this is an issue: "I do think there are kill zones," said panelist Paul Arnold, founder and partner at Switch Ventures. "[Companies that thrive by amassing personal data] don't want you aggressively limiting their extremely valuable information collection."

Ram Shriram, managing partner of Sherpalo Ventures LLC, noted that the venture market was alive and well. "I think the vibrancy and the health of the VC business is better than it's ever been before, and that's because there's lots of companies buying. So, the idea that companies that were really small couldn't go public anymore is a good thing."

Susan Woodward, founder of Sand Hill Econometrics, noted that the state of VC funding in February was healthy: "We've only had really three dips. One was the colossal dip after the dot-com recession, and then another dip after the Great Recession, and then the 2016 dip I'd like to call the 'World Anxieties dip,' Brexit and other phenomena."

Panelists also noted that the long-standing consumer welfare standard in antitrust may not be properly measuring the anti-competitive effects of large platforms. As Roger McNamee, co-founder and managing director of Elevation Partners, pointed out, if we view the actions of internet platforms providing a service in exchange for data as a barter of services for data, rather than a free service, then the consumer welfare test for price increases is easily met — and has been for years.

Shriram focused on improvements made in big tech, citing ad rates down 30% and improved ad quality and advocated for a different measure of dominance in tech firms: "[T]he market share test is not the only test one should use in determining dominance in a market because you should use who collects the majority of the profits in the market as a more important test."

She also argued that the abundance of startup activity coming out of dominant players is a sign of healthy competition."[T]he next new winner [] could potentially take out one of these big companies and that, I suspect, will happen in the next 10 years."

Arnold advocated data portability as a way to keep dominant firms accountable as well. "[W]here you can force openness with certain datasets or you force portability of a data from one company to a competitor. … It brings competition in there and forces the owners of these modes to actually be responsive in … a market competitive way and brings a net surplus," he said.

Monetizing Data

In the second panel participants explored dominant firms' use of data and the value of data to incipient competitors. In 2017 the Economist published an article titled "The World's Most Valuable Resource Is No Longer Oil, but Data." As Susan Athey, director of Golub Capital Social argued, unlike raw materials data may be used more than once. And data is not necessarily interchangeable or as useful to one party as the next. It might be complementary, and it might be useful depending on the context. Data is also perishable; it goes out of date, sometimes quickly.

Next panelists considered: What are the consequences of one party having superior data? Can it use that information to target some customers and avoid others?

"We see this in high-frequency trading or in the insider trading rules," Athey said. In the ad exchange markets the ad seller, e.g., Google, gets to peek under the hood of the advertising strategy and targeting of its competitors. One firm is able to skim the cream. "The combination of data and access to a user base, that's what's really powerful." Athey said.

Advertising is the key issue in the antitrust analysis of big tech, because most dominant tech companies make the majority of their profits on ads. As Ari Paparo, co-founder and CEO of Beeswax, pointed out, Google knows when a consumer downloads an app on their Android because it owns the Google Play app store. Google can then target that consumer with knowledge of their interests. That is valuable "first-party data." Only Google has it, and others cannot freely mine the same data from public sources.

Panelists also explored how that affects competition in tech markets. "[W]hat we've seen is that products start out being interoperable, data flows across, tools allow lots of different players to come.You can bring your own data. You can bring your own analytics. But then, over time," Athey said, "they close up and become not interoperable."

Athey suggested that "putting conditions on mergers to make sure that interoperability remains is another type of tool that could potentially alleviate some of the conflicts that arise when you go from separate firms to combined firms."

Investing in Platform-Dominated Markets

Finally, the conversation turned to investing in platforms. "From an investment perspective, nirvana is the emerging large market with no competition," said Patricia Nakache, general partner at Trinity Ventures. Investors would much rather pursue a market "that has tailwinds behind it as opposed to a market that has matured, and that has deep, entrenched incumbents." Ad-tech is one of the markets that have been a "bit of a wasteland" from the VC perspective, it has been difficult to attract capital.

But as Nick Grossman, a partner at Union Square Ventures pointed out, venture capitalists must also ask how much room there is in the market to maneuver and innovate; platforms offer a place for startups to reach scale and shine, but there is also an inherent risk in investing in platform-reliant tech.

Mark Lemley, a professor at Stanford Law School and partner at Durie Tangri LLP advocated for a combination of more stringent merger control coupled with an easing of restrictions on IPOs to make it more realistic for startups to compete. "We've made … exit to glory harder," he said, "that's driving more of the market into the acquisition space. … [and] that's why I think you need a combination of carrots and sticks."

Regulating mergers should be "coupled with ways to make sure that we are in fact encouraging innovation in this space. That can be easing some of the restrictions on IPOs, making IPOs easier," he said.

Ben Thompson, founder of Stratechery, argued that the acquisitive nature of the tech space serves to increase competition by making it easier for engineers and innovators to do what they do best, without having to worry about how to scale the technology. "There is much more license to do a pure tech startup in a world of acquisitions. You don't need to worry about having a business plan… or a go-to-market and actually building a company. You can literally go out and build super-cool tech knowing that they're going to be fighting over you, and you'll get acquired," he said.

What Does This All Mean for Competition Policy?

The tensions between consumer welfare, pricing, large business interests and competition were apparent throughout. Kill zones are certainly a real threat, and they are especially prevalent in areas that challenge the business models of entrenched competitors.

Consider, for example, a nascent technology company that enables users to better control or export the personal data held on platforms like Google or Facebook. It is in a dominant firm's best interest to acquire that technology early on; not to nurture it, but to kill it. Does the acquired company mind? Maybe not, if they are compensated enough. Does it affect price, the traditional measure of consumer welfare? No. But are consumers better off? Certainly not.

And while perhaps venture capital funding mitigates the risk that dominant players will acquire and kill disruptive startups, since the advent of the global COVID-19 crisis Feb. 12 seems like a much simpler time. Whether we will see another dip like those Shriram discussed remains to be seen, but feels inevitable.If so, we may also see even more "killer" acquisitions of nascent companies with insufficient venture funding by cash-rich giants in the coming year or years.

Shriram's alternative measure of market share using profit share is a good suggestion to help enforcers combat this trend, though neither metric should be exclusive. Regardless of market definition, courts and enforcers need to be significantly more aggressive in looking at incipient anti-competitive effects in developing tech-related markets.

Degradation in quality is another good way to measure market power in this context. For example, when Facebook was founded it competed with entrenched competitors, e.g., MySpace, on the promise of privacy. We all know that privacy has degraded over time, yet Facebook's market share has not. Data portability, which is becoming a hallmark of many emerging and proposed privacy regimes, is one way to check dominant firms' use of that power and is sure to be welcomed by nascent tech competitors.

A large volume of startup activity is encouraging as well, but despite panelists' optimism these startups are unlikely to present real challenge to entrenched players in the near future. Considering the acquisitive nature of dominant platforms and a stagnation in the number of IPOs in recent years, will any startup ever have the wealth of data to reach that scale or even want to?

The "data and oil" comparison has become cliché among experts in the intersection of antitrust and privacy, but is it accurate? There are certainly similarities: The world's most valuable companies need data to run, and they mine it like industrialists once mined oil. And like oil, data must be properly refined to be useful; jumbled data has little value.

But there are key differences between oil and data: Data is infinite, becomes stale quickly, and has different value to different parties. So even if a better and more moderate answer is forcing dominant players to license or share their essential input, data, that too may be insufficient.

Perhaps then the behemoths must be broken up, as we heard several presidential candidates argue this year. Of course, breaking up powerful tech firms will be difficult, and mandating that nascent firms have fair, reasonable and nondiscriminatory access to standardized technology is a more attainable goal. But proponents of that solution seem to ignore that mandating fair, reasonable and nondiscriminatory access to standardized technology is a behavioral remedy; it will require constant monitoring.

Though difficult, the separation of dominant platform operations from their data mining and ad businesses might prove to be a more competitive solution and better enforcement policy than behavioral remedies or merger conditions. In the age of 5G, the internet of things, and self-driving cars, the crucial importance of interoperability is everywhere.

This leaves us to ask: Other than increased scrutiny at the merger stage, or after the fact structural remedies breaking up the "big boys," how can antitrust address the barriers facing tech startups? Even if imperfect or evolving over time, a plan is needed. Just as hope isn't a business plan, hope is not a viable competition policy or road map for antitrust enforcement.

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