INTERVIEW

Ben Thompson Aggregate demand to take all

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Since 2014, as an independent analyst, Ben Thompson has been writing full-time from Taiwan on big tech firms' strategy for his blog Stratechery (box 1). Thompson presents himself as 'the business world's theoretical physicist', enthralling readers interested in strategy as well as technology executives, venture capitalists and investors. On Stratechery they find the real reason why they've taken that smart strategic decision or why their product is going to fail in the long run.

Thompson, who has an MBA from the Kellogg School of Management and has worked for Apple and Microsoft – he no longer does, his ethics statement is extensive – using his self-developed Aggregation theory as the framework underpinning his analysis. This theory is based on his experience from inside the strategic engine room, and therefore yields valuable new insights, especially when it is about platforms as aggregators.

Upon the completion of the *ESB* dossier on digital platforms, I was able to interview Ben Thompson and ask him about some of the recent moves the big tech firms have made and the regulatory responses to those.

A point of concern in this dossier is whether big tech companies actually face stiff competition. Do they?
"Google, Facebook, Amazon, Microsoft and Apple, each of these companies is very strong on its core business. They are all operating in distinct markets, Apple with their devices, Microsoft with enterprise software in the cloud, Amazon with e-commerce, Google with search, and Facebook with their time-wasting network – when you are bored, you open their apps and you waste time. And that is a great place to advertise because you are kind of open to new things.

Each firm faces very little competition on their core competences. I think all of them are in some respects motivated to go into other industries, so that they can say they're facing competition. Each of these companies is very highly motivated to say that they face intense competition. An image that this is the case helps to avoid regulation of their core business."

Could you briefly explain the theory you've developed?
"Aggregation theory begins with a division of a market into supply, distribution and demand. In the pre-internet era, there were basically two ways to make large profits. The first is by establishing a horizontal monopoly

What is Stratechery?

BOX 1

The blog Stratechery.com – a contraction of *Strategy* and *Technology* – has subscribers from over 85 different countries. Thompson writes extensive free weekly articles, and has a subscriber service for daily updates: 10 dollars a month, or 100 dollars a year.

In Dutch:
esb.nu/20047405

on one of these three parts of the market. The second is to integrate two of the parts – supply and distribution – so that the firm has a competitive advantage in delivering a good to consumers on the demand side. A newspaper publisher owns the newspaper, and can bundle content with advertisements. That's how the publisher makes a profit. Importantly, in those days, the transaction costs were high for the consumer who wanted a broader set of choices.

The internet removed the boundaries to distribution: transaction costs have gone to zero and distribution is basically free. As a distributor, the challenge now is to capture a large group of consumers, or put differently: to create a portal through which consumers search for suppliers. If the platform does that, they have leverage over these suppliers. And they can put an add alongside every connection they facilitate.

Moreover, because of the leverage that the owner of the portal has over suppliers, they can make specific bundles of different supplies for each consumer, based on individual preferences. I refer to that as 'aggregation'. Hence, there is a significant increase in quality for the consumer. The firm that controls most consumers will control the market, and therefore the most important factor determining success is the user experience leading to fierce winner-takes-all effects (Thompson, 2015)."

In which sectors do incumbents have to worry about aggregators?

"In order to know whether a market is susceptible to aggregation, you need to know whether it can be digitized. For that, you need to have an understanding as to what the key linchpin of that industry is. If it can be digitized, there will be massive competition and a tendency towards centralization.

I love the Airbnb example, because it shows that there are surprising parts of your business model that can be digitized. And because it can upset an entire industry. The biggest value hotels had, turned out not to be their amenities, but the consumer's trust that they were reliable and safe places to stay. Airbnb could digitized this trust in private residences, with an eBay-like reputation model. What it meant was that now trust was no longer the controlling factor, but became one of the many priorities, along with the quality of the room and the location. It didn't make hotels obsolete, but it made the things that they were competing on different than before.

I've also spent a lot of time writing about publishers. Putting a newspaper on the internet is relatively easy, and therefore the power and implication of aggregation theory is much higher in that sector than in almost any other industry. In the case of publishing, the real value of publishers came from their control of distribution. They could physically put the newspaper or magazine or book in front of the consumer, which made them an attractive place for advertisers that wanted to reach those consumers. When Google and Facebook came in they made the distribution of text free and aggregated the suppliers.

There's infinite choice on the internet: you can read any newspaper you want and you can order anything you want. The power now originates from the place where users go to find something, the place where they start in this world of abundance."

If distribution is so important, why did you start an independent blog?

"In a way, digitization made the business model work. I occupy a space in the middle: in between bloggers and journalists covering the day-to-day news of technology and products on the one hand, and financial analysts on Wall Street talking about the financial statements of these companies on the other hand. Here, there was a niche for articles about why companies make certain promises, how that fits in with a company's business model, the way these companies think about the market and how the strategic decisions play through to the financial results.

The internet opened up an entire market where there are sufficient people out there that are interested in my work, and that will pay directly for it, making it a very viable and attractive sort of career. Occupying that spot in the middle required certain tools and opportunities that the internet made possible."

You emphasize digitization and distribution, yet a company like Amazon expands into physical goods like medicine (PillPack), grocery stores (Amazon Go) and retail (Alexa). Why is that?

"The companies that own huge user bases are the companies where consumers decide to go first. In the case of Amazon, fifty percent of shoppers in the United States start their search on Amazon.com. These companies or brands immediately become massively more valuable when connected to such a platform than they would have been independently, because Amazon – or Google or Facebook – has its entire user base to bring to bear

on them, which adds a huge amount of value to every company, product or generic brand they buy. So it's no longer about the synergies in distribution and production with the other parts of the company, as in a classic merger & acquisition analysis."

What does this mean for suppliers?

"What makes it so powerful is that, when a platform has all the users, suppliers have to come onto that platform on its terms. Suppliers have a very egocentric viewpoint, because they think they're all that matters. But that's not the case anymore. The power has shifted from owning supply to owning demand via a portal, and Google and Facebook now own the users on the demand-side.

Newspapers in Europe have been particularly frustrated with Google, and attempted to get Google to pay for their content. But after it withdrew *Google News* from Spain, newspapers were begging Google to come back two weeks later. That is because Google is not stealing content, Google is delivering them users.

The good news is that this also offers some sort of a view on how to compete. Competing is possible by having highly differentiated content and highly differentiated supply, whether it be an e-commerce product or a publication. Differentiation motivates users to find a supplier outside of Google or Facebook. I don't run ads from Google or Facebook, for example, but I rely on end-users to find me directly and then pay me directly. My revenue per user is much higher than it would be on any sort of ad-supported site."

Are consumers better off?

"Yes. Thanks to the internet, consumers receive much higher quality content in much more narrowly focused niches than previously possible. Traditional newspapers were not writing about the strategy of business and technology. It was a completely underserved market, and the same goes for e-commerce items for example, or Airbnb. Is it bad for consumers that they have a million more options for where to stay? I don't think so.

The fact that publishers, hotels or Consumer Goods companies are complaining isn't necessarily representative of whether it's a good or bad thing for consumers, it merely means that they are struggling because they have built businesses based on the old model of controlling supply and growing distribution.

This comes with a risk. Large companies are more likely to have an outsized influence with regulators. But I don't think their businesses are being hurt by Google or Facebook, their business are being hurt by the internet and the fact that distribution is free."

Do you believe the European Commission was right to fine Google for breaching antitrust rules?

"I had a very difficult time with the European Commission's decision on Google Shopping and find it an example of how the European Commission's approach is flawed. First, Google's product is an advertising product, and I'm very wary of regulators interfering with the company's right to make money. Second, what regulators want from Google is that Google points people searching for shoes to other shopping comparison sites, instead of pointing them to shoes. Somehow they deem it in the consumers' interest to demand Google to make its product worse. I think the European Commission is more focused on competition than on consumers per se.

The European Commission's decision on Android is different. Google's limitations on OEM (operating system), to not even be allowed to make alternative versions of Android, was clearly anti-competitive. On that point, I think Google was wrong. On some of the other points, I do think we need to preserve the right for companies to benefit from their innovations. At the same time, the US approach with a focus on consumer welfare clearly has problems as well, in the sense that nothing actually happens."

You have written that Facebook's acquisition of Instagram was the greatest regulatory failure of the past decade. Why?

"The problem with Facebook acquiring Instagram was that, as a result of the merger, they acquired end-users and they acquired a network. The number one regulatory change that I would make is that a company predicated on network effects should not be allowed to buy another company predicated on network effects, which means that one social network should not be allowed to buy another social network.

We just talked about these companies paying a lot to acquire other companies because they can plug them into their user base, and the value this adds. Advertising is a scale game. Due to the merger, Facebook now owns multiple large user bases – Facebook and Instagram and WhatsApp – and they can build a common advertising product that fits into all of them, giving them huge economies of scale.

If Facebook did not own Instagram right now, the company would be in tremendous trouble, because Instagram would have become a serious threat to Facebook. In other words: the market would still be working if Facebook hadn't been allowed to buy the competing social network.

It's a regulatory failure because, as a result of this acquisition, there is discussion of more heavy-handed regulatory action. Take GDPR for example, which I am very critical of. GDPR makes it extremely difficult to build a challenger to Google and Facebook as the regulation is completely focused on these companies. Now you have a situation where failed regulation in the merger and acquisition process has led to worse data protection regulation – the GDPR – that has made it even less likely for a competitor to emerge on the market."

Do you think they fear antitrust regulation in the Facebookboardroom?

"The obvious remedy is to split up Facebook, Instagram and WhatsApp. But the reality is that it's not clear what harm Facebook is propagating. They aren't harming consumers, because they offer a free service that consumers value highly. Facebook isn't being anti-competitive, because anyone can go to their platform. Publishers just dislike Facebook because it creates infinite competition within the publication space.

To the extent that there is harm, it's probably in the advertising markets, in that there is a decreasing number of places other than Facebook that are desirable for advertising. But at the same time there are an infinite number of other places for advertising on the internet. There's no limitation on supply. Facebook simply makes more money because they're better at targeting.

This gets back to the question why the Instagram acquisition was so problematic, because once the decision to approve the merger is made, it's unclear how to undo it. With Google you can have debates about how they've leveraged search into other areas. With Facebook it's very unclear what exactly they're doing that is illegal."

REFERENCE

Thompson, B. (2015) *Aggregation theory*. Article at stratechery.com.