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Microsoft / Yahoo! Search Business – Substantive issues – Counterfactuals, auctions and two-sided markets

Frederic Depoortere (Skadden, Belgium) · Monday, August 23rd, 2010

In my last post, I focused on a procedural element of the Commission's Microsoft/Yahoo! decision. The decision is also very interesting from a substantive point of view, and shows the Commission's determination to investigate the transaction in some detail, even though on the face of it (as the Phase I clearance subsequently confirmed), it raised no substantive issues.

Almost two years after Google/DoubleClick, the decision offers a relatively detailed discussion of the dynamics governing the fast-growing multi-billion industry of on-line advertising.

The Commission's competitive assessment starts out in the traditional way. First, it defines the markets. Second, it notes that search engines are two-sided platforms, offering services both to advertisers and users, where the demands of the two sides are interdependent, in that the platform becomes more attractive to advertisers when it attracts more users, and it becomes more attractive to users when it is able to display more relevant ads. The decision then concludes that the Parties' combined shares on both sides of the platform (i.e., with advertisers and with users) will remain very limited and do not even result in any affected markets. As a result, the decision concludes that the concentration should not raise doubts about its compatibility with the common market.

However, the decision does not stop there. It goes into a more thorough analysis of the search market, because of its complexity, the fact that the transaction reduces the number of players in the EEA from three to two, the high entry barriers that characterize the business, and the fact that competition takes place mainly in terms of quality and innovation.

Before doing so, the decision analyzes in detail the counterfactual. While the counterfactual is always part of the Commission's analysis, the fact that this was a three-to-two merger probably explains why the decision so explicitly emphasises this element. Basically, the question is asked what would happen absent the transaction, given what the decision describes as Yahoo!'s declining shares, performance and investments in innovation, Microsoft's lack of scale and Google's position as the "entrenched market leader" (note that the decision avoids calling Google "dominant").

The decision then focuses on the following issues.

First, it analyzes the role of scale in search and search advertising in the context of the Parties' argument that they individually do not have the scale to compete effectively with Google, but together they will have the scale to better compete. The Commission does not come to a final

conclusion on this issue.

Second, in terms of effects on advertisers, the Commission finds that the price to advertisers (“cost-per-click”) is unlikely to increase materially as a result of the elimination of competition between Microsoft and Yahoo!, and even if it does, the combined platform will likely lead to a higher return on investment realized by the advertisers due to the improvements in quality of the search platform resulting from the merger.

Third, the Commission investigates the effects of the transaction on users and concludes that it would not negatively affect Yahoo!’s incentives to innovate or the level of relevance of search results and advertising, especially as compared to the counterfactual.

Last, the decision investigates the effects on publishers (third party websites that display search results provided by the Parties), as well as distributors, but finds no harm.

As a conclusion, the decision provides a detailed analysis of the search and search advertising markets, even in a case that, based on the market shares alone, would have qualified for a simplified procedure. It provides a glimpse of the specific economics involved in the on-line search and advertising markets, and more specifically two-sided platforms and auctions.

From a purely theoretical perspective, one could regret that the decision does not really go into auction theory or two-sided markets. While the Commission establishes that advertiser prices are set through auctions and that search platforms are two-sided, it does not really adapt its analysis to the specific economics of these elements and instead relies on its more traditional analysis of market structure and the impact of the transaction on pricing incentives and innovation. On the other hand, a Phase I investigation does have its limits in terms of time and resources and the fact that the Commission is able and willing to perform in Phase I what appears to be a relatively extensive market investigation and a detailed analysis in a complex market is a positive development.

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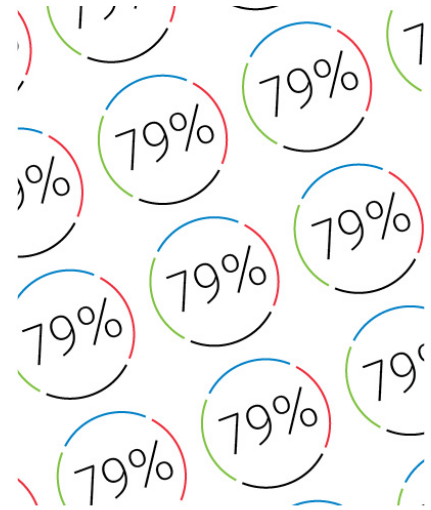
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