COMPETITION

Considerations for the digital economy – Insight from UNCTAD

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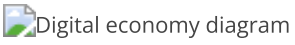
The United Nations Conference on Trade and Development ("**UNCTAD**"), during 2019, considered in detail the implication of the digital economy with regard to developing countries and specifically the ability of the digital economy to create and capture value[1]. Considering the Competition Commissions strategy document – Competition in the Digital Economy, there are definitely pertinent considerations to be noted from UNCTAD.

It is evident that competition policy will have to play a more important role in the context of creating and capturing value, in light of the network effects within the digital economy and the tendency towards market concentration. Therefore, in order to ensure and provide for competitive and contestable markets in the digital era, existing frameworks need to be reconsidered and adapted. At its core, competition law measures harm to consumers in the form of higher prices. However in the digital era, additional considerations are important and cannot be ignored, for example, consumer privacy, personal data protection, consumer choice, market structure, switching costs and lock-in effects. Also, regional or global frameworks must be considered and country specific competition policy cannot function in isolation from the rest of the world.

Digital data and digitalisation can help improve economic and social outcomes, and be a force for innovation and productivity growth. This is due to the fact that the infrastructure provided by platforms can enable more effective transactions, networking and exchange of information that benefit economic growth. From a business perspective, the transformation of all sectors and markets through digitalisation can lead to the production of more and better goods and services. Data and information can also be useful for improving processes and increasing access to markets. Through their use of data, firms can better meet the needs of consumers by offering on-demand goods and services, and customised products.

The digital economy spans the globe. The current state can be depicted as follows –

Figure 1


Digital economy diagram

Source: *(http://www.netzoekonom.de/vortraege/#tab-id-1)*

The study conducted by UNCTAD however points out that in developing countries, at the level of the firm, a growing digital economy does not automatically lead to an expansion of opportunities for local digital firms[2]. As is clear from figure 1 above, the major platforms and data providers shaping local digital economies are owned by large multinational enterprises, or by digital firms operating not within the developing countries as such[3]. UNCTAD points out that in developing countries, digital ecosystems are made up of local start-ups (such as payment providers, logistics or mobile app/service providers), which are all important for localising digital services[4]. While providing more opportunities for skilled work in the digital economy, these firms often end up in uneven relationships with large platform providers, the decisions of which shape the activities, profits and ultimately the direction of growth of the smaller players[5].

Form a consumer perspective, digital platforms allow access to more variety and choice of goods and services at lower costs. They also provide convenience as well as customised or personalised products and services. Consumers may further benefit by getting goods and services quicker due to fewer intermediaries. Moreover, in terms of employment, an expanding digital economy in developing countries can generate new high-skilled jobs, especially in the core digital sector and in areas requiring relatively advanced technical and analytical skills. However, what is clear is that digital platforms generally provide fewer opportunities for low-income groups. This results in a dilemma for developing countries where job creation is of crucial importance.

The digital economy and participants are shaping user-producer relationships through e-commerce, including by leveraging customer information and interaction to a much greater extent than in traditional commerce. E-commerce platforms bring together a broader range of buyers and sellers and provide opportunities for offering a greater variety of goods and services[6].

A few major e-commerce platforms (e.g. Amazon, Alibaba Group, eBay and Rakuten) are capturing significant segments of the overall market, benefiting from economies of scale and network effects. The UNCTAD study points out that in many developing countries, the global platforms may not be present, or they may be complemented by national or regional ones, such as Jumia in Africa, MercadoLibre in Latin America, Lazada in South-East Asia and Flipkart in India. Locally oriented platforms have sometimes been able to grow owing partly to the absence of global competitors in the local market. They may provide more convenience for consumers through shorter shipping times, tailored payment options, products more suited to local markets and local language interfaces. Other potential benefits to the domestic real economy may be related to linkages with local industries and suppliers, reduced reliance on imports and greater openness to support exports.

Data generated on these platforms provide valuable insights into consumer behaviour and opinions, and how the platforms are working. Firms on e-commerce platforms can use their data to develop intelligence that can help improve product designs, as well as to innovate[7]. More active users are also contributing to new forms of value in e-commerce through user-induced innovation[8], or as producers (sometimes called "prosumers"). Thus, consumer/user activities can provide a potential base for firms to dynamically improve and add value to their products and services[9].

A key characteristic of the most successful digital platforms is their rapid capture of considerable market shares. UNCTAD identified three main factors to help explain why platforms tend to become monopolies.

- The first and most significant factor is network effects: the more users of a platform, the more valuable that platform becomes for everyone. Taking the example of Facebook, the more friends, family and colleagues that are on the platform, the more useful it becomes as a tool for social engagement and connection. With Uber, network effects hold across the different sides of the platform: more drivers mean riders are more likely to find a ride, which in turn leads to more riders using the platform. As more riders appear, drivers see less downtime and more income, leading more drivers to join the platform. As a result, a virtuous cycle is built between the two sides of the platform. Crucially, with network effects, a threshold is reached at some point, whereby it makes more sense for a new user to simply join the biggest existing platform. With such a "winner-takes-all" dynamics, existing and potential competitors easily fall by the wayside.
- The second factor is the platforms' ability to extract, control and analyse data. Since they are positioned as intermediaries, they accumulate data from every interaction. This typically gives platform owners a major competitive advantage over non-platform companies. Effectively, the more data that can be accessed and transformed into digital knowledge, the more the company can cut costs, satisfy customers and improve its products relative to more data-light competitors. As with network effects, a virtuous cycle can emerge: fewer rivals mean more users, more users mean more data, and more data means rivals can be outcompeted.
- The third contributory factor is the dynamics of path dependency. Once a platform begins to gain traction, the costs to users of switching to an alternative platform start to increase[10]. Users of social media, for instance, invest time and data into building their profiles and personalising services. Leaving a platform may mean leaving behind years of messages, posts and photos, which discourages users from switching to another platform.

Market regulation concepts, such as an open market, marked maximum retail price, competing firms, checks against price fixing and collusion, are important factors for competition regulators to consider. As digital monopolies become entrenched, the terms of engagement may gradually shift towards the interests of the platform owners. Against this background, policies are needed to protect the interests of various economic actors engaged on digital platforms.

According to the UNCTAD study, African digital platform entrepreneurs face specific market and infrastructure challenges that require critical adaptations compared with business models used by global platforms. The following are examples of such adaptations:

• Having a person to function as the customer's interface with the digital platform. This may involve sales or extension agents using tablets to facilitate data entry, allowing cash payments on delivery, building up local call-centre capacity for quick call-backs and customer service.

• Establishing physical supply-chain and logistics services, such as distribution centres, payment points, warehouses, drivers and delivery vehicles.

• Consolidating and sharing physical supply chain and logistics services across different e-commerce verticals. Using text messages and Unstructured Supplementary Service Data (USSD) codes (i.e. analog-era communications technology), for offline orders and confirmations, for example.

• Investing in the development of entrepreneurial and managerial knowledge, such as understanding Africa-specific launch and competitive strategies or pricing. Due to the weaknesses in the local ecosystem (e.g. poor bandwidth and reliability, or inefficient payment systems) and low technological capacity of customers and employees, and/or issues with physical logistics (e.g. delivery services), digital platforms in developing countries have to employ a range of business-model innovations to be viable.

While some issues can be addressed through national policies and strategies, the global nature of the digital economy will require more dialogue, consensus building and policy-making at the international level. South Africa does not function in isolation. At this stage there are many more questions than definitive answers about how to deal with the digital economy. Given the rapid pace of technological change, policy responses will need to be constantly re-assessed.

Policy decisions must increasingly be made under uncertainty about future digital and other developments. While progress has been made in answering some of the most pressing and difficult questions that governments face today, more work is needed to understand some complex issues and to design resilient policy frameworks in response.

Enhancing the e-commerce readiness of a country is important so that more firms and people are able to create value through the digital economy. Given network effects and the tendency towards market concentration in the digital economy, competition policy can play a major role in the creation and capturing of value. Its success definitely lies in the how.

As a country, we need digital markets to develop and data, as data is a mechanism of access to value that will benefit the economy in the long-term. Digital markets need to be understood by regulators and digital market participants ought to partake in economic activity, in innovative ways that do not bring about a detrimental impact on competitors and customers. Those companies that are ready and agreeable to disrupting themselves to take on developing capabilities like machine learning and AI will have embraced increased competitiveness and be well equipped to handle the digital future and economy.

And the last thought to consider in light of the digital economy growing at an unprecedented speed, is "*is big always bad*"?

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[1] UNCTAD Digital economy Report 2019 https://unctad.org/system/files/official-document/der2019_en.pdf accessed 23 November 2020

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