

Would regulation cement Facebook's market power? It's unlikely

Written by Catherine de Fontenay, Associate Professor, Melbourne Business School

Facebook CEO Mark Zuckerberg faced a four-hour grilling from the US Senate Commerce and Judiciary panels yesterday in response to a number of revelations – that Russian operatives had targeted Facebook users to influence the US election, that Cambridge Analytica had gained personal information on 87 million users, and that “malicious actors” ([Facebook's words](#)) were able to identify and collect data on most of its 2.2 billion users.

Read more: [Mark Zuckerberg's Facebook apology is the linguistic equivalent of 'shit happens'](#)

Senator Lindsay Graham [raised pointed questions](#) about Facebook's monopoly power. Graham pointed to the lack of competitors to Facebook in the social media space, and Facebook's purchase of Instagram – its main competitor. Graham was asking whether the forces of competition were enough to keep Facebook from misbehaving.

For example, if I have the choice of two social media platforms, I might join the platform that isn't misusing my data. But if Facebook is the only game in town, then there is a much higher cost to deleting my account.

If competition isn't restraining Facebook's behaviour, then regulation may be needed to place limits on how Facebook may store, use and release our data.

At this point, Senator Dan Sullivan raised an interesting twist.

Regulation can cement the dominant power ... One of my biggest concerns is that the next Facebook, the guy in the dorm, that you are becoming so dominant that we won't be able to have the next Facebook.

If that's the case, then regulation might protect some of our privacy, but at the cost of leaving Facebook in a dominant position forever.

Concerns about regulation are ill-founded

It's true that it can be [difficult for a small new player to enter an industry](#) where there are big "fixed costs" to meeting regulatory requirements.

Suppose for example that in order to start a new trucking company, I must spend \$5 million to develop safety protocols and set up a safety oversight department with centralised computer oversight of all my trucks.

Then there won't be many new trucking companies since I only start if I am reasonably certain I can quickly reach a volume of business to cover the \$5 million cost. A frequently-used solution to this problem is to have lower regulatory requirements for smaller firms.

Read more: [**The law that made Facebook what it is today**](#)

But notice that Facebook has grown to be a monopoly in the absence of regulation. Regulation has not created its dominance, rather its dominant position comes from two key features of social media:

1.

There is a strong [network effect](#), in that I want to be on the same social media as my friends. A new social media site is useless until lots of people join it, which makes them very hard to take off. Facebook started among a tight network of people – Harvard undergraduates – who could quickly coordinate with each other to join, and who have plenty of time to try new things.

2.

Facebook already has huge amounts of data on 2.2 billion people. That data means it gets better prices from advertisers, who are more confident that their advertisements are getting to their target audience. Any advantage created by regulation would be very minor compared to that advantage.

Can anyone challenge Facebook's dominance?

With or without regulation, the current scandal does create a market opportunity. If a new social media site with a more compelling interface were to appear, some communities might switch and its appeal could grow. This is the [story of Instagram](#).

Read more: [How to stop haemorrhaging data on Facebook](#)

The remaining question is whether there are funding sources in Silicon Valley who are willing to play the long game, and fund that new competitor through a long period of low revenue and high costs, before they beat Facebook.

Instagram found such a funding source when the founder met venture capitalists [at a party](#). I don't think these big-picture venture capitalists would be deterred by having more regulatory costs. The bigger problem is that, once they beat Facebook, we would still be stuck with a monopoly.

Regulation – rather than competitive pressure – is looking pretty attractive right now.

Catherine de Fontenay does not work for, consult, own shares in or receive funding from any company or organization that would benefit from this article, and has disclosed no relevant affiliations beyond their academic appointment.

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