

## **Comments on the CMA's Facebook/GIPHY investigation**

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### **The CMA's key points on the Facebook/GIPHY investigation**

On August 12, 2021 the CMA issued provisional findings (from now on, "PF"), claiming that the acquisition of GIPHY by Facebook back in May 2020 will likely result in:

- (a) horizontal unilateral effects resulting from loss of potential competition in display advertising in the U.K.; and
- (b) vertical effects resulting from input foreclosure in relation to the supply of social media.

The CMA further states in its PF that the only acceptable remedy would be a complete reconstitution and divestiture of GIPHY.

As scholars of competition and innovation in digital markets, we are concerned that the CMA's decision, grounded as might be on the presumptions and prospects of the dynamic effects on the competitive landscape, might fail to consider other important counterfactuals, in which the CMA's decision might potentially hold a far more reaching negative impact on the broader startup innovation ecosystem than the possible benefits to have on the competition side. Because this matter may shape thinking of future cases, we write to suggest a way to frame issues in this case but to think beyond the specifics of this case.

Below we provide a brief commentary on the points we believe should deserve more careful attention in the analysis. We have no direct knowledge of the matter at hand other than the documents and PF shared by the CMA; we draw our considerations on the basis of such documentation and related arguments, and on the related management literature.

We do not question the idea that some deals potentially may be nascent competition deals and/or may foreclose markets. Competition authorities routinely address such concerns, as they should. However, traditionally, competition law and competition authorities have taken very narrow views of efficiencies. One of us has specifically written about other efficiencies that should carry more weight (Blair, Wilson, Sokol, Klovers and Sanford 2020).<sup>1</sup> We believe that such efficiencies should be part of the decision-making of competition authorities generally. We also have some specific concerns regarding this particular merger as to thinking through counterfactuals and making inferences as to policy from such counterfactuals.

The CMA claims that there would be a substantial lessening of competition on the supply of display advertising services in the UK "arising from a loss of dynamic competition." This

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<sup>1</sup> Roger D. Blair, Christine S. Wilson, D. Daniel Sokol, Keith Klovers & Jeremy A. Sanford, 23 George Mason Law Review 761, 774-782 (2020)

finding is based on the CMA’s assertion that the most likely counterfactual is that GIPHY would have continued to supply GIFs to third party social media platforms (including Facebook), and continued to innovate and develop its products and services.

However, as also noted by the CMA’s PF, the evidence does not seem to support this counterfactual. To the contrary, GIPHY had no clear path to monetization, having “not yet demonstrated that its Paid Alignment model would be successful at scale” (PF 7.98); lacked investors’ interest in continuing to fund its business (PF 6.108; 6.94; 6.65); and lacked alternative options (to Facebook’s acquisition) to continue its business (PF 6.122).

This evidence seems to suggest a different counterfactual than the prospect of GIPHY becoming a potential competitive threat in display advertising. And in fact, no evidence from Facebook’s internal documents has been found in the PF (PF 7.157).

Lacking specific anchoring of the evidence in the PF and consideration of the different counterfactuals, we are concerned that the decision may be grounded on presumptions of alternative competitive landscape that do not seem supported by a clear-eyed analysis of the likely evolution of a digital service. This might constitute a precedent rising ambiguity of law in this realm.

### **What (antitrust) issues does the decision fix?**

We submit that different counterfactuals must be assessed in such situations. The issue of the lessening of dynamic competition should be examined not on the ground of whether the target has (or not) the theoretical potential to become a direct competitor over time to the acquirer – in dynamic terms, in the digital space, any potential target in the core or complementary markets of the acquirer *might* become a competitor to the extent that the value of these complements could become central and make them core to an ecosystem. In these terms, *any* acquisition should then be forbidden, notwithstanding the possible efficiency gains from the merger on the supply or demand side. We do not believe that such an approach was intended and therefore we take the opportunity to provide some clarifying principles.

We believe and submit that, for imposing structural separation, we need stricter criteria, ones that look at the impact of the resulting structure. The first aspect to consider is:

- *Does the integrated service create a strategic bottleneck to the customer journey?*

Structural separation, we believe, should be considered in the context of structural limitations to competition. This implies looking at two aspects in the context of platforms and digital markets:

1. The technology solution (of the target) in and by itself is an important, central aspect of the customer journey rather than simple add-on features of a broader platform technology offering. Missing that element, the customer is more likely to not complete the purchase of collateral product/service, interrupt the transaction, or reduce drastically usage of the core and collateral services offered by the platform.
2. The technology solution does not have standalone network potential. However, when integrated into an existing core platform can prove to be a “killer app” (i.e., a must have for the customer) that tilts the balance of competition and tips the market for the platform

that offers this integrated feature. Providing exclusive access to it (and foreclosing access to others) will de facto grant monopolistic power to the platform in its core market vis-à-vis competing platforms.

In such cases, the technology can be a strategic bottleneck to the digital value chain – control over the technology grants control over the entire ecosystem, i.e., the general production and distribution of the value being produced directly or indirectly around the technology for the customer.

In our understanding of the PF, the CMA has not provided evidence of either of these two cases. The CMA provides no quantification or other empirical basis for the importance of GIFs for user engagement in social platforms - GIFs are considered by some other platforms “... ‘nice to have’ but not critical or foundational to their growth or user engagement.” (PF 8.78). Also, GIFs are not provided exclusively through GIPHY or Facebook – other competitors exist, including large ones such as Tenor (owned by Google), and switching across these services seems to be relatively easy.

The other aspect to consider is:

- *Does the post-merger integrated structure create potential “ecosystem failures”?*

In a recent paper, Jacobides, Cennamo and Gawer (2020)<sup>2</sup> lay out a framework to understand the kind of market failures that digital platforms help solve as new organizational models, and the inherent, post hoc “ecosystem failures” that may emerge as a result of these new structures. They distinguish between *functional failures*—problems with the inherent ability of platforms and ecosystems to deliver value to the final customer; and *distributional failures*—issues relating to an orchestrator’s abuse of power and its ability to extract excessive value from its partners and complementors.

The question is whether negative incentives for investments in quality and/or variety of complements emerges as a result of the new integrated structure, or whether a problem of value distribution across and within ecosystems results from the new structure. In the Facebook/GIPHY case, these failures might arise if, e.g., excluding access to GIFs library may prevent other providers within (or outside) the Facebook ecosystem to provide a value proposition to its users, or whether the integration with Facebook’s platforms reduce the incentives to invest in the quality and variety of GIFs and make them available to other ecosystem members.

The CMA’s PF provides no evidence of such potential issues. Also, a formal commitment for Facebook to keep GIPHY’s APIs open to other social media platforms or grant access to them under FRAND conditions seems to us can properly address any vertical foreclosure concerns. It is thus to us unclear what the basis of antitrust concerns is.

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<sup>2</sup> Jacobides M., Cennamo C. Gawer A. (2020). Complementarities and externalities in platforms and ecosystems: From value creation to inherent failures. Working Paper: London Business School.

## Possible negative impact on the VC funding and startup innovation ecosystem

Lastly, our major concern relates to the counterfactual on the ex-ante incentives to fund innovation activity by startups in the digital realm, which is not considered in the CMA's investigation. This, we believe, is a serious shortcoming that risks doing more long-term harm than the eventual benefits that a structural separation may attain. We have already written of the possible negative effects that overreaching regulation or interpretation of antitrust law can have on innovation of small firms, and dynamics competition (Cennamo and Sokol 2021).<sup>3</sup> We take the opportunity to reiterate some of those points to the specific relationship between investment incentives in startup innovation and acquisitions by big tech companies.

Some have raised concerns that acquisitions by big tech firms of start-up companies might be “killer acquisitions”<sup>4</sup> of potential prospective competitors or contribute to the creation of “kill zones” by discouraging additional investment by venture capitalists (VCs) in lines of business with a strong presence of big tech firms. However, there are other views and empirical evidence that suggest the opposite scenario. Big tech acquisitions are one of the key “exit strategies” used by venture capitalists to realize a return on their investment in startups (Gompers et al. 2020; Dushnitsky and Sokol 2021)<sup>5</sup>. A track-record of successful exits is also important for venture capitalists to establish a reputation and attract new investors. Also, having a large-scale digital platform playing in an industry segment is important to attract interest by VCs and venture investment in start-ups focused on complementary innovations (Foerderer et al., 2018)<sup>6</sup>. There is evidence suggesting that for big tech firms (the “GAFAM”) acquisitions tend to be a substitute for in-house R&D; i.e., as a way to speed up development of technology functionalities and IPs, which they then integrate in their ecosystem (Gautier and Lamesch 2020)<sup>7</sup>. Recent analysis by one of the most pertinent and comprehensive study on the topic (Prado and Bauer 2021)<sup>8</sup>, examining more than 32,000 venture capital deals and nearly 400 tech startup acquisitions by big tech firms over the last 10 years, provides strong evidence of the positive spillover effects that these acquisitions have on innovation through further investments by VCs, indeed. Instead, some economic models suggest that making such acquisitions more difficult may result in less VC investment, and thus lower innovation (Cabral, 2021).<sup>9</sup> Whereas, other models carefully identify the boundary conditions under which a merger may result in a “killer acquisition” or in an efficient upgrade of target's technology, but one which suppress potential competition (see Motta and Peitz 2020).<sup>10</sup>

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<sup>3</sup> Cennamo C., Sokol D. (2021). [Can the Eu regulate platforms without stifling innovation?](#) Harvard Business Review.

<sup>4</sup> Cunningham, C., Ederer, F., and Ma, S. (2021). Killer acquisitions. *Journal of Political Economy*, 129(3), 649-702.

<sup>5</sup> Gompers, P. A., Gornall, W., Kaplan, S. N., and Strebulaev, I. A. (2020). How do venture capitalists make decisions? *Journal of Financial Economics*. 135 (1): 169–90.

Dushnitsky, Gary and Sokol, D. Daniel (August 5, 2021). [Mergers, Antitrust, and the Interplay of Entrepreneurial Activity and the Investments that Fund It](#). USC CLASS Research Paper No. CLASS21-35, USC Law Legal Studies Paper No. 21-35.

<sup>6</sup> Foerderer, J., Kude, T., Mithas, S., and Heinzl, A. (2018). Does platform owner's entry crowd out innovation? Evidence from Google Photos. *Information Systems Research*, 29(2), 444-460.

<sup>7</sup> Gautier A., Lamesch J. 2020. [Mergers in the digital economy](#). CESifo working papers 8056.

<sup>8</sup> Prado T.S., Bauer J. M. (2021). Effects of big tech acquisitions on start-up funding and innovation. [Quello Center Working Paper No. 04-21](#)

<sup>9</sup> Cabral L. (2021). [Merger policy in digital industries](#). *Information Economics and Policy*, 54, 100866

<sup>10</sup> Motta M., Peitz M. 2020. [Big tech mergers](#). *CEPR Discussion Paper No. DP14353*

We are therefore concerned that the CMA's decision might have important negative effects on dynamic innovation by foreclosing one important mechanism to realize returns on investment in startups and thus muting the incentives to fund innovation in the digital tech. At the same, we are sceptical about the alleged anticompetitive effects that the merge, in this specific case, is causing, and that the structural separation will guarantee a more competitive environment. A case like this may establish an important precedent, also and especially because it is the first investigation to invoke the concept of dynamic competition as a way to judge the anticompetitive effects of the merger. But the concept of dynamic competition is strictly related to the one of dynamic innovation (see e.g., Cennamo 2021; Petit and Teece 2020; 2021)<sup>11</sup>. We would have hoped for the delineation of stricter and clear criteria in such assessment by the CMA's investigation, drawing on existing research, which would have served as new benchmark. We remain convinced that such approach is needed to clearly separate problematic cases from legitimate acquisitions. The risk we envision is a scenario whereby important innovation by small startups will fail to find proper market valuation, whereas large-scale digital platforms may develop internally these add-on features by imitating the innovation and create walled gardens of innovation instead.

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<sup>11</sup> Cennamo C. 2021. [Competing in Digital Markets: A Platform-Based Perspective](#). Academy of Management Perspectives, vol. 35, No 2.

Petit N., Teece D. 2021. [Big tech, big data, and competition policy: Favoring dynamic over static competition](#). Working paper.

Petit N., Teece D. 2020. [Taking Ecosystems Competition Seriously in the Digital Economy](#). Hearing on Competition economics of digital ecosystems, OECD.