

PUBLIC EQUITIES

Fixing the Internet, One Tweet at a Time

INSIGHTS



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The likelihood that the E.U.'s Digital Markets and Digital Services Acts achieve their aims, and significantly alter the status quo for major internet companies, remains low.

April 2022 may very well turn out to have been a pivotal period for the evolution of the internet. During that month, the long running efforts of E.U. regulators to craft a set of rules and regulations that give them a better grip of how the internet operates within Europe reached a crescendo. An agreement was reached on the provisional text for the Digital Markets Act (DMA), while a political agreement on the Digital Services Act (DSA) followed closely behind.¹ However, news of these milestones was overshadowed by the announcement that Twitter’s board had agreed to Elon Musk’s bid to take the company private.

In a recent paper on [ESG in Technology](#) we looked in depth at a number of social and governance conflicts that exist within the technology sector. As the specifics related to regulating internet platforms are now emerging, we take a closer look at the details and what this means for the shifting regulatory backdrop for the internet in the E.U.—and how it relates to the business models of the largest platforms.

“Elon, there are rules.”²

Musk’s stated ambition is to dramatically reduce restrictions on free speech placed on Twitter’s content by moderators on the platform. The E.U. responded immediately, threatening Musk with the full force of their pending powers to fine companies in breach of its rules up to 6% of their global revenues. En garde!

“Free speech is the bedrock of a functioning democracy, and Twitter is the digital town square where matters vital to the future of humanity are debated. I also want to make Twitter better than ever by enhancing the product with new features, making the algorithms open source to increase trust, defeating the spam bots, and authenticating all humans. Twitter has tremendous potential—I look forward to working with the company and the users to unlock it.”³

Elon Musk

If Musk can complete the deal to take Twitter private⁴, the duel between the world’s richest man and those tasked with regulating the internet in the E.U. could very well set the tone for the laws and rules applied to online businesses in other democratic societies—as well as shape the long-term financial opportunity for all internet companies, big and small.

1. Source: European Commission. As of April 2022.

2. E.U. Commissioner Thierry Breton warned Elon Musk that Twitter must comply with the E.U.’s rules. As of April 2022.

3. Source: Twitter.com. As of April 2022.

4. Elon Musk tweeted that the deal to purchase Twitter is on hold, following a Twitter disclosure of the number of “fake” accounts on the platform. As of May 13, 2022.

While Musk has since clarified his comments on reducing the amount of content moderation to the point of complying with local laws and regulations⁵, arguing that lawmakers will set rules in the best interests of the constituents that voted them into office, a move toward less online censorship has set all sides of the debate into a frenzy.

The New Regulated Reality

Any discussion of the state of online regulation within the E.U. has to first acknowledge that the platforms which concern regulators the most are based outside of the E.U. Meta Platforms (formerly Facebook), Alphabet, TikTok, Amazon, Snap, Tencent, Alibaba, Apple and Twitter are leaders within their specific E.U. markets, leaving little oxygen in the room for domestic competitors, current or future, to breathe while trying to build competitive internet businesses.

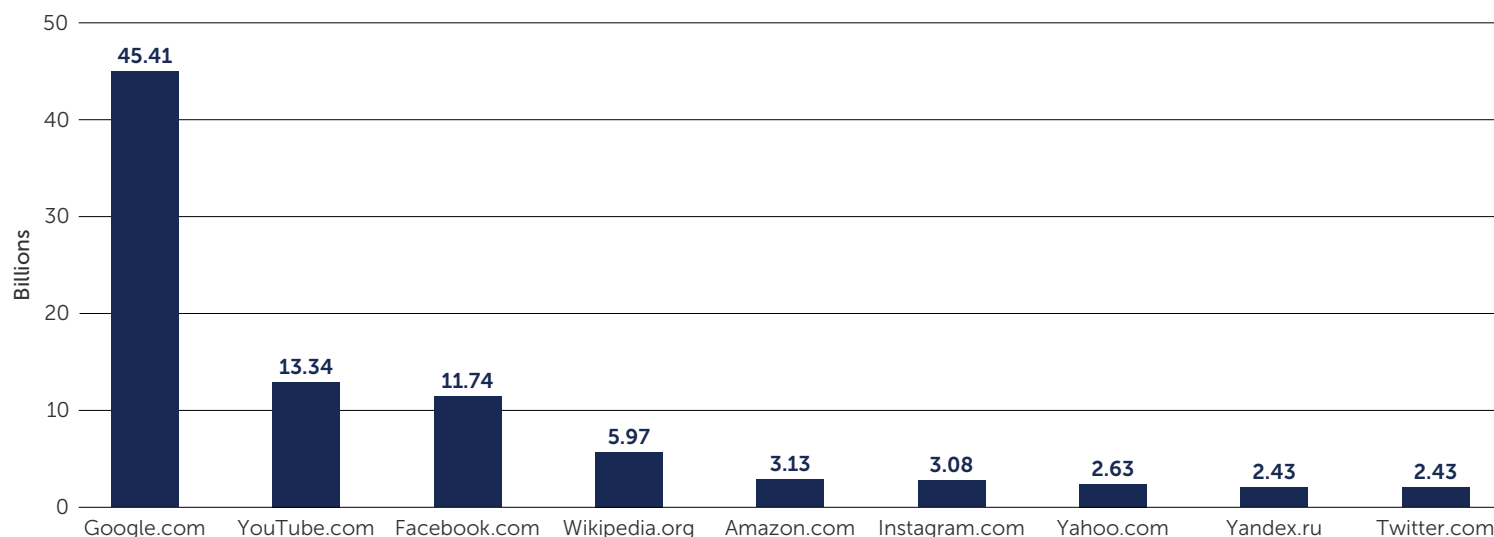
As a result, the new DMA focuses on anti-trust and limiting the market power of these large online platforms, notably setting the scope for rules specifically to capture the largest platforms. At the same time, the proposal will aim to avoid burdening smaller, E.U.-based companies with additional compliance costs.

Meanwhile, the DSA is set to focus more on creating a safe internet ecosystem. The use of sensitive data, user tracking, limiting the spread of harmful content, and misinformation are all key issues to be covered. While the precise wording of the text is still being worked upon, the tenor of the announcements so far point to an attempt by E.U. regulators to place greater liability onto the platforms for the publication and amplification of content the E.U. deems damaging to society.

Trade-Offs: Competition Versus Safety

Achieving these goals is far more complicated than it first appears, not least the issue of where to draw the line on defining what is “damaging to society”. However, once this is defined, the E.U.’s regulators will likely face another challenge. On the one hand, they see anti-trust regulation aimed at non-E.U. platforms as the key lever to “leveling the playing field” and promoting E.U.-based competitors—and hence, the DMA was proposed. On the other hand, the measures to weaken market power also risk worsening the online consumer experience in terms of usefulness of the services, as well as the privacy and safety features that derive from the centralized control of an online platform.

Figure 1: Most Popular Websites Worldwide by Total Visits



Source: Statista. As of November 2021.

5. Elon Musk tweeted “By ‘free speech’, I simply mean that which matches the law. I am against censorship that goes far beyond the law. If people want less free speech, they will ask government to pass laws to that effect. Therefore, going beyond the law is contrary to the will of the people.” Source: Twitter.com. As of April 26, 2022.

These laws will look to address a number of issues, including:

SELF-PREFERENCING OF OWN SERVICES

One avenue that will likely be taken will be to prevent self-preferencing of a company's own services. For example, Google will have to show third-party search results for hotel bookings ahead of their own, regardless of whether prices offered to consumers are more attractive through Google or not. Google's unrivalled consumer reach means that all hoteliers have to list their prices on Google.com to have the best chance to sell their inventory. This will create greater price transparency, competition between hoteliers, and therefore lower prices for consumers.

INTEROPERABILITY BETWEEN MESSAGING SERVICES

The DMA will also force interoperability between messaging services. For example, Facebook's Messenger and WhatsApp will have to be able to communicate with Apple's iMessage.⁶ This should reduce consumer lock-in, increase competition, and therefore drive innovation—but the historical evidence is not positive. Email and SMS messaging are both open platforms and are interoperable across providers. However, despite this, Google, Microsoft and Apple control 90% of the email market, and innovative collaboration tools like Slack and Teams are usurping email as a communication tool at work.⁷ SMS messaging was out-innovated by newer messaging services like WhatsApp in large part due to Facebook's control of the whole experience, and their drive to increase engagement by offering a superior service, which is also free for consumers.

If that wasn't enough to give regulators pause, an important feature of many of the most popular messaging services used by consumers is end-to-end encryption that protects users' privacy. To enable interoperability, this encryption needs to be broken. While a technical solution to this problem may emerge in the future, it does not appear to exist today. Law enforcement agencies will be pleased if they can more easily gain access to suspects' messages, but such an outcome is a contradiction to the DSA's intention to protect user privacy.

MARKET DOMINANCE & PRIVACY

The economics of digital markets are defined by the zero-marginal costs of distributing digital goods. As the internet grew into a huge and wildly complex network, Google emerged with their page rank algorithm to make sense of it. Their domination of the internet search business was a natural outcome of being the first to bring a useful search algorithm to the internet, and to monetize and invest in its growth. For the E.U. to break that dominance, they must force Google to make the data they utilize on their platform available to new entrants. However, the sharing of data across platforms is prevented by the regulations being brought to bear on concerns over internet safety and privacy. This paradox crops up in relation to all of the internet platforms.

6. Telegram and Signal fall below the DMA's hurdles for coverage in the regulation.

7. Source: Gartner. As of March 2021.

The DSA looks to address this thorny issue by forcing internet companies to give greater disclosure on the data they collect, as well as the algorithms they apply to that data, **but only to the regulators**. This middle ground hopes to balance the protection of the intellectual property underlying the companies' business, with the privacy of the users. At the same time, U.S. authorities are contemplating a similar requirement, but with less obvious enthusiasm.

NEW ENTRANTS

An adjacent problem for regulators looking to promote new entrants is the limits on a user taking their contacts with them to another network. Allowing portability of one's social graph opens the door to third parties sharing your contact details with social media companies that you have not authorized to have that data. Instagram would probably not exist today without the leg-up they received from access to Twitter's social graph (in other words, their database of users and their connections).

Prior to being bought by Facebook, Instagram started as a tool for adding filters to your photos that you could then share across Twitter or Facebook. It evolved into an insurgent social network by taking the Twitter graph and building their own photo sharing community. Under existing GDPR laws, and the incoming DMS, any new entrant hoping to make use of the preferential treatment from the anti-trust laws in the DMA may well be stopped in their tracks by the drive to protect personal data.

One crucial reason that regulations have so far failed on both anti-trust and safety is that the two goals are not easily compatible. It is not yet clear that the E.U.'s efforts through the DMA and DSA fully recognize the economic realities of online business models and industry structures, and the inherent trade-offs they create between fair competition, innovation, privacy, and safety. For these reasons, we believe the likelihood that the DMA and DSA achieve their aims and

significantly alter the status quo, such that the major internet platforms find themselves weakened within Europe and subject to a deluge of new competition, remains low. In our opinion, what is more likely to happen is that the natural evolution of changing consumer behavior and tastes will remain the biggest determinant of shareholder returns for investors in internet companies.

Metaverse to the Rescue

The lack of clear share price reaction to the impending E.U. regulations reminds that the equities market is a discounting mechanism of the growth yet to come. As we look further into the future, the real stranglehold over the internet's evolution appears to be most acute in the device used to access it. The two dominant smartphone operating systems, Apple's iOS and Alphabet's Android, enjoy unparalleled control and visibility into online consumer behavior and the efforts by developers to monetize that behaviour.⁸ As regulators are moving to investigate the extent of this market power, Meta Platforms for one is pushing ahead on a different path with its multi-billion dollar investment in what they believe will be the next online paradigm—the Metaverse.

Where the DMA and DSA decry the market power abuses of large platforms, Meta is investing ahead of what they believe will be a much more open internet experience with far less friction for users to cross from one ecosystem to another. In other words, breaking down the walled gardens that today govern users' behavior and engagement with online ecosystems. But why would Meta risk disrupting its own highly profitable business? The recent move by Apple to prevent third parties from tracking user behavior within applications accessed through iOS, or websites on the Chrome browser, hammered home the need for Meta to build an alternative for consumers that disperses the control of access more broadly—which will ultimately leave more profit on the table for Meta to compete for.

8. Amazon.com enjoys a similar position in terms of visibility over product search and purchasing behavior in e-commerce, anchored by their significant investments in physical fulfilment and shipping assets.

Their success, or otherwise, is likely to be evidenced by the amount of engagement by third-party developers with their own ecosystems and profit incentives, who are able to find a way to engage with Meta in building the protocols and connections that will enable users to move seamlessly from one ecosystem to another. In our view, regulators should be encouraging this process as a way to create viable alternatives to the industry structures they are so critical of today.

Key Takeaway

Elon Musk has rattled the cage of regulators around the world, but particularly those in Europe given the timing of the agreements behind the Digital Markets and Digital Services Acts. The suggestions Musk has aired publicly for changing how Twitter operates, in particular reducing the content moderation and removing anonymity from the platform, would likely trip over many of the rules that the E.U. is hoping to enforce.

The regulations themselves do not appear to resolve the intractable trade-offs inherent in operating large-scale online platforms. Preserving freedom and innovation, while also limiting the power of the companies that are best placed to innovate and to mitigate the misuse of online platforms by malicious actors looking to cause societal harm, is an incredibly difficult needle to thread.

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