Competition in Digital Markets: Vertical Integration and Acquisitions

July 21, 2020

Competition in digital markets is drawing attention from Congress, foreign regulators, and antitrust authorities. The House Judiciary Committee opened an investigation of digital markets in 2019. The same year, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) reportedly opened antitrust investigations into four companies—Alphabet, Amazon, Apple, and Facebook. These firms, along with Microsoft, are currently the most valuable publicly traded companies in the United States, and are often referred to as "Big Tech." Possible issues in the pending investigations may include the effects of vertical integration and acquisitions on competition.

On June 30, 2020, the DOJ and FTC released new Vertical Merger Guidelines. The guidelines outline the agencies' approach to examining mergers and acquisitions at different stages of a supply chain. The guidelines do not explicitly address digital markets, leaving it unclear how these agencies are examining "Big Tech" in their investigations. This CRS Insight analyzes competition issues raised by vertical integration in digital markets and how acquisitions involving "Big Tech" may differ from those in other industries. A companion CRS Legal Sidebar provides a general overview of vertical merger enforcement and discusses the implications of the new guidelines.

Identifying Supply Chains and Markets

In markets for physical products, vertical relationships tend to be clearly defined as goods flow from commodity producers to processors to distributors, and then to consumers. In digital markets, these distinctions tend to be less clear. For example, some users of websites and apps—such as Facebook's Instagram and Alphabet's YouTube—are paid to post images and videos if they obtain a certain number of followers, meaning these users serve as both consumers and suppliers.

The difficulty of defining supply chains for digital markets can make it challenging to determine when vertical integration may be harmful to competition. For example, a company that publishes books might try to integrate vertically by purchasing the only company that makes a certain type of paper; antitrust authorities might then investigate how the acquisition affects competition with other publishers and prices faced by book buyers. In digital markets, companies have built assets, such as fiber optic cables and satellites, to transmit their data, possibly faster or more reliably than competitors who do not own such infrastructure. Content providers like Alphabet, Amazon, Facebook, and Microsoft collectively own or lease more than half of the global capacity of undersea cables. It is unclear how this may affect competition in the markets these companies operate in.

Competition analysis usually begins by defining markets, but digital products may not fit neatly into defined markets. For example, Alphabet's YouTube allows users to produce and post their own videos and offers movies and television shows produced by entertainment and media companies. YouTube could hypothetically increase its market share in the social media market while simultaneously decreasing its share in the streaming services market, which overlaps with the broadcast television market. None of these market definitions addresses Alphabet's share of the digital advertising market, which serves as its major source of revenue.

Vertical Integration in Digital Advertising

The digital advertising market has undergone vertical integration. In addition to selling ad spaces adjacent to content on their online platforms, some "Big Tech" companies have integrated into advertising-related services that can be used by advertisers to target ads and bid for ad spaces. This creates the possibility of tying, in which a vertically integrated company might require that its advertising-related services be used to place advertisements on its online platforms. If other online platforms use these advertising-related services, the vertically integrated company might then be able to obtain additional data to help the advertisers that use its services target ads more effectively to consumers. Thus, a company that has integrated vertically may have an advantage over competitors that are less vertically integrated, potentially reducing competition in advertising-related services. Because consumer prices are not affected, U.S. antitrust authorities may not focus on such conduct. In 2019, the European Commission fined Google €1.49 billion ($1.7 billion) for violating the European Union's antitrust rules by preventing rivals from competing in the online search advertising market.

Acquisitions in Digital Markets

In some cases, mergers and acquisitions have given rise to vertical integration. Google's acquisition of Android in 2005 helped it develop a mobile phone operating system that consumers can use to access apps, including those created by Google (now part of Alphabet). However, vertical integration often emerges from internal product development. For example, consumers use Alphabet's Google Play and Apple's App Store, developed by the respective companies, to download apps onto various devices. Alphabet and Apple can charge owners of other apps to be included in Google Play and the App Store, even when the apps compete with similar apps owned by Google and Apple. It is unclear how the DOJ and FTC might evaluate these forms of vertical integration, particularly if the integrated components were not the result of acquisitions.

Issues for Congress

Competition in digital markets and related concerns have been subjects of interest in Congress. A Senate Judiciary Committee subcommittee has held hearings on digital markets, including one in 2019 on the acquisitions of potential competitors and one in 2020 on self-preferencing by digital platforms. As a part of its digital markets investigation, the House Judiciary Committee has held five hearings explicitly addressing competition issues related to "Big Tech," with a sixth scheduled for July 27. A primary concern throughout these hearings has been how to ensure companies are not impeding innovation with anticompetitive conduct, while encouraging innovation in fast-changing markets. As it evaluates possible changes in legislation, Congress may also wish to consider whether the revised Vertical Merger Guidelines provide sufficient guidance to firms in digital markets.

Author Information

Clare Y. Cho
Analyst in Industrial Organization and Business

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.