NSR Tech Policy: The Strength of Weakness: How Big Tech's fragility could affect regulatory risk

By Matt Perault | July 5, 2022

Overview: Is Big Tech dominant or fragile? Since 2016, the narrative in policy circles has focused on dominance. This perception of dominance laid the foundation for regulatory proposals aimed at constraining Big Tech's power. Regulatory proposals in areas like antitrust, content moderation, and privacy have all been driven by the view that more government action is necessary to curb Big Tech's strong position in the market.

But now, cracks are showing. Equity prices for Big Tech companies have fallen sharply since the start of the year, and Big Tech has responded by slowing or freezing hiring and reducing spending. Fear of competitive threats and regulation has led to significant product pivots. Chinese tech firms seem poised to grow sharply again, now that the Chinese government's techlash seems to be lifting.

This new evidence of fragility is in tension with the dominance narrative. If Big Tech companies have such a strong market position, then why are there signs of weakness now?

Given our focus on public policy, our purpose here is not to resolve that question. Instead, we evaluate the impact that real or perceived fragility might have on regulatory risk for Big Tech firms. That relationship is typically inversely correlated: while dominance may be good for business in the short term, it has a negative effect on regulatory risk in the long run. Conversely, while fragility may pose a threat to business, it typically diminishes regulatory risk over time. Accordingly, while signs of Big Tech's fragility aren't good for business, they may reduce the likelihood of sweeping reforms that fundamentally alter tech products and business models.

Evidence of fragility:

A number of data points suggest that Big Tech companies are significantly more fragile than they were one year ago.

Market valuation: Equity prices for Big Tech firms have fallen sharply since the start of the year. Meta (-52%), Amazon (--34%), Apple (-22%), Microsoft (-23%), and Alphabet (-25%) have all suffered significant declines in market valuations, and those declines outpace the declines in most market indices (DJI -14%, S&P 500 -20%, but NASDAQ Composite -26%). The declines in Big Tech valuations have outpaced declines at several of their tech and non-tech competitors (Twitter -12%, Walmart -15%, AT&T +15%), although some competitors have experienced similar or even more significant declines in market valuations (Snap -72%, News Corp -29%).

Chinese competitors rebound: As the Chinese government's crackdown on its tech sector has begun to lift, China's Big Tech companies are showing signs of strength. According to a recent analysis by Bloomberg, the valuation of China's Big Tech firms — Alibaba, Baidu, and Tencent — has increased 37% since mid-March, while the valuation of the US's five Big Tech companies has declined 11% over the same period.

Companies respond by slowing hiring and spending: The US tech sector has responded to this market correction by imposing restrictions on hiring and spending. Meta, Microsoft, Twitter, Coinbase, Salesforce, and Uber have all slowed the pace of hiring, with reports indicating that Meta may reduce its planned engineering hiring by 40%. Several companies, like Uber and Meta, have also made efforts to reduce spending and warned of future belt-tightening.

Significant product changes: According to reports of leaked internal memos, Meta is planning a dramatic product shift, moving away from the emphasis on content from friends and family that has defined the core Facebook product since its inception and toward a discovery model more akin to TikTok. The shift highlights TikTok's strength and Meta's desire to compete more effectively for user attention, particularly with younger users. Instagram Reels (20.1%) now ranks behind TikTok (48.5%) and YouTube Shorts (25.3%) as the third most-preferred short-form video platforms for US users over the age of 18. Meta's product pivot may also reflect its concern about TikTok's advertising growth, which is predicted to jump 184% in 2022.

Regulatory risk has narrowed business options: The threat of regulation has impacted business options for several Big Tech firms. For instance, Microsoft has been able to be more aggressive in its merger strategy than other companies like Amazon or Meta could be, since it has largely escaped the intense merger scrutiny that followed deals like Facebook-Instagram and Amazon-Whole Foods.

The shadow of regulation has also prompted some companies to take steps to address regulators' concerns in areas like privacy and content moderation, even in the absence of government action. Some of these measures have constrained growth, such as Apple's App Tracking Transparency initiative, which Meta and Snap allege has affected their revenues.

Impact on regulatory risk:

Fragility will likely reduce regulatory risk for Big Tech companies.

Antitrust rules and enforcement: Antitrust necessarily considers size and market position. Antitrust reform proposals that have been introduced in the House and Senate use a definition for "covered platforms" that uses metrics like the size of the user base (50 million monthly US users) and market capitalization ($550 billion) to determine which platforms fall within the legislation's scope.

Due to the declines in its stock price over the past 6 months, Meta's market capitalization now falls below that threshold. The legislation includes provisions that enable Meta to still be considered a "covered platform," but the company's poor stock performance makes it more challenging for the proposal's proponents to argue that the company's size necessitates regulation. Since antitrust analysis under traditional US law requires a showing of dominance, evidence of fragility will make it harder to make out an antitrust case.

Ease political anxieties: More generally, the effort to pass sweeping reforms to impose constraints on the tech sector is more challenging when the sector appears markedly less powerful. Ailing Big Tech companies may help to soothe the anxieties of both Democrats and Republicans: if platform power is waning, then Democrats may be less concerned about powerful corporate influence and Republicans may be less concerned about their ability to suppress conservative voices. While neither parties' principal concerns are entirely erased by the sector's increasing fragility, their interest in reform – and their willingness to stake political capital on reform – is likely to decrease when the business picture looks more uncertain.

The politics of China: Big Tech companies have repeatedly argued that the US government should consider the effects of tech reform on competitive dynamics with China. They argue that increasing regulatory burdens on Big Tech will provide an advantage to Chinese tech companies and may introduce risks that threaten national security. Those arguments have been advanced by various former government officials, think tanks and academics, but also criticized as being substantively weak and self-serving.

Signs of Big Tech fragility will likely strengthen this argument, not because they affect its underlying substance but because they increase the risk of dismissing it entirely. Both parties are less likely to seek to curb Big Tech's power when the companies' equity valuations are decreasing and Chinese firms' valuations are rising, since action is more likely to be perceived as undercutting US businesses at a time when they face increasing competition from China.

As the midterms approach, Republicans and Democrats are likely to be particularly sensitive to taking any steps that could be perceived as giving a handout to the Chinese government or to Chinese businesses. Both parties recognize the political value of signaling that they are tough on China, and with the midterms looming, they are already taking steps to flex their muscles on this issue. The Biden Administration has announced a number of measures to address potential national security risks related to business transactions with Chinese entities, and several Republican Senators sent a letter to the Biden Administration about TikTok, questioning the Administration on steps it has taken to enforce the Trump Administration's divestment order.

But regulatory risk is unlikely to dissipate entirely: Although fragility is likely to reduce regulatory risk for Big Tech, that risk will not evaporate. Future events could create momentum for new policy proposals. Just in the last week, for instance, there have already been reports about privacy and content moderation proposals in the wake of the Supreme Court's decision overturning *Roe v. Wade*. That decision is also likely to accelerate the shift in policy focus from the federal government to state capitals, which have already been more successful than Congress in enacting tech reform. Putting more emphasis on state policymaking could increase the likelihood of significant tech policy reform at the state level.

In addition, fragility is less likely to dampen the momentum for reform if smaller firms appear to be even more fragile than the larger platforms. For instance, if Big Tech competitors like Epic Games, Snap, Spotify, Twitter, and Yelp are perceived to be more fragile than Alphabet, Amazon, Apple, Meta, and Microsoft, regulators may seek to initiate reforms or enforcement actions that protect those smaller competitors.

Finally, Big Tech fragility is unlikely to affect the incentives of competing industries to continue advocating for tech reform. News publishers and telecommunications operators have been vocal advocates of reform, seeking to use regulatory initiatives to improve their ability to compete with Big Tech. These advocacy efforts have largely been successful, and so competing industries are likely to continue them. To the extent those industries exhibit fragility themselves – as stated above, News Corp's value has fallen 29% YTD – their advocacy may even intensify.

Conclusion: Fragility isn't good for business, but it may decrease the risk Big Tech faces from regulation. This dynamic between market realities and political incentives will likely be in flux as the November midterms approach. We will provide an update on these developments in our Q3 presentation on regulatory risk in the tech sector in September. Past updates are available HERE and HERE.

Full 12-month historical recommendation changes are available on request

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