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From: Hal Varian
To: David Stallibrass
Cc: John Fingleton; Fabien Curto Millet
Subject: Re: passing along ad prices?
Date: Wednesday, September 9, 2020 12:43:26 PM

My concern is with "market" which I usually think involves financial transactions of some sort. There's no such "market" for search, though there is a market for search advertising of course. If you look at radio station mergers in the US, all of them defined "the market" as the advertising market, not the "content" market.

This chart is interesting, as it shows that most people arrive at shopping sites via direct navigation. Overall search ads are only 8% of the total. (Source.) There are other related numbers: 94% of clicks are organic, 6% are ad. Google advertisers get 5 times as many organic clicks as ad clicks on average.

On Wed, Sep 9, 2020 at 8:56 AM Hal Varian Redacted @google.com> wrote:

> "The EU find that specialist search is a complement, not substitute, for general search. They support this by noting that most specialist searches are preceded by general searches."
>
> By that logic, kissing is a substitute for intercourse.
>
> On Wed, Sep 9, 2020 at 1:00 AM David Stallibrass Redacted @fingleton.com> wrote:
>
>> On market power:
>>
>> What the CMA says:
>>
>> The CMA never formally defines a market (3.25 of their main report).
>>
>> They refer to the EU Shopping Case, which finds a market for General Search due to limited demand-side substitution (5.2.1.2 of their infringement decision). The EU find that specialist search is a complement, not substitute, for general search. They support this by noting that most specialist searches are preceded by general searches.
>>
>> The CMA found similar results for MoneySuperMarket and UK CSS services who also receive significant traffic from general search.
>>
>> The CMA also looked at Amazon (3.50), but were swayed by Amazon's argument that they can't be horizontal competitors given how much money Amazon spends on Google ads. The CMA also noted that retail search ads are <20% of total search revenue.
>>
>> They concluded that "specialised search providers provide only a limited competitive constraint to Google Search on the consumer side of the platform."
>>
>> In essence, they define market power by extension: Google wins auctions to be the default General Search provider, Google wins consumers from other General Search providers, and Google makes a lot of money.
>>
>> What I think:
>>
>> I have sympathy with not wanting to define a market. It's drawing a bright binary line which doesn't really exist.
>>
>> Having said that, there are a number of places where "General Search" is a clear product, such as default search bars. Google wins most (all?) auctions to be initial default. Google also wins in the market where defaults are changed by the user (either in app or through replacing Edge with Chrome etc.)
>>
>> The user may have a range of intents when they interact with the product, but I think it is reasonable to consider General Search as a well-defined focal product in these instances.
>>
>> Once you've defined "General Search" as a focal product, it's relatively easy to conclude that Google has market power in it.

While an alternative frame of analysis might focus on user intent to define markets - the search term rather than the search product characteristics - I suspect that boat has sailed.

d.

On Tue, 8 Sep 2020 at 00:31, Hal Varian Redacted @google.com> wrote:

> Back to the CMA issue... what does the CMA mean by "market power in search". I understand what it means to have "market power in online advertising" because you might consider "online advertising" to be a "market". (I don't, but I can see why some people say that.)
>
> But market power in search? What does that mean? Search for products? Search for hotels? Search for Socrates orations? Search for rock bands?
> With all these searches having zero cost to users. What does "market power" mean in this context?
>
> On Mon, Sep 7, 2020 at 4:23 PM Hal Varian Redacted @google.com> wrote:
>
> > Thinking a little more about the VC industry in the UK...
> >
> > You should talk to Patrick Pichette who was Google's CFO for many years and is now a VC in London.
> > He specializes in the EU-UK-CA geos, and knows a lot about what works and what doesn't.
> >
> > Another point: fully half of venture funded firms expect to be acquired rather than go through an IPO. If the antitrust authorities here make it harder for acquisitions, your going to see less entry by VCs exactly contrary to what you want. So I would say be extremely cautious about large firms acquiring small ones --- it's large firms acquiring large ones where the antitrust authorities should focus.
> >
> > On Fri, Aug 21, 2020 at 11:52 AM Hal Varian Redacted @google.com> wrote:
> >
> > > Hi, John. I've attached some notes I jotted down and a more finished piece from Brattle.
> > > See my inline notes below:
> > >
> > > On Fri, Aug 21, 2020 at 5:33 AM John Fingleton Redacted @fingleton.com> wrote:
> > >
> > > > Hal
> > > >
> > > > Excuse me jumping back into the conversation but could I ask a question? Are you aware of any good research that addresses evidence on ex ante incentives to invest and ex post success?
> > >
> > > There's a lot of work on the venture capital industry; see the Hall-Woodward links in my note.
> > > The VC industry in the US works on a portfolio basis and 70% of startups fail. So if 70% of your investments return zero or a nominal amount, then you have to do really well on a few investments to get a reasonable risk-adjusted return.
> > >
> > > > I ask because an important angle into this debate could be to try to influence those politicians (of whom there are many in the UK) who are very committed to growing innovation, which I see up close as I happen to chair the governing council of Innovate UK, which is a bit like DARPA. For example, the UK gives huge tax breakers to people who exit their companies at a personal level.
> > >
> > > Yes, there are some good tax breaks here as well. Most startups are funded by convertible loans: if the company fals you get to deduct your investment as a short term loss, but if it succeeds you can convert the note to stock and take long term capital gains. What a deal!
> > >
> > > > If competition people think that successful businesses can only earn competitive returns, then that does not leave a lot of overall return to innovation.
> > >
> > > I think that one of the Hall-Woodward papers tries to estimate the returns in VC.
> > >
> > > > I realise that there are limits to this line of argument, but one of the benefits might be that there is a large cluster of would-be innovators that might be concerned with a competition policy that means success results in taxation of that.
> > > >
> > > > In terms of research, what would be brilliant is any evidence of a policy shock that was shown to reduce innovation levels at an economy-wide level. I expect that may be asking too much.
> > >
> > > The US must be doing something right in this area; see below. BTW, why did the UK let Dyson trundle off to Singapore? That seems like a loss to me.

John

John Fingleton
Founder and CEO
Fingleton
10 Haymarket
London, SW1Y 4BP
www.fingleton.com

If you are still using it, please delete my old email Redacted @fingletonassociates.com and replace with Redacted **@fingleton.com.**

On Tue, 18 Aug 2020 at 01:54, Hal Varian Redacted @google.com> wrote:

On Mon, Aug 17, 2020 at 12:00 PM David Stallibrass Redacted @fingleton.com> wrote:

Hal, Fabien,

The difficulty with engaging with the CMA report is that it is, as my former Fingleton colleague Sam Bowman says, broad as an ocean and shallow as a puddle.

But it's already being picked up and recycled in the US and Australian.

So three thoughts below on some ways to respond to the "Google market power in search → higher prices for goods and services" argument, building on your comments.

1: It's hard to defend high profits, and I think it's an elephant trap to try

The base of most concerns with Google is that you have strong prima-facie market power in search, that you make a very large amount of profit, and that these are linked.

You can argue that you don't have market power in search, but it's going to be extremely difficult to win that argument

> until you stop making large amounts of money.
>
> You can argue that the amount of money you make is somehow fair - the investors need the returns, or something - but that's going to be something of an uphill battle, to say the least.
>
> This leaves competition agencies with the question of how those rents would be returned if you did not have market power. Which again I suspect is a question that Google doesn't want to get into.
>
> So I think there's quite a large part of the debate that in effect you need to cede in order to find some ground where you can get traction. While it might be necessary for legal reasons to dispute issues such as market power in search, I think doing so to a non-legal audience risk reducing the credibility of your more reasonable arguments.

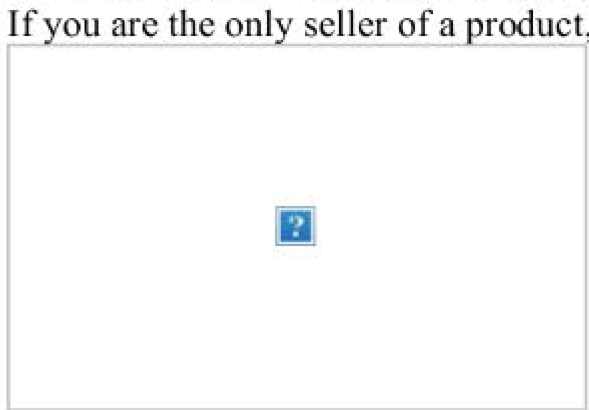
I agree with the point that defending Google's profits is difficult, but I'm going to try anyway.

1) Google is profitable because it lowered the price of ads and increased add effectiveness. Essentially we built a better (and a cheaper) mousetrap.

2) If you look at Google's revenue per user, it is on the order of $130B/2B = $65/year.

3) Google's median advertiser in the UK (according to the CMA) spends around £[200-300] per year. It used to be that global advertising was only for big multinationals. Google has made global advertising available to everyone. (See our https://economicimpact.google.com/ report.)

4) most of our ads are single ads on the page ("undersold auctions"), but more of our revenue comes from "fully sold auctions". If you are the only seller of a product, you get a fantastic deal.




> This is where I think your narrative on how Google does not unfairly extract the benefits of increased advertising efficiency is important. Rather than defend the absolute scale of Google profitability, it may work better to defend the relative benefit to Google of the various innovations that Google surfs, or acts as gatekeeper to, compared to other stakeholders.
>
> (Having said this, as you say the auction mechanism extracts a lot of the value of a search ad regardless of your market power, so it may be hard to show that advertisers are really benefiting that much from the ads side of the product rather than the organic side).

The auction only "extracts value" if there are lots of sellers. In the case where there are only a few sellers, the advertisers do very well in terms of surplus.

If you assume rational bidding, the attached BOE note shows that advertisers are getting a lot of surplus. Experiments also show very high return on ad spend. Like I said, it's a better mousetrap.

> **2: Clearly distinguish in your response between product-listing ads and other search ads**
>
> As you point out, much of the evidence that the CMA cites elides normal search ads with PLAs and other specialised ads. But the concerns for each differ significantly.
>
> I think it would be helpful to unpick the key charts in Appendix C (23 to 35) to separate normal search ads from PLAs / specialised ads.
>
> I think it would then be helpful to double down on the argument that PLAs and specialised ads are a consumer benefit, showing as much of the internal documentation as possible.
>
> You can then deal with the remaining non-specialised ads separately.

I think that's a good idea. The great thing about PLAs is that the shopper gets to choose whether or not they want to see more ads.

> (As an aside, I don't think the evidence that Bing has a lower market share but more adverts is quite the magic bullet that we would like. As I understand it, the CMA basically think the "market for search" is broken such that Bing can only win

> customers by paying for defaults and then keeping inert customers who don't switch. If the market "worked", consumers would more actively choose between Bing and Google and Bing would see different incentives on quality. I know this sounds really weird, but it's the strong impression I got from a couple of chats with CMA / BEIS economists, and consistent with Paragraph 106:

Of course Bing is the default search engine in the Edge Browser which is installed in every desktop PC shipped, so it's Google that is paying for pre-loading Chrome. Basically the Bing users are already ad-blind so the ad load isn't really a big deal to them. Bing, Yahoo, MySpace all had/have the same problem: excessive focus on short term revent. See this great article about MySpace.

>)
>
> **3. Take it to the detail on the particular concern of adverts for financial and consumer services and related comparison sites**
>
> The concern I have heard from both the CMA and BEIS relates not to *product* comparison sites but to financial and consumer services (such as gas, electricity, telecoms) comparison sites. Examples include moneysupermarket and gocompare. They are considered important to consumer outcomes in the markets they serve. They do not engage in the product carousel, but buy standard search ads for relatively standard search terms. They aren't Nextag.

What is curious is why moneysupermarket is so successful in the UK but there is no comparable site in the US. I think that their saturation ad campaign when the first started allowed them to build a brand, not just a search result. Netflix and eBay had a similar strategy.

> So I think the CMA's concerns can first be addressed by establishing that there is no link between Google market power on the consumer side of search and the cost to these services of obtaining leads from Google - either "per-lead" or in total. This would involve disputing the various transmission mechanisms set out in Appendix Q.

I would be willing to bet that AdWords would have a lower CPA than TV. The problem is that the marketing folks still have a TV mentality and are fundamentally innumerate.

> Unfortunately, this may still leave the conclusion that the auction mechanism does extract a lot of the value of the advert to the advertiser, independent of market power on the other side of the market. It may be that Google can live with this - after all, this is now no longer a matter of abuse of market power.

But it is a great model where the new entrant with a novel business with few direct competitors pays a lower price than the large incumbent. Take a look at Pinterest or Zoom.

> But I think it may be good to engage with the detail on how much the adverts cost, what the conversion rate is, and what the business models are of the relevant firms (comparison site, consumer/financial service provider) to show, if possible, that the impact of ad prices on final consumer prices for the services will be negligible.

I definitely agree, but I think that any of the hundreds of small online-marketing consultants can do this most effectively. As I recall the CMA did talk to some of these folks.

Thanks again for the stimulating conversation!

> ---
>
> Happy to discuss on a hangout.
>
> D.
>
> PS: As background, this question of ad-price passthrough has been a hobby-horse of mine for a while. I drafted another blog post about this exact issue the day after the report was published, but it was too angry and snarky and was therefore

not (I thought) helpful to Google. So I left it as a rant (you can read it here, complete with references to late 90s UK Shock Jocks that Fabien may get).

On Sun, 16 Aug 2020 at 07:46, David Stallibrass Redacted@fingleton.com> wrote:

Hal,

If it helps, I'll try this evening to pull together your suggestions in a way that might work with the more detail oriented types at the CMA / BEIS. Of course, as you suggested at first, there's also the broader stroked political arguments going on that we need to hit.

D.

(Hi Fabien!)

On Sun, 16 Aug 2020, 02:20 Hal Varian, Redacted@google.com> wrote:

Nextag's CEO, Jeffrey Katz, summarized this business model in his testimony to the US Senate:
*"We estimate that under 10% of our shoppers remember us when asked, and that is precisely because we **are among the** world's experts in how to use Google as a marketplace. For example, we are a very large Google search advertiser […]. We manage and bid on hundreds of millions of Google search keywords using very sophisticated software […] What we do, very few companies can replicate.*

See also this.

On Sat, Aug 15, 2020 at 6:14 PM Hal Varian Redacted@google.com> wrote:

Their case in point is price comparison sites (PCS's) for services, such as insurance and mortgages and electricity - moneysupermarket, gocompare etc.

Let's look at PCSes (known in Europe as CSS's). They get their product feed from merchants. Originally, there were a few different formats for uploading prices and product descriptions, but they've converged to a single format.
Once a merchant creates the data feed for Google Merchant Center, that same data feed can be uploaded to any online CSS. Over the last few years there have been over 300 price comparison sites created in Europe with an average of about 20-30 per year. This is an industry with very low entry costs. The major cost is letting users know you exist which is why they rely on advertising.
This is why Nextag got 65% of its traffic from Google --- and then complained that it wasn't enough!

On Sat, Aug 15, 2020 at 4:08 PM Hal Varian Redacted@google.com> wrote:

The CMA's main practical transmission mechanism for this seems to be that Google has increased advertising prices by degrading the user experience through the substitution of organic results for paid results, especially for navigational queries but also through product universals (relitigating search).

There is a commonly held view that ads are inferior to organic for search users. But if the searcher is looking to buy a product, the ads (particularly the PLA ads) are far superior for the searcher. So what you want to do is to have ads that the user can expand (if they are shopping) or if they are doing something else where ads are not relevant. This is the role of the ad carouselle which has been a big win.

WRT ads note that Google chooses the creative for the organic ads, but the advertiser choose the creative for the ad. This is a big plus from the advertiser point of view, since the advertiser can supplement (or repeat) the message in the organic result. See the Macy's ad and organic link.

Screenshot from 2020-08-15 15-58-29.png

On Fri, Aug 14, 2020 at 7:28 PM Hal Varian Redacted@google.com> wrote:

Never mind, I found the CMA reference. I attach some comments on the relevant pages.

Thanks again for describing the CMA point of view.

On Fri, Aug 14, 2020 at 1:22 PM Hal Varian Redacted @google.com> wrote:

> David, thanks for your insights into how the CMA views things. Here some comments about how we might respond.
>
> On Fri, Aug 14, 2020 at 6:05 AM David Stallibrass Redacted @fingleton.com> wrote:
>
>> Hal,
>>
>> I think the fact that total advertising spend has not changed, despite the significant increase in the technological efficiency of advertising brought about by targeting, is a point in their favour. It is consistent with the theory that Google has appropriated the surplus created by the possibility of targeted advertising over the internet.
>
> If by "appropriated" they mean that all the benefits of search have accrued to Google, it is clear that they are wrong since
> both users and advertiser's use Google search. It is widely documented that most visitors to most commercial websites come from organic clicks. See [this chart]:
>
> 
>
> Or [this study]. Our own internal studies of our 100,000 largest advertisers show they get 5-7 times as many organic clicks as ad clicks.
>
>> The CMA concern is particularly where firms are in relatively undifferentiated oligopolistic competition with each other, and get much of their traffic through search. Their case in point is price comparison sites (PCS's) for services, such as insurance and mortgages and electricity - moneysupermarket, gocompare etc.
>
> I think that most of the top sites get most of their visitors via direct navigation. It depends on your brand strength, of course. I don't recall seeing a comparison between between organic and ad clicks by the CMA, even though they have the data to do this. Perhaps they did a comparison and decided not to report it?
>
>> These sites are considered important for enhancing competition and consumer engagement in their relevent downstream markets. They have featured prominently in recent market studies and investigations into energy and banking, for example. Which is why I think the theory has relatively strong support (and the complainants find a sympathetic ear).
>>
>> I think the CMA argument is superficially attractive:
>>
>> - Google has market power in search (probably true)
>
> One metric to look at is the fraction of clicks and/or revenue where at least one advertiser is paying the reserve price.
> It turns out that this is a small fraction of our revenue. As economic theory would predict most of the revenue comes from "fully sold" auctions where it is competition that sets prices, not the reserve price.
>
>> - Market power enables a firm to extract rents through PQRS (true)
>
> Is that a definition?
>
>> - Price comparison services spend a lot of money on Google search ads such, and any profitability that is undifferentiated from their competitors will be largely lost in escalating bids for search leads (probably true)
>
> This sounds a lot like double marginalization: booking.com is charging hotels and Google is charging booking.com.
> So the remedy is for Google to acquire booking.com (just kidding of course)!
>
>> - Reducing Google maket power in search would reduce the amount that PCS's paid for their leads

> (intuitively attractive but imo false primarily due to two sided market).

Is their view that Google is artificially restricting the number of ads shown? So the remedy is for Google to show more ads?
Of course, there is also the question of "what price"? CPC? CPM? CPA? CPA is the only meaningful price and the CMA report says little about it.

> The CMA's main practical transmission mechanism for this seems to be that Google has increased advertising prices by degrading the user experience through the substitution of organic results for paid results, especially for navigational queries but also through product universals (relitigating search).

But Google has reduced the maximum number of ads shown. It used to be 8, now it is 4 and only a small fraction of queries (a few percent) get the 4 ads. We are making increasing use of carousels which are great from the user point of view. Those who want to see more prices and products can scroll sideways; those who don't want more ads don't scroll.

WRT navigational queries they work the same as they always have. Sites can choose whether or not to advertise in addition to the organic result. Contrary to the public reports, this can be beneficial to advertisers since the ad creative is chosen by the advertiser, while organic snippets are chosen programmatically.

> This mechanism is also flawed unless it can be established that the changes are truly a revenue-increasing degradation of service quality that competition would prevent. Which the CMA do not try to do.

Right, and they do state that Bing shows more ads that Google. This is also true of Yahoo, I believe.

> So the error, I think, is that the CMA (or more accurately, their economists) can't bring itself to accept that the nature of search is going to lead to the search engine getting most of the surplus from ads for relatively undifferentiated oligopolistic products.

In Shopping, we require that advertisers post prices and it is known that advertising prices results in lower prices. (There are studies for optometrists, lawyers, alcohol, etc. using regulatory variation across US states.) So if anything Google Shopping should push prices down.

> Anyhow. The short of it is that I am doubtful that the evidence you suggest will change hearts or minds at the CMA or BEIS, and may even by counterproductive.

I expect you are right. But consider the counterfactual where ad prices rose over the last decade. This would certainly be touted as evidence of market power! The fact that they have remained more or less constant for a century seems to me to be pretty compelling.

> Very happy to discuss on a call if you'd like.
>
> David.
>
> On Thu, 13 Aug 2020, 23:33 Hal Varian, Redacted@google.com> wrote:
>
>> Hi, David. I don't think the CMA is thinking about counterfactuals, they are looking at actual digital ad spend which has indeed increased. But they should be looking at total ad spend which has essentially remained constant. In the counterfactual where digital ads were illegal, then there is no reason why other forms of advertising would have changed, so there is no harm to the consumer compared to that counterfactual (at least on the consumer side).
>>
>> Claim 1 (CMA) "...an increase in advertising costs may increase final prices".
>> Claim 2. (Hal) therefore, "..a **decrease** in advertising costs may **decrease** final prices"
>> Claim 3. (CMA) "...the costs of **digital advertising**, which amount to around £14 billion in the UK in 2019, or £500 per household, are reflected in the prices of goods and services across the economy."
>> Claim 4. (Hal) "... but the total expenditure on advertising (of all sorts) has been essentially constant"
>> Claim 5.(Hal) So, on average, that alleged £500 increase in digital advertising has been counterbalanced by a £500 decrease in some other form of advertising. So in net there is no incremental cost per household from the increase in digital advertising expenditure since there was no change in total ad spend.

image.png

On Thu, Aug 13, 2020 at 12:53 PM John Fingleton Redacted @fingleton.com> wrote:

> Hal
>
> Great to hear from you. The piece is actually by my colleague David Stallibrass. His comment was that the antitrust counterfactual is not "before Google" or "without internet" but rather "with internet but without Google." But in case you want to discuss further, and because David is a very bright and creative mind who knows and is known to a lot of your colleagues, I thought I would connect you.
>
> Best wishes
>
> John
>
> John Fingleton
> Founder and CEO
> Fingleton
> 10 Haymarket
> London, SW1Y 4BP
> www.fingleton.com
>
> If you are still using it, please delete my old email Redacted @fingletonassociates.com and replace with Redacted **@fingleton.com.**
>
>
>
> On Thu, 13 Aug 2020 at 02:53, Hal Varian Redacted @google.com> wrote:
>
> > Hi, John. Just read your piece on passing along ad prices. Take a look at the attached and this chart: https://nber.org/reporter/2020number2/
> > The total expenditure on ads has barely changed; online has grown by about the same amount that print has contracted, leaving spend about the same.
> > So there's nothing to pass along.