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Disruption Outlook: The Political Game of Breaking up Big Tech

Disruptive Forces in Investing

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Anu Rajakumar: Make no mistake, big tech companies have unparalleled access into the lives of their users. Whether it be their social networks, their consumer behavior, their personal photos and videos or their health and wellness. Despite the immense convenience and generally positive nature of the relationship between a big tech company and the customer, there is growing concern about how private data is collected and used, the lack of competition and also how the spread of false information could influence a democracy's election. My name is Anu Rajakumar, and in the last of our three part miniseries on political impacts to key investment markets, I'll be joined by Hari Srinivasan, Senior Research Analyst with Neuberger Berman's equity research department, to discuss the key factors weighing on big tech. And Hari, there's a lot to discuss today. So thank you so much for joining me.

Hari Srinivasan: It's great to be here.

Anu: So Hari, in the U.S., on the presidential campaign trail, we've seen key contenders express vocal support for breaking up big tech companies, all in the name of defending the consumer. What do you make of all of this, and where do you think we're heading?

Hari: I think the simplest way to express this is that the regulatory environment is going to change. The operating environment for these companies is going to be very different in the next three to five years compared to what they've experienced so far. And I think there are three primary buckets in which we see where the regulatory risk could happen. The first one, I would call is privacy, which deals with essentially protection of consumer data and the rights of the consumer, because in some cases the consumers don't really know how the data is being used by these companies going forward. The second one is what I put broadly under the umbrella of antitrust. What I mean by that, is these companies have become very large and there seems to be a perception that they are being uncompetitive, and it's very difficult for innovation to happen in these industries. And therefore, they ought to be broken up so that there is greater competition, and there's a lot of startup innovation that currently doesn't seem to exist. And the third area that I would say, and this has been a new area that we have to follow, is that a lot of the state attorney generals are now not even looking to the federal agencies to do the regulatory work. They are pooling their resources together—you have 50 states, and if you combine the number of lawyers they have, it's quite a lot. And they're actually going to court directly. And in some cases, if the decision by the federal agencies is not something that they agree with, they bring their own case. So there are so many fronts on which these companies need to fight the battle.

Anu: Now, on the antitrust front, this is interesting because in the context of big tech. It's so different to its original context or original meaning, because for the most part, most big tech customers aren't paying for anything. Can you talk a little bit about antitrust and how this view is changing now?

Hari: Yeah. Historically, the U.S. has been much more focused on consumer welfare. Whereas Europe historically has focused much more on competition, and that's been one of the areas where we've seen the regulatory environment being very different. But what is happening in the U.S. is given some of the mistakes that these companies have made and the fact that the elections in 2016, rightly or wrongly, people think have been influenced by these media companies. There is just tremendous amount of pressure by Congress on these federal agencies to do something about it. And also, there is this feeling that Europe is kind of gaining a lead on the regulatory scrutiny of these companies, and historically, the U.S. has been at the forefront of antitrust regulation. So what we see happening is that the last 30 years, I think in the late 60s onward, the antitrust was essentially decided based on a consumer welfare standard. That is whether a merger can go ahead, and how will it affect consumer over the long term. But now, I think these companies have become so large and they control such large portions of the U.S. economy, I think the regulators are looking at it and saying, “Are there any network effects that permanently make them like a monopolist in that industry and they, therefore, suppress competition and innovation.” And there is also this perception in Congress that the U.S. ought to take the lead back from Europe, and therefore, the antitrust rules need to be looked at completely in a different way in favor of this tech evolution and tech dominance.

Anu: And what's your view on the innovation piece that you just mentioned? Do you think that innovation is being suppressed by keeping these companies in tact at the size that they are, or should they be broken up?

Hari: I personally think that these companies have been very innovative. I think we can all look and see how Google has changed our lives with the services that they provide. How Amazon has improved the whole e-commerce experience for us, and then how Facebook actually has helped people communicate and keep in touch with relatives. I have relatives all over the world, and WhatsApp is the primary media by which we communicate. But having said that, I think there are issues that need to be looked into. I would definitely see it on the data privacy and the consumer protection areas. There could be some work that could be done, and then the other area is this competition/innovation is something that the regulators are not comfortable with and it's something that we need to look into. The more important issue here is that we just don't have any regulations. So these companies are operating without any framework. If Congress can actually sit down and lay out this is the rules of the law, these are the rules of the game, I think these companies can implement them and run away with it.

Anu: And so what have the companies been doing in response to the focus on privacy and antitrust? What has been the company response?

Hari: Most of these companies have realized that privacy is a very important aspect, and they do have some kind of experience in this area. For example, Europe, Postrel, local GDPR. Which is essentially providing customers with an opportunity to make sure that if they don't want Google or Facebook cannot use the data for advertising purposes and these companies have implemented new rules and regulations around it. The other thing that they have done, especially Facebook and Google, is they've spent a lot of dollars. In some cases larger than the revenues of some of their smaller competitors. So they are doing a lot moving in that direction, and I think one of the things I would also highlight is that a lot of these issues happened in 2016. And if you look at the elections that have happened after that, we haven't seen any problem, especially the midterm that we had last year.

Anu: I think you just alluded to this. But, you know, in recent weeks we've seen some of these tech companies announcing updated policies with regard to political advertising. What kind of effect do you see this having on the upcoming U.S. presidential election, if any?

Hari: I think the 2016 election has been a good learning experience for these platforms and they're taking this thing very, very seriously. Facebook has invested significant amount of resources in improving the privacy and the accuracy of information on the platform. And I think a case for their investment or a positive scenario would be the 2018 midterm election. We didn't really find any discrepancy, at least nothing that we know so far, which tells us that whatever investments in the policy changes that these companies have implemented on the platform is working so far. The bigger issue that I'm completely not sure right now is whether breaking up is going to solve anything, because to really improve the privacy and the accuracy of information on the platform, it requires a lot of capital. Facebook has invested more than a couple of billion dollars in improving the accuracy of the platform. They've hired more than 30,000 people just to monitor the content. And I think if you break them companies and lower their revenues overall, they might not have the financial power that's needed to really satisfy the accuracy requirements that are required going forward. So it is something that we all need to look at and not get totally carried away by the rhetoric, but look at it in the broader frame of mind and see how the regulators ought to implement these regulations. I'm not saying that regulations are not important. They are definitely important because right now we have nothing that it's more like a “Field of Dreams“ kind of story, But I think some kind of regulatory thing is important. But I don't think that breaking up is the right way to do it.

Anu: Sure. I'm curious about what you think the likelihood of a breakup for some of these big tech companies is, and if that does indeed come to fruition, how do you think that will change the way that investors think about investments in technology and how will that risk profile change?

Hari: I think the chances of breakup are not that high right now unless there is a legislative change, because the way I see this case is proceeding is that I do expect the federal agencies, whether it's the DOJ or the FTC, bringing out a case next year against Google, Amazon and Facebook saying that these companies ought to be broken up, and they're just getting too big for the economy's sake and they’re suppressing competition and innovation. But I think these companies will challenge them in court. And If there is no legislative change, what I see happening is the courts are going to probably favor these companies because they're going to go based on the consumer welfare standard, and based on that particular standard, I think they haven't done any harm so far. So that's an area that we have to watch, whether there's any political change in DC and how does the legislative framework change. Now as far as how investors are looking at it right now, what I would say is that I think investors aren’t very worried about it. They're not really sure how this thing is going to play out. And whenever you have uncertainty in the market investor, they're very careful. And people are little concerned as to what the future is going to look like. But having said that, I think we have to monitor the whole thing very carefully to see how we go about doing things because they are also very important parts of the economy. In this slow growth environment you can't really find too many companies that are growing 20 percent or more on a secular growth basis. So they're very attractive to investors, but at the same time, there's a lot of risk associated with it.

Anu: And now we've focused our discussion largely on U.S. tech companies. What about outside of the U.S.? How could an increased regulation on these largely American companies, how is that either translating or affecting non-U.S. companies?

Hari: One of the pushbacks that these companies have made is that the size of the company and the amount of investments that they made in the technology platform, because these days it does require a lot of capital to get into new areas, whether it's artificial intelligence, or machine learning, or AR/VR like augmented reality or virtual reality or the public cloud. The size of the companies that would actually help them invest in this new market and allow U.S. to gain competitive advantage over the long term. We are seeing that the Chinese internet companies are becoming pretty big, and they're growing much faster than the U.S. companies, and they're becoming a force to reckon with. And one of the things that these companies are pushing back on regulatory framework is that because of the dominant to the U.S. internet companies and U.S. companies in the internet industry in general, the internet has evolved with a democratic framework and with U.S. core values at stake where people can express their opinion freely being worried about any kind of feedback or any kind of pushback from regulators or from government.

And also they are very confident. They trust the platforms, that they're not going to share the data with the government. So the platform is a free open platform. Internet has become a free and open platform where people can express themselves. I think if these companies are broken up and the Chinese companies who're already pretty large begin to dominate, one of the worries that we have is the world can get split into two different areas. There could be a Western world focused technology industries and a Chinese focused technology industries. And the internet, rather than being open, might be more regulated.

Anu: And finally, Hari, I'm curious about whether you think there are any big misconceptions that people have regarding big tech and regulation. For example, what are investors potentially misinterpreting here when it comes to investment opportunities?

Hari: Yeah, I would classify that into three big buckets. I think the first one is the whole consumer welfare standard that we discussed. I think there is this perception among some investors that because these people are not hurting the consumer, they don't really have much of a risk. I think the chance of an antitrust risk are very minimal and I think people don't realize the level of anger and animosity towards these companies in Congress, which can translate into something really bad for these companies from a regulatory perspective. The second area where I think there's a lot of misconception is people believe that a lot of the acquisition that these companies have made in the last four to five years cannot be taken apart, because historically they were all approved by the FTC and therefore, you can't do that. But I think we are hearing from Congress that they're looking at every single acquisition. So they can even go ahead and kind of break away some of the acquisitions that they've made or some of the acquisitions that have been consummated. And that could be a big negative because that, I don't think, is something that people are anticipating from that perspective. And the third thing that I think it's important for for investors to really understand, is that the this is going to be a long, drawn affair. And therefore, the way I think this is going to play out, it's going to probably play out in the courts for the next three to five years. And based on the current legislative framework, I think the chances are minimal. But what we are hearing from the people in DC is that there might be some legislative change. And therefore, for legislative change to happen, you would really have to look at what you were talking before, whether there would be any change in political landscape in DC next year. Let's say, just for the sake of discussion, if the Democrats take over the Senate and the presidency, I think there could be some change in its legislation, and that can help the courts reinterpret the legal framework. Because right now the courts are looking at this from the consumer welfare standard, and I think the risk is minimal. But if Congress changes the rules of the game, there's a lot of pressure in Congress to do that because they believe this antitrust law is outdated. It doesn't really stand the true test in this technology driven landscape. So those are things that we are monitoring in DC. I make a lot more frequent trips to DC to really see where the pulse of the whole discussion is. But those are the three areas that I would be watching over the next 12 months.

Anu: Sure. Great. Well, Hari thank you so much for chatting with me on this very fascinating and pretty complex topic. Now, I personally am not sure what big tech will look like in five or 10 years, but I'm very sure that you'll be keeping extremely busy keeping up with all these important developments in the space. So thank you again.

Hari: Thanks for the opportunity Anu.

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