On Network Effects

Following my previous submission "On the Statement of Unresolved Issues (SoUI)", I'd like to follow up with a commentary on the discussion of Network Effects mentioned in the SoUI.

The SoUI makes a number of points regarding network effects in the property information market in New Zealand, for example:

> *SoUI 44.1 vendors/agents want their listing to be seen by as many potential buyers as possible so will want to list on the platform with the most buyers; and*
>
> *SoUI 44.2 potential buyers will tend to visit platforms that have more listings to give themselves the best chance to find a house that best meets their needs/preference.*

These discussion points and others ultimately lead to the conclusion in SoUI Point 125:

> *SoUI 125: "We also recognise that the Proposed Acquisition will allow the merged entity to gain audience. This gain in network effects will raise barriers to expansion to firms such as OneRoof".*

This conclusion consists of 3 unestablished clauses:

1. That the merged entity will gain audience, and;
2. That the gain in audience has network effects, and;
3. Network effects will raise barriers to expansion to firms such as OneRoof.

My counterargument is set out as follows:

1. Any gain in audience will be small to none due to the size of Trade Me's existing audience and likely overlap with Homes.co.nz. There may be no audience gain at all.
2. Any network effects will therefore be small to none.
3. Low marginal costs of multi-homing will continue, and will allow all companies to compete normally in the factual case. This is because companies only need a small differentiation in utility to allow consumers to utilise their offerings, given the low marginal cost of consumption.

I add more detail to this counterargument below.

> Lemma 1: The merged entity may gain audience, *if and only if* one audience is not a complete subset of the other.

Trade Me's audience is large, approximately 50% of New Zealand's population are registered users. It therefore appears on the balance of probability reasonable to conclude that the overlap in audience between Trade Me and Homes.co.nz is large and possibly complete. Therefore any gain in audience or the merged entity is highly likely to be correspondingly small and possibly zero.

The corollary of the above leads directly to the conclusion that any network effects from the factual case will be small to zero.

However, let's consider the case where there is a gain in audience and that that gain in audience. The SoUI assumes that a gain in audience leads to network effects, comparatively raising the competitive positioning of the merged entity. This conclusion is not justified, given the existence of multi-homing in the property-information market and the non-linearity of that market.

MULTI-HOMING

The vast majority of vendors will list on many online sites, as well as print materials. There is a tiny marginal cost of doing so compared to the value of a house sale, and the potential gain from additional exposure. Real Estate Agents also commonly bundle marketing options making multi-homing for vendors the default.

The SoUI term this behaviour "multi-homing" and discusses in detail in Points 38 to 41. Multi-homing is the default for the New Zealand property market, allowing multiple sites with ostensibly similar information to all generate suitable returns on investment.

The next two Lemmas (2 and 3) are true by definition:

> Lemma 2: Marginal costs for consuming data from multiple sites is small (SoUI 39.1.2).
> Lemma 3: Marginal utility for consumers will approach marginal costs of consumption.

These 2 lemmas reinforce the fact that multi-homing is the logical default behaviour of this market.

The only other point I would like to make in response to SoUI 40 request for feedback is that utility is not only a function of information quantity. It is also a function of consumer preference.

Consumer preference includes a wide variety of invidual-specific factors. For example:

1. ease of consumption,
2. marketing approach,
3. content,
4. user interface (attractiveness of website, image size, fonts, mobile versus web etc),
5. technical considerations (e.g. data consumption, speed) or any other difference in consumer preference.
6. Etc.

Utility is therefore also a function of time as these consumer preferences are not static, and neither are the sites themselves.

Changes in utility are a normal part of doing business, and this situation will not change in the factual case. The low marginal cost of consumption will benefit any business who can provide any utility greater than or equal to this low marginal cost.

SUMMARY

This submission has looked at network effects, and in particular the conclusion stated in SoUI 125.

I submit that audience gain for the combined entity in the factual case is likely to be small to none, based on Trade Me's existing audience. Therefore, network effects are also likely to be small to none.

To respond to the request for information in SoUI 40, I also show that multi-homing is the default behaviour because of minimal marginal costs, and utility being a function of information, consumer preference and time. Small gains in marginal utility through changing consumer preference (bought about by UI differences for example) suggest that on the balance of probability, multi-homing will continue to be the default behaviour for the market.

Individual firms able to react to the market normally and adjust the utility they provide both vendors and information consumers in the factual case by changing their content, their user-interface, their methods of communicating with their users, etc.

On the balance of probability, I conclude that because any audience gain is likely to be small, any network effects will similarly be small, and multi-homing will negate the impact of those (small) network effects.

Therefore, SoUI 125 can be rejected in its entirety.

Please contact me directly if any clarification or discussion is required.

Kind regards

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