

Organizational Theory and Decision Making

Part I: Foundations and Boundaries of Organizations

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Part I.A: Transaction Cost Economics

Video 3:
The Hold-Up Problem (Examples)

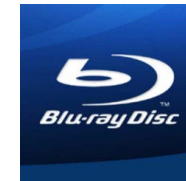
Real-World Hold-Up: Multisided Platforms (1)

Based on Hagiu and Yoffie (2009) «What's Your Google Strategy?», Harvard Bus. Rev.



App Store

YAHOO!



ebay

ricardo.ch



amazon.com



COMPACT
disc
DIGITAL AUDIO



Google



Real-World Hold-Up: Multisided Platforms (2)

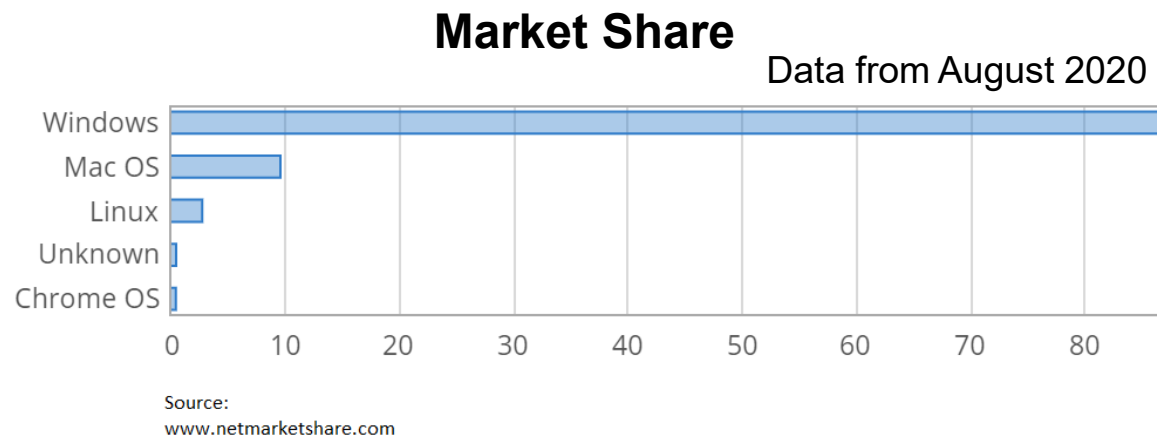
- A multisided platform (MSP) is a technology or service that connects different types of customers with each other
- Examples:
 - Amazon / eBay / Ricardo
 - Merchants / Internet consumers
 - Google / Yahoo
 - Advertisers / Users
 - Windows / Mac OS / Game Consoles / Smart phones
 - Software developers / Users / (Hardware manufacturers)
 - Blu-ray / Compact Disks
 - Content providers / Users / Manufacturers of players

Real-World Hold-Up: Multisided Platforms (3)

- MSP's can be very useful for companies
 - they facilitate search capabilities and reduce transaction costs
 - they make sales more efficient and increase customer reach
- ... but MSP's can also be dangerous, because they may become very powerful and engage in hold-up
 - Working with MSP's often requires substantial specific investments
 - Many MSP's insist on exclusivity agreements
 - Companies may become strongly dependent on MSP's
 - MSP's can exploit this dependence to hold up companies and to extract more value for themselves

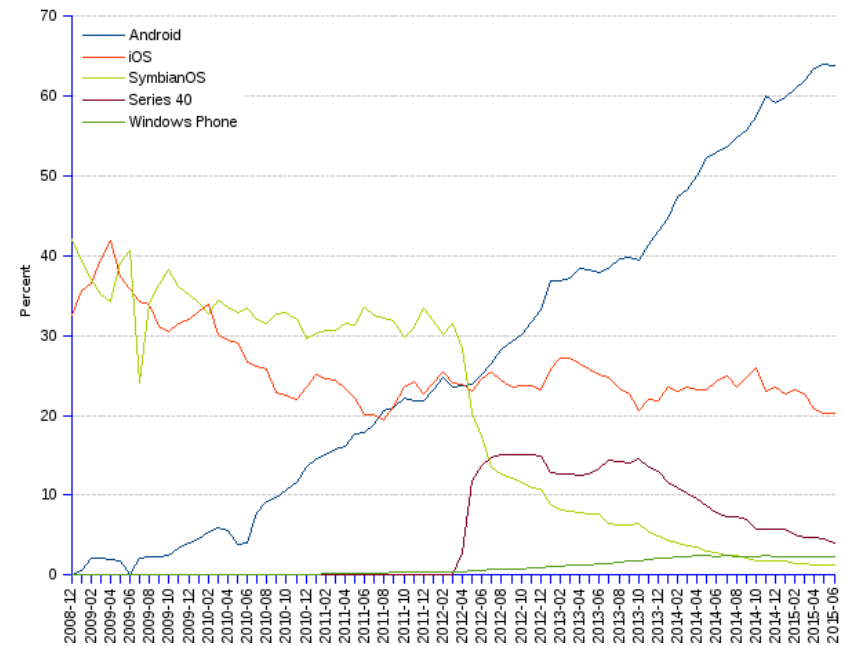
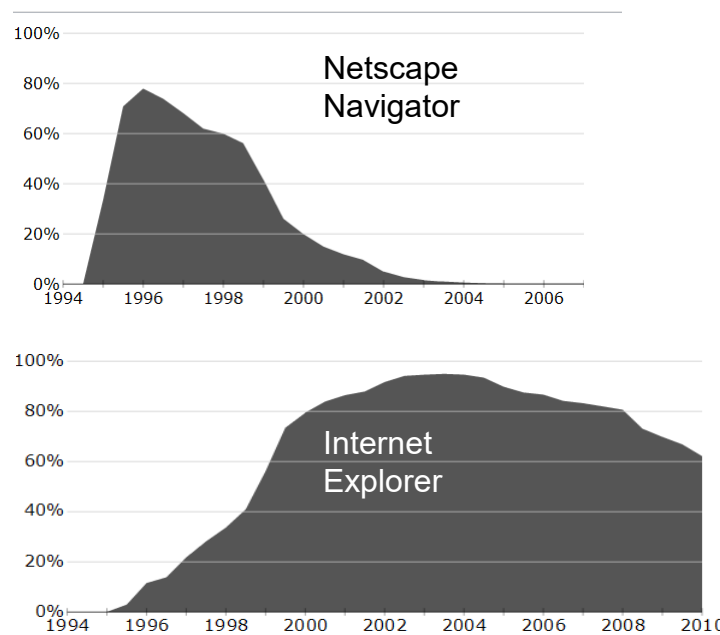
Real-World Hold-Up: Multisided Platforms (4)

- MSP's have different ways to engage in hold-up:
 - Increasing prices once the MSP is successful
 - After Windows became dominant, Microsoft raised license prices for manufacturers every other year



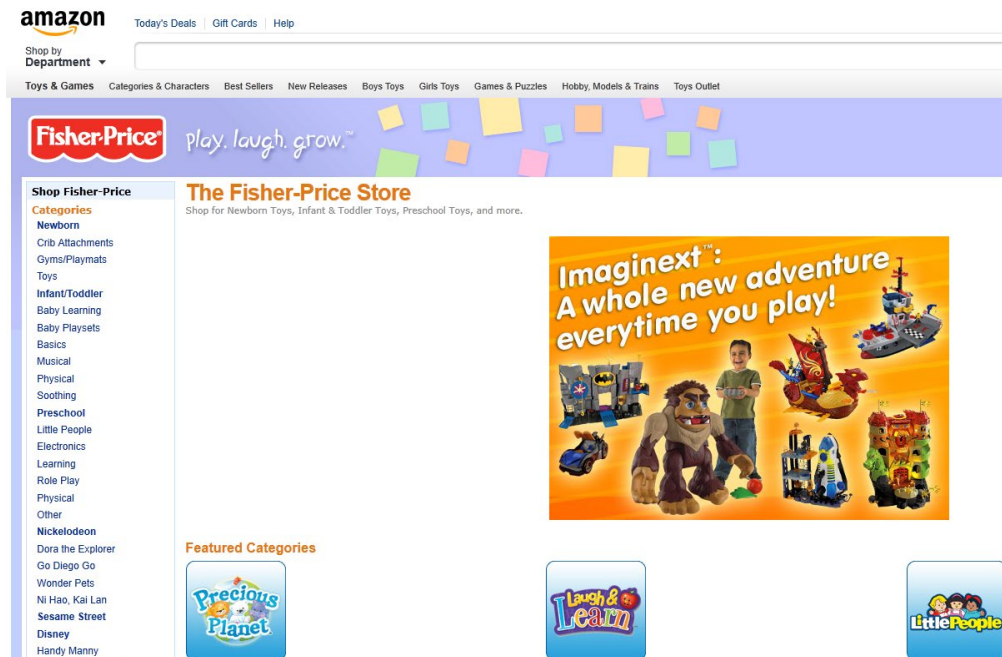
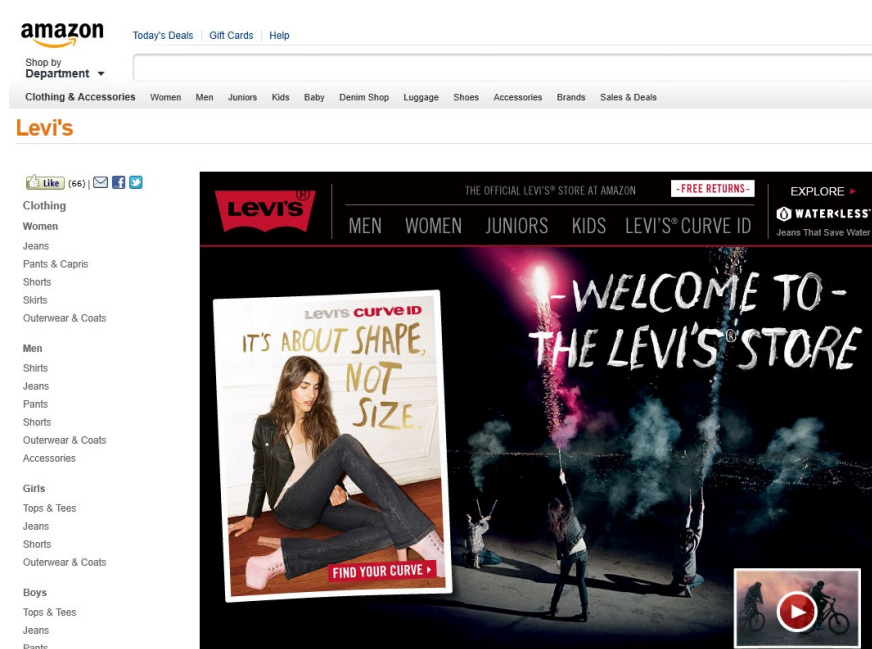
Real-World Hold-Up: Multisided Platforms (4)

- MSP's have different ways to engage in hold-up:
 - Vertically integrating in companies' businesses
 - Microsoft: Integration of Explorer in Windows
 - eBay: Setting up PayPal as the payment standard
 - Google: Development of phone operating system "Android"



Real-World Hold-Up: Multisided Platforms (4)

- MSP's have different ways to engage in hold-up:
 - Weakening companies' relationship with customers
 - Amazon often used large companies to set up a new category of products on its website (Toys“R”Us, Gap, Borders etc.). Once a category was established they opened up for other vendors in the same category, which considerably hurt the “starters”



Real-World Hold-Up: Skype, eBay & Joltid



Real-World Hold-Up: Skype, eBay & Joltid (1)

- Skype was founded in 2002 by Niklas Zennström and Janus Friis (cofounders of “Kazaa” and “Joost”)
- Skype offers high-quality voice communications to anyone with an Internet connection anywhere in the world
 - Free computer to computer communication (with video)
 - (Relatively) cheap computer to phone conversations
- In 2005 eBay bought Skype for \$ 2.6 Billion, because they thought that there would be productive synergies
 - Integration of Skype would allow for simple voice communication between buyers and sellers on eBay (especially helpful for more complicated transactions like buying used cars etc.)
 - PayPal services could be used to pay for Skype services

Real-World Hold-Up: Skype, eBay & Joltid (2)

- Meg Whitman in 2005 (CEO of eBay, 1998-2008):

“By combining the two leading e-commerce franchises, Ebay and PayPal, with the leader in internet voice communication, we will create an extraordinarily powerful environment for business on the Net”

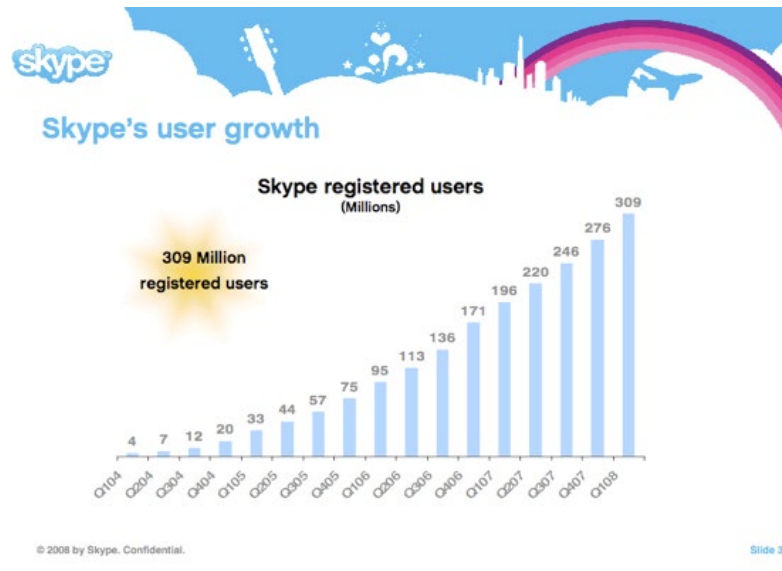


Real-World Hold-Up: Skype, eBay & Joltid (3)

- Skype (as well as Kazaa and Joost) was based on a technology called the “Global Index”
- The “Global Index” is an advanced peer-to-peer technology owned by Joltid Ltd., a company controlled by Zennström and Friis (the founders of Skype)
- When eBay bought Skype, the deal didn’t change the ownership rights for the Global Index (i.e., it remained in the hands of Joltid)
- Joltid and eBay signed a long-term licensing agreement which granted eBay full use of the technology (but only very limited rights to modifications)

Real-World Hold-Up: Skype, eBay & Joltid (4)

- Unfortunately, it turned out the eBay and Skype have actually only very small synergies
 - Most eBay sellers cannot afford staff to handle voice conversations
 - Voice conversation play almost no role on eBay
- However, Skype has grown immensely over the years (548 million users in 2009) and has become a communication standard



Real-World Hold-Up: Skype, eBay & Joltid (4)

- But since Skype has no relation to eBay's core business, eBay announced in spring 2009 that they would spin off Skype through an initial public offering (IPO) in 2010
- This would create a substantial amount of money for eBay, which they need to deal with some of their more recent acquisitions (e.g. Gmarket, a large Korean e-commerce site)

Real-World Hold-Up: Skype, eBay & Joltid (5)

- John Donahoe (eBay CEO, 2009):

“It’s clear that Skype has limited synergies with eBay and PayPal. We believe operating Skype as a stand-alone publicly traded company is the best path for maximizing its potential”



Real-World Hold-Up: Skype, eBay & Joltid (6)

- After eBay had announced the spin off, Joltid started to claim that eBay had violated the licensing agreement
- This legal dispute between eBay and Joltid called the Skype IPO into question and made it very hard to sell Skype to any bidder except the Skype founders
- However, when the founders offered to buy Skype back, eBay refused and announced that they would develop alternative software to make Skype independent from Joltid
- Unfortunately, the development of such an alternative turned out to be difficult and the dispute between eBay and Joltid could not be resolved quickly
- In September 2009 it was announced that Silver Lake (a private equity fund) might buy Skype for about \$ 2 Billion

Real-World Hold-Up: Skype, eBay & Joltid (7)

- In November 2009 it was announced that eBay and Silver Lake had reached an agreement with the Skype founders
- The deal involved the following components:
 - Silver Lake took over 56 percent of Skype
 - 30 percent remained in eBay's hands
 - Zennström and Friis got 14 percent and two seats on the board of Skype
 - In exchange the Skype founders transferred the “Global Index” over to Skype
- In May 2011 it was announced that Microsoft agreed to acquire Skype for \$ 8.5 billion

Real-World Hold-Up: Skype, eBay & Joltid (8)

- Shortly after its acquisition, Microsoft began integrating the Skype service with its own products
 - Default messaging app for Windows
 - Replaced Windows Live Messenger
- Microsoft redesigned its Skype clients in a way that transitioned Skype from peer-to-peer service to a centralized Azure (cloud) service

Number of Skype users registered worldwide
(in billions)

