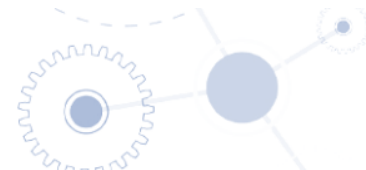


# Discussion of Knieps and Bauer's “The Industrial Organization of The Internet”

Dan Herweg

December 11, 2018



# The industrial organization of the internet has shaped the industrial organization of firms that thrive on it

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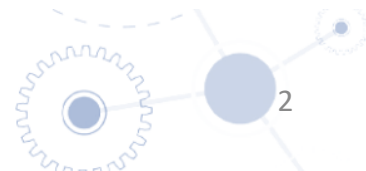
## 2. The industrial organization of the Internet

*Günter Knieps and Johannes M. Bauer*

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### 2.1 INTRODUCTION

Outlining the elements of an industrial organization of the Internet requires an operational delineation of its boundaries and reliance on theoretical frameworks appropriate to its rapid pace of change. We respond to the first challenge by examining the Internet as a multi-layered socio-technical system. Embracing an inclusive perspective of the entire Internet ecosystem we differentiate, where appropriate, network infrastructure from



# The industrial organization of the internet has shaped the industrial organization of firms that thrive on it

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## 2. The industrial organization of *Günter Knieps and Johannes M. Bauer*

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### 2.1 INTRODUCTION

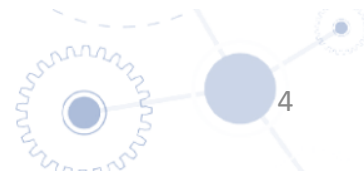
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# Amazon provides a case study illustrating many of the concepts put forth in this paper

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- Centralization and decentralization
- Low variable/high fixed costs
- Regulatory pressures
- Increasing returns to scale



# Amazon harnesses market forces on a centralized platform

## Centralization and decentralization

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- Amazon Marketplace allows 3<sup>rd</sup> party sellers to compete with Amazon, often using Amazon's own fulfillment
- The network effect brings buyers and sellers together in a positive feedback loop
- Transaction costs are minimized
- Scope of products offered increases



# Amazon has built cost and differentiation moats

Low variable/high fixed costs

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- Competing with Amazon would require large, sophisticated investments
- Amazon's scale is massive, reducing the burden of these costs
  - Fixed costs become a lower % of revenue
  - Variable costs also decline, due to
    - Scale
    - Negotiating leverage
    - Efficiency improvements



# Amazon's dominance has attracted attention from regulators


## Regulatory pressures

### Amazon's looming challenge: Europe's antitrust laws

By Matthew Yglesias | @mattyglesias | matt@vox.com | Sep 21, 2018, 1:00pm EDT

f t SHARE



 **Donald J. Trump**  
@realDonaldTrump

I am right about Amazon costing the United States Post Office massive amounts of money for being their Delivery Boy. Amazon should pay these costs (plus) and not have them borne by the American Taxpayer. Many billions of dollars. P.O. leaders don't have a clue (or do they?)!

80K 2:55 PM - Apr 3, 2018

### Austrian retailers file antitrust complaint against Amazon

REUTERS DECEMBER 10, 2018 2:55 AM



HOME / RESEARCH / NEW YORK'S "AMAZON..."

### New York's "Amazon Law": An Important Tool for Collecting Taxes Owed on Internet Purchases

JULY 24, 2009 | BY MICHAEL MAZEROV

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# Amazon's CEO has made moves that appear to seek favor and influence in Washington DC

## Regulatory pressures

### HQ2 in the D.C. area could help Amazon snag a \$10 billion Pentagon contract

Published: Nov 20, 2018 10:48 a.m. ET



Aa

Two congressmen voice concerns about how the JEDI cloud-computing contract is tailored



Crystal City, Va., is one of the possible locations for Amazon's second headquarters.

As Amazon.com Inc. moves forward with setting up its second headquarters,



### Amazon boss Jeff Bezos buys Washington Post for \$250m

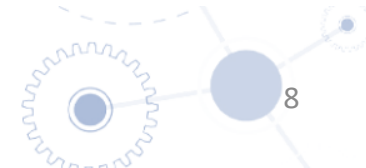
The boss of Amazon, Jeff Bezos, has agreed to purchase the Washington Post newspaper for \$250m (£163m).

Mr Bezos is buying the paper and its other print properties in a personal capacity.

The Post has been owned by the Graham family for 80 years.

Michelle Fleury reports from New York.

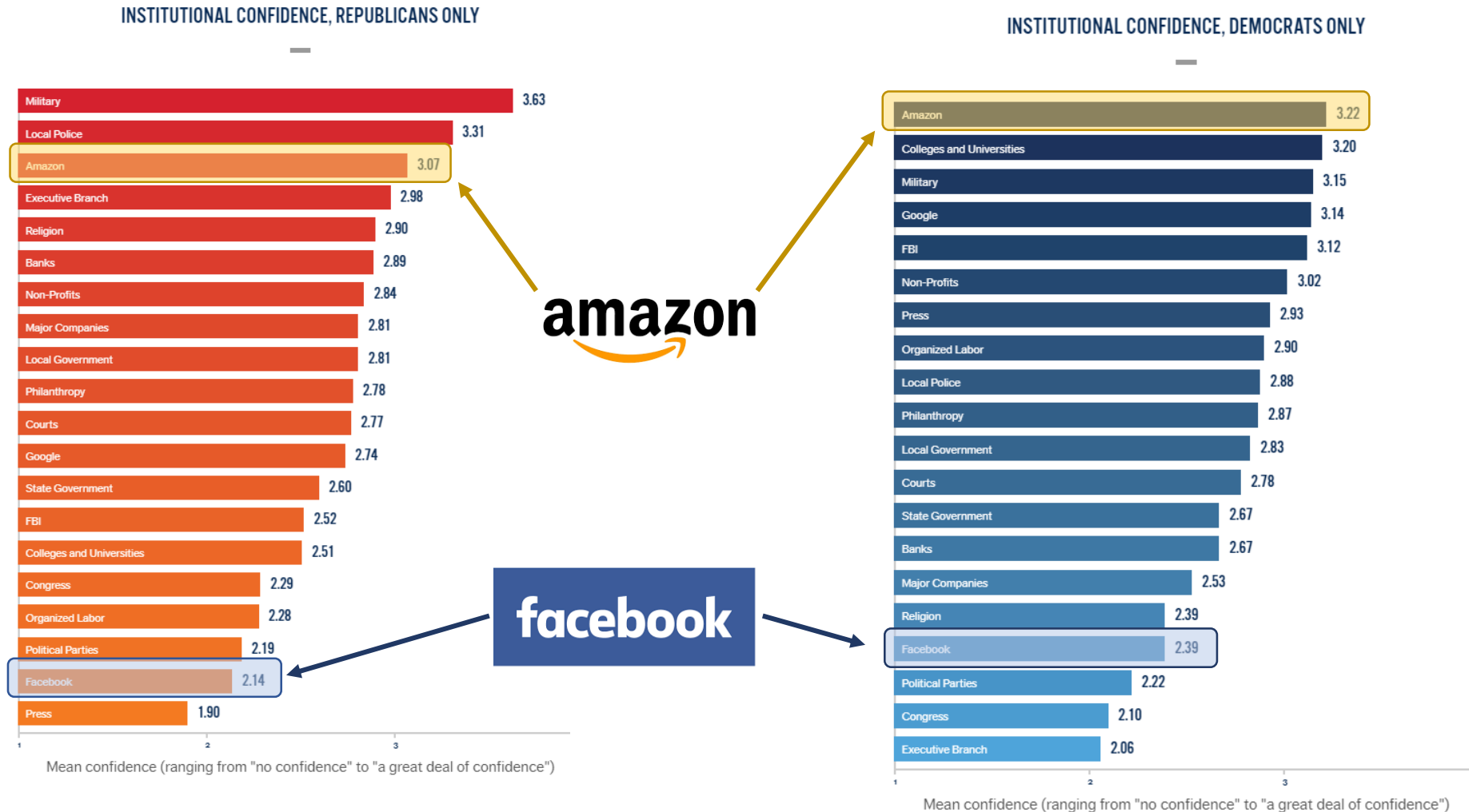
© 06 Aug 2013





# However, Amazon's popularity remains bipartisan

## Regulatory pressures



Source: <https://bakercenter.georgetown.edu/aicpoll/>

# Amazon is obsessed with the customer and market leadership

## Increasing returns to scale

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The foundation of our decision-making philosophy was laid out in our 1997 letter to shareholders, a copy of which is attached:

- We will continue to focus relentlessly on our customers.
- We will continue to make investment decisions in light of long-term market leadership considerations rather than short-term profitability considerations or short-term Wall Street reactions.
- We will continue to measure our programs and the effectiveness of our investments analytically, to jettison those that do not provide acceptable returns, and to step up our investment in those that work best. We will continue to learn from both our successes and our failures.
- We will make bold rather than timid investment decisions where we see a sufficient probability of gaining market leadership advantages. Some of these investments will pay off, others will not, and we will have learned another valuable lesson in either case.

You can count on us to combine a strong quantitative and analytical culture with a willingness to make bold decisions. As we do so, we'll start with the customer and work backwards. In our judgment, that is the best way to create shareholder value.

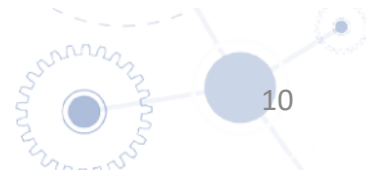


Jeffrey P. Bezos  
Founder and Chief Executive Officer

Source: 2005 Annual report

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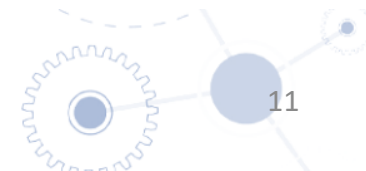


# Amazon has an ecosystem of products and services to capture larger share of wallet

Increasing returns to scale



- Platforms like Kindle and products like the Echo retain consumption within the Amazon ecosystem
- Features like Prime and One-Click Ordering enhance the convenience of the customer experience



# This customer obsession is recognition of the importance of increasing returns to scale

Increasing returns to scale

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- In a path-dependent world of increasing returns, this is how you win (Amazon's “flywheel”):

