Platform users behaving badly – Why successful platforms have laws, police, judges and jails, sort of

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Lindsay Lohan got busted in late 2008. It wasn't for driving drunk, doing coke, or lifting jewelry. Facebook caught the actress posting under an assumed name. And, that was a violation of its policy. The social network didn't kid around. No probation, house arrest, or a nice jail cell. It just kicked her out. "All I can think," she wrote on her blog, "is WHO is running this site? And how can they just "disable" my account without first sending me a warning notice, or AT LEAST asking me some account verification questions."

Voting Ms. Lohan off the island was all in a day's work. Facebook's "User Operations" polices this massive community. And it shows. Facebook is a lot nicer placer to hang out than MySpace, which had been termed a "vortex of perversion" at one point in its lifespan. In addition to not using a fake name, Facebook reserves the right to exile those who show too much skin, harass people, engage in hate speech, and even call someone a jerk. It takes a lot of people to patrol a village as big as Facebook. As of April 2009, almost a fifth of Facebook's employees were assigned to that patrol and out looking for offensive content.

It seems odd for a private company to have a division that, sort of, polices, prosecutes, and punishes its own customers. But it makes sense when you think of Facebook as a community. One of the ways in which Facebook provides value is providing a place - and of course many tools - for people, businesses, celebrities, advertisers, and developers to get together and interact. Those members create positive externalities. Merchants like having more fans and people like having more friends to hang out with. We tend to aggregate in cities and towns because of these same sorts of positive externalities. But, in any community, members can do bad things to each other. Which is the reason democratic societies choose to pay for police, prosecutors, courts and jails.

It turns out that Facebook has a lot of company when it comes to imposing rules on customers and kicking them off the property when they don't obey. Facebook is a platform. These sorts of businesses often have well-established governance systems for dealing with bad behavior.

A platform creates value by acting as an intermediary between different types of customers who create value by getting together and interacting. (Check out my Catalyst Course for an introduction.) They are big players in the economy now. The iPhone is a platform that connects users, content providers, and application developers. Google's search engine puts users and advertisers together. eBay has a platform for buyers and sellers to do deals. It also operates PayPal, which has a payment platform for senders and receivers of money. Platforms aren't all new business by any means. At least since the first village matchmaker figured out they could make a living by finding men and women suitable mates there have been platforms. Any advertising-supported media is a platform. So too are payment systems, shopping malls, and financial exchanges. Like Facebook, all of these businesses operate a community where different types of people and businesses get together.

These platforms typically lay out rules for what members of the community can and can't do. They also spell out the penalties. For extreme cases they kick wrongdoers off the platform altogether. Like Lindsay Lohan, violators get the boot. (My Governing Bad Behavior paper, which is coming out soon in the Berkley Technology Law Review, provides a detailed analysis.)

The disturbing case of Vitaly Borker - aka Tony Russo, aka Stanley Bolds - shows why platforms need tough rules to protect their communities. Borker figured out that search engines didn't distinguish between good and bad cites to his website - the only thing that mattered was having lots of content about his business So he responded to complaints with highly offensive emails and posts that generated even more complaints. "I've exploited this opportunity because it works," Borker told a reporter. "No matter where they post their negative comments, it helps my return on investment. So I decided, why not use that negativity to my advantage?" When people pursued their complaints against him, he threatened them with bodily harm including death or rape.

After the story broke, Google developed an algorithm to detect efforts to increase search rankings by encouraging bad comments. Although Borker slipped through the cracks, the search company, like Facebook, has devoted much effort to stopping bad behavior. Web site operators naturally want to come out at the top of search results and can make much money when that happens. The search engine giant provides guidance on what websites should do to get a fair shot. It has come up with a list of practices such as setting up link farms to drive artificial traffic. But since there are infinite opportunities for gaming the ranking algorithms Google has a general rule against doing things to inflate search results artificially. It exiles violators to low search rankings for a while. Scofflaws go into the penalty box or what's sometimes called Google jail. Meanwhile, Mr. Borker ended up in a real jail after pleading guilty to wire fraud, mail fraud, and sending threatening communications.

Being able to kick wrongdoers off a platform is critical for dealing with bad behavior. Private businesses can't put people in jail, garnish their wages, or bar them from practicing their professions. It's also hard for private businesses to fine those who do bad things. Insisting on a security deposit that the platform could dip into if a customer engaged in wrongdoing would discourage customers from joining and make it difficult to get the critical mass of customers on both sides that platforms usually need. Trying to collect penalties would require much legal expense. Often, the most efficient way to keep a platform clean is to bounce the customers who mess it up. And, when customers know they may lose platform privileges, they tend to avoid bad behavior.

Anyone starting a platform needs to think carefully about developing rules and enforcement mechanisms. MySpace went into a death spiral mainly because it got platform governance wrong. Justin Timberlake and friends bought the remnants for the price of a mid-size Beverly Hills mansion ($35 million). Meanwhile, Facebook is looking at roughly a $100 billion market cap - in part because it got governance right. Platforms create communities of users with shared interests who benefit from interacting together.

Successful platforms have identified positive interdependencies between users, figured out how to reduce transactions costs between these users, determined ways to price and developed other mechanisms for bringing these users together, thereby coordinating them into a community. Some users, however, create negative externalities that reduce the value of the platform. Bad behavior ranges from the criminal to the juvenile.

Platform users commit fraud, such as selling counterfeit goods or not shipping the goods they promise. They also misrepresent themselves: from men adding a few inches to their height on dating sites to websites artificially pumping up their search rankings. It gets worse though. Sexual predators prowl some platforms. And then there are cases where social networks are used to cause mental distress that can drive some people into depression and even to suicide.

Lack of information imposes costs on actual and potential trading partners. In the extreme this can lead to market breakdowns. This is known as the famous "lemons problem." and came into prominence in 1983 with the relatively young videogame market in the United States. Consumers could not distinguish low quality from high quality games before buying them. As a result, game producers had incentives to create cheaper, low quality games that drove the high quality, higher priced games out of the market. But consumers did not want to buy video game consoles to run low quality games. The market imploded.

To avert these lemon problems, many platforms invest effort in trying to provide reliable information about people and businesses that are exchanging value with each other. That ranges from page rankings for websites, those five-star ratings, and detailed questionnaires for dating sites.

eBay, as a platform the unites buyers and casual sellers, faces all these problems and has adopted policies to deal with them.

If someone wins an auction on eBay but does not get the good, or the good is not what was advertised, they can complain to the e-commerce site. The site may decide to punish the merchant, including prohibiting them from ever selling again on eBay. Merchants receive protections too. Consumers are required to pay for any item they win in an auction and can bid only if they intend to buy the item if they win. Among other things these rules prohibit consumers from bidding in several auctions for similar items and then only paying for the cheapest item they have won. Consumers that have too many unpaid items or complaints from sellers can lose their buying privileges as well.

eBay also provides a mechanism for consumers to rate merchants after they have made a purchase. They send consumers reminders to provide these ratings. These ratings reduce the risk associated from buying from a seller whose brand is otherwise unknown. This has worked well for eBay overall, but in particular for eBay Motors, which is a large part of eBay's revenues. A consumer can minimize the likelihood of getting a car with undisclosed problems by buying from an automobile dealer that has a very high rating. Automobile dealers presumably know that a negative rating can have a serious effect on their ability to make sales. The reviews and ratings process deter automobile dealers from taking advantage of consumers by exploiting asymmetric information. They also limit the ability of dealers to impose negative externalities on each other since good dealers tend to drive out bad dealers as consumers lower their expectations on the quality of cars they get from bad dealers. Similar rating systems are common now on web-based platforms that connect buyers and sellers.

Of course, no one likes being voted off the island. Ms. Lohan just vented on her blog. But sometimes they sue or otherwise appeal to the government for help. Businesses in particular try to dress their complaints with the antitrust laws.

An interesting example of taking recourse to the government involves the birth of the modern stock exchange. The London Stock Exchange traces its roots back to a bunch of brokers who met in Jonathan's Coffee House. People who trade stocks need to trust each other. After operating informally this group organized itself and refused to let people they didn't like join them. As one account from 1761 tells us, "The gentlemen at this very period of time . . . . have taken it into their heads that some of the fraternity are not so good as themselves . . . . and have entered into an association to exclude them from J-----'s coffee-house." When one of the excluded traders, a Mr. Renoux, tried to get into the coffee house there was a scuffle. He sued and the court said, that this early stock exchange couldn't bar people from coming in to the trading exchange at the coffee house.

This court decision impeded the emergence of modern exchanges because it limited the ability of traders to enforce rules and bar people who behaved badly. It took another four decades to sort the mess out. Eventually a real stock exchange emerged which was allowed to impose and enforce rules for fair dealings among its members.

Antitrust regulators in Brussels and Washington, D.C. and Brussels are wrestling with governance systems now as platforms have become both important and controversial. Many of the complaints against Google involve websites that saw their rankings sink. Google says that's the result of having algorithms that are among other things constantly changing to deter cheating. The complaining websites say this is part of an effort by the search engine to suppress competition. The enforcers and courts will eventually decide whether this is like Lindsay Lohan whining about being caught red handed, or anticompetitive exclusion. Hopefully, they won't make the same mistake as the English courts did with Mr. Renoux.

Although platforms have been around for millennia, they have become very prominent businesses in the last decade. And, because this business model has spawned many billionaires in recent times, entrepreneurs, not to mention existing companies, are creating even more of them. They all need to think carefully about how to govern bad behavior by their members. The old saying that the customer is always right doesn't apply to these platforms. Not only is the customer not always right, the customer may be downright dangerous. Just like a nightclub, a platform for connecting single men and women, they need a bouncer to keep the place safe.