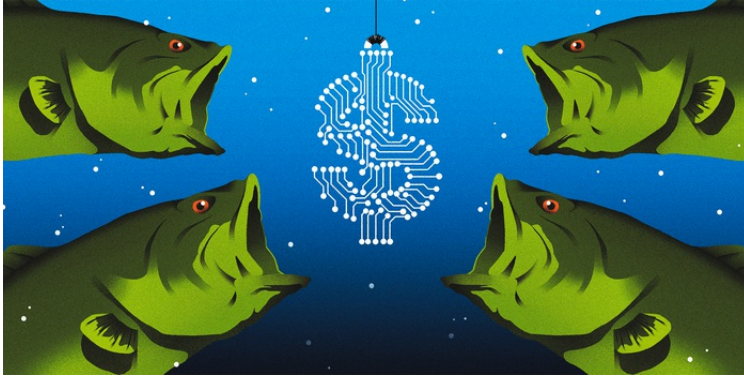


It's Official: Silicon Valley's Entire Business Model Is A Scam And San Francisco Is A 'Shit Hole Nation'

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It's official: Silicon Valley's entire business model is a scam



New research reveals that Silicon Valley uses predatory pricing to crush competitors and scam investors — evidence the government can use to bust up tech monopolies.
Tyler Le/Insider



[Adam Rogers](#)

[Asshole And Liar Musk Says Twitter Has Lost Nearly 50% Of Ad Revenue, Struggling With A 'Heavy Debt Load'](#)

In 2016, Matt Wansley was trying to get work as a lawyer for a tech company — specifically, working on self-driving cars. He was making the rounds, interviewing at all the companies whose names you know, and eventually found himself talking to an executive at Lyft. So Wansley asked her, straight-out: How committed was Lyft, really, to [autonomous driving](#)?

"Of course we're committed to automated driving," the exec told him. "The numbers don't pencil out any other way."

Wait a minute, Wansley thought. Unless someone invents a robot that can drive as well as humans, one of America's biggest [ride-hailing companies](#) doesn't expect to turn a profit? Like, ever? Something was clearly very, very screwy about the business model of Big Tech.

"So what was the investment thesis behind Uber and Lyft?" says Wansley, now a professor at the Cardozo School of Law. "Putting billions of dollars of capital into a money-losing business where the path to profitability wasn't clear?"

Wansley and a Cardozo colleague, Sam Weinstein, set out to understand the money behind the madness. Progressive economists had long understood that tech companies, backed by gobs of [venture capital](#), were effectively subsidizing the price of their products until users couldn't live without them. [Think Amazon](#): Offer stuff cheaper than anyone else, even though you lose money for years, until you scale to unimaginable proportions. Then, once you've crushed the competition and become the only game in town, you can raise prices and make your money back. It's called predatory pricing, and it's supposed to be illegal. It's one of the arguments that progressives in the Justice Department used to [bust up monopolies](#) like Standard Oil in the early 20th century. Under the rules of capitalism, you aren't allowed to use your size to bully competitors out of the market.

The problem is, conservative economists at the University of Chicago have spent the past 50 years insisting that under capitalism, predatory pricing is not a thing. Their [head-spinning argument](#) goes like this: Predators have a larger market share to begin with, so if they cut prices, they stand to lose much more money than their competitors. Meanwhile their prey can simply flee the market and return later, like protomammals sneaking back to the jungle after the velociraptors leave. Predatory companies could never recoup their losses, which meant predatory behaviors are *irrational*. And since Chicago School economists are the kind of economists who believe that markets are always rational, that means predatory pricing cannot, by definition, exist.

The Supreme Court bought the argument. In the 1986 case [Matsushita Electric Industry Co. v. Zenith Radio Corp.](#), the court famously ruled that "predatory pricing schemes are rarely tried, and even more rarely successful." And in 1993, in [Brooke Group v. Brown & Williamson Tobacco Corp.](#), the court said that to convict a company of predatory pricing, prosecutors had to show not only that the accused predators had cut prices below market rates but also that they had a "dangerous probability" of recouping their losses. That effectively shut down the government's ability to prosecute companies for predatory pricing.

"The last time I checked, no one — including the United States government — has won a predatory pricing case since Brooke Group," says Spencer Waller, an antitrust expert at Loyola's School of Law. "Either they can't prove below-cost pricing, or they can't prove recoupment, because a nonexpert generalist judge who buys the basic theory when they read Matsushita and Brooke Group is super-skeptical this stuff is ever rational, absent really compelling evidence."

Lots of economists have come up with [solid counter-counterarguments](#) to the Chicago School's skepticism about predatory pricing. But none of them have translated to winnable antitrust cases. Wansley and Weinstein — who, not coincidentally, used to work in antitrust enforcement at the Justice Department — set out to change that. In a new paper titled "[Venture Predation](#)," the two lawyers make a compelling case that the classic model of venture capital — disrupt incumbents, build a scalable platform, move fast, break things — isn't the peak of modern capitalism that Silicon Valley says it is. According to this new thinking, it's *anticapitalist*. It's illegal. And it should be aggressively prosecuted, to promote free and fair competition in the marketplace.

"We think real world examples are not hard to find — if you look in the right place," Wansley and Weinstein write. "A new breed of predator is emerging in Silicon Valley." And the mechanism those predators are using to illegally dominate the market is venture capital itself.

Venture investing is the answer to the question of what would happen if you staffed a bank's loan department with adrenaline junkies. The limited partners in venture funds demand high returns, and those funds are transient things, lasting maybe a decade, which means the clock is ticking. Venture capitalists and the investors who put money into their funds aren't necessarily looking for a successful product (though they wouldn't turn one down). For VCs and their limited partners, the most profitable endgame is a quick exit — either selling off the company or taking it public in an IPO.

Those pressures, Wansley and Weinstein argue, encourage risky strategies — including predatory pricing. "If you buy what the Chicago School of economists think about self-funded predators, you might think it's irrational for a company to engage in predatory pricing for a bunch of reasons," Weinstein says. "But it might not be irrational for a VC." The idea that it's so irrational as to be nonexistent is "a bullshit line that has somehow become common wisdom."

Take Uber, one of their key examples. It'd be one thing if the company had simply outcompeted taxicabs on the merits. Cabs, after all, were themselves a fat and complacent monopoly. "Matt and I don't have any problem with that," Weinstein says. "You have a new product, scale quickly, and use some subsidies to get people on board." Disrupt an old business and make a new one.

But that's not what happened. As in a soap opera or a [comic-book multiverse](#), the ending never arrived. Uber kept subsidizing riders and drivers, losing billions trying to spend its competitors into oblivion. The same goes for a lot of other VC-backed companies. "WeWork was setting up offices right next to other coworking spaces and saying, 'We'll give you 12 months free.' Bird was scattering its scooters all over cities," Wansley says. "The pattern to us just seems very familiar."

"Uber is one of the best investments in history, and it was a predatory pricing."

On its face, it also seems to prove the point of the Chicago School: that companies can never recoup the losses they incur through predatory pricing. Matsushita and Brooke Group require that prosecutors show harm. But if the only outcome of the scaling strategy used by Uber and other VC startups is to create an endless "[millennial lifestyle subsidy](#)," that just means wealth is being transferred from investors to consumers. The only victims of predatory pricing are the predators themselves.

Where Wansley and Weinstein break important new ground is on the other legal standard set by the Supreme Court: recoupment of losses. If Uber and WeWork and the rest of the unicorns are perpetual money losers, it sounds like the standard isn't met. But Wansley and Weinstein point out that it can be — even if the companies never earn a dime and even if everyone who invests in the companies, post-IPO, loses their bets. That's because the venture capitalists who seeded the company *do* profit from the predatory pricing. They get in, get a hefty return on their investment, and get out before the whole scheme collapses.

"Will Uber ever recoup the losses from its sustained predation?" Wansley and Weinstein write. "We do not know. Our point is that, *from the perspective of the VCs who funded the predation, it does not matter*. All that matters is that investors were willing to buy the VCs' shares at a high price."

Let's be clear here: This isn't the traditional capitalist story of "you win some, you lose some." The point isn't that venture capitalists sometimes invest in companies that don't make their money back. The point is that the entire model deployed by VCs is to profit by disrupting the marketplace with predatory pricing, and leave the losses to the suckers who buy into the IPO. A company that engages in predatory pricing and its late-stage investors might not recoup, but the venture investors do.

"The single most important fact in this paper is that Benchmark put \$12 million into Uber and got \$5.8 billion back," Wansley says. "That's one of the best investments in history, and it was a predatory pricing."

This new insight — that venture capital is predatory pricing in a new wrapper — could prove transformative. By translating the Silicon Valley jargon of exits and scaling into the legalese of antitrust law, Wansley and Weinstein have opened a door for the prosecution of tech investors and their anticompetitive behavior. "Courts will have to adjust the way they're thinking about recoupment," Weinstein says. "What did the investors who bought from the VCs think was going to happen? Did they think they were going to recoup?" That, he says, would be a "pretty good pathway" for courts to follow in determining whether a company's practices are anticompetitive.

"Capitalism is supposed to allow competition to foster innovation and choice; monopolies quash all that so a few people can get rich."

What makes this argument particularly powerful, from a legal perspective, is that it doesn't reject the basics of the Chicago School's thinking on antitrust. It accepts that consumer welfare and the efficiency of markets are paramount. It just points out that something [uncanny](#) — and illegal — is taking place in Silicon Valley. "I'm pro-enforcement and anti-Chicago School, so I'm always looking for areas where I think they're wrong," Weinstein says. "And here's one."

That kind of "serious legal scholarship" can be particularly successful with the courts, according to Waller, the antitrust expert at Loyola. "It's a good, modest strategy to say, 'We think your model's wrong, but even if your model's right in general, it's not right here.' That's both how you win cases and how you chip away at an edifice you want to challenge."

With so many industries imploding into oligopolies — tech, healthcare, pharma, entertainment, journalism, retail — it's a hopeful sign to see the trustbusting mindset stirring to life once more. Capitalism is supposed to allow competition to foster innovation and choice; monopolies quash all that so a few people can get rich. But the new scholarship on predatory pricing could ripple well beyond the courts. Wansley and Weinstein's paper put me in mind of "The Big Con," David Maurer's linguistic study of con artists first published in 1940. Maurer said the most delicate part of a con was the end — the *blow-off*. After the sucker has been bled dry, the grifter has to ditch the victim, ideally in such a way that they won't go to the cops. In the perfect crime, the mark doesn't even know they've been had. The transfer of lousy tech equity to late-stage investors who have been led to believe it's valuable sure looks like a good blow-off to me.

So now that we know precisely how Silicon Valley's big con works, maybe the marks won't be so quick to fall for it. Once you know what a phishing email looks like, you tend to stop replying to them. The same goes for recognizing the outlines of this particular grift. "It's not a Ponzi scheme, but it favors certain investors," Weinstein says. "If people in Silicon Valley start thinking about this as a predatory pricing scam, then I think the late-stage investors will start asking questions."

And not just about ride hailing or office sharing. Maybe grocery delivery? Or streaming-service subscriptions? The same kind of *aha!* light that went off for Wansley during his interview with the Lyft executive could start to go off for other people as well. Some of them will be investors who decide not to park their money in predatory tech companies. And some of them, perhaps, will be government regulators who are looking for ways to bust our modern-day trusts.

[Adam Rogers](#) is a senior correspondent at Insider.

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