

Incentivizing Firms to Protect Consumer Data: Can Reputation Play a (Bigger) Role?

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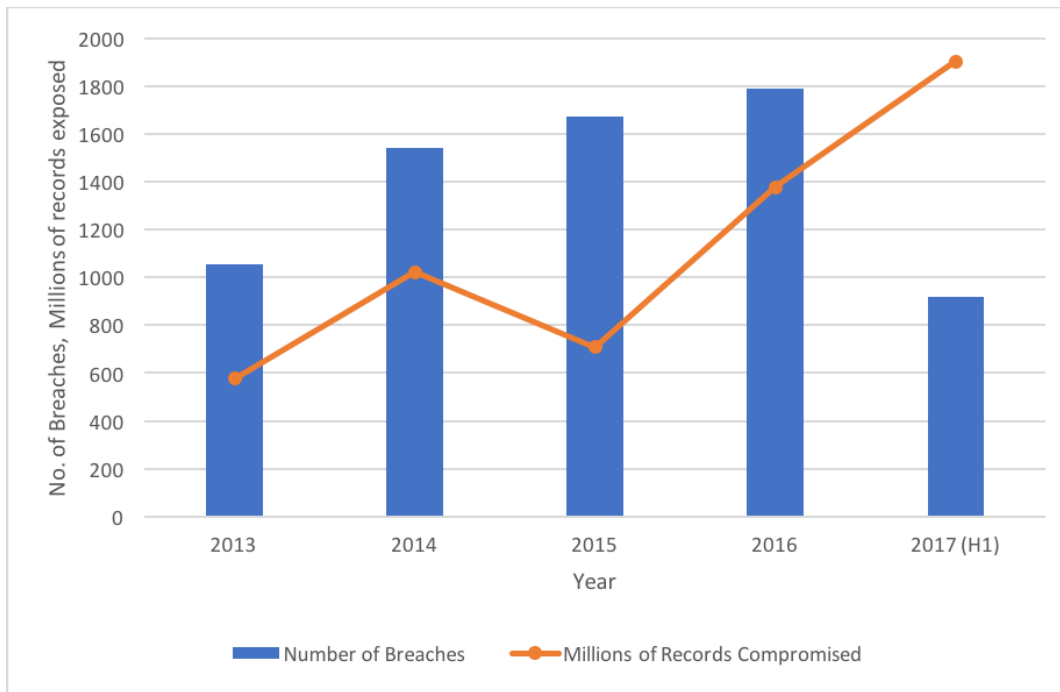
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PRIVACYCON

Growing number of data breaches



Market Failures



Can reputation play a role?

In theory, yes

- Investment lowers the probability of breaches



Can reputation play a role?

In practice,

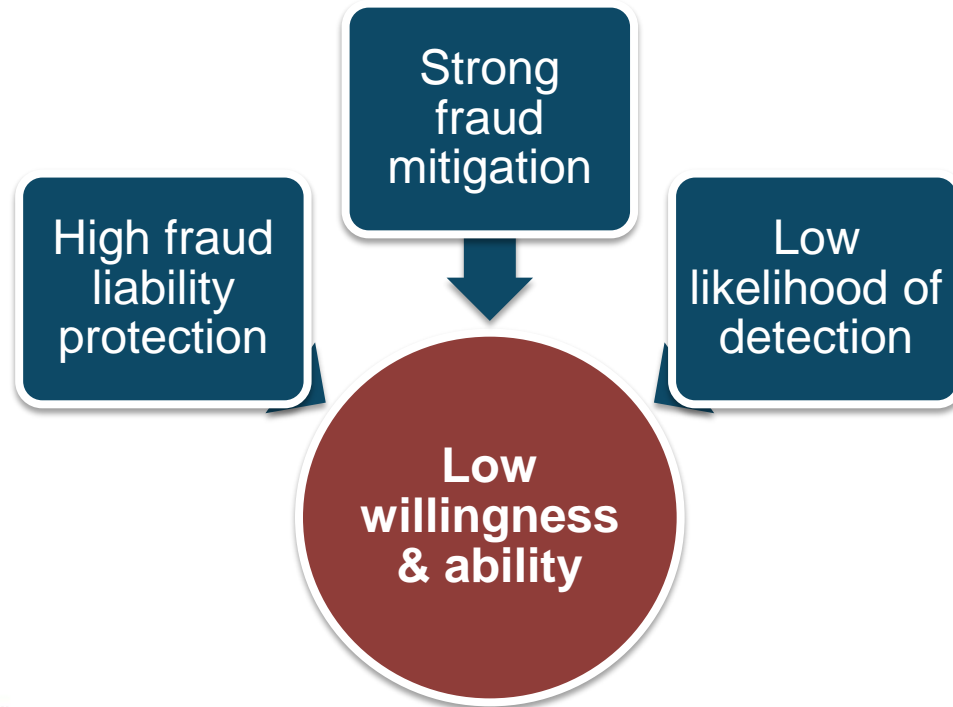
Are consumers *willing* to punish the firm?

- Are losses high relative to valuation?

Are consumers *able* to do so?

- Do they know about the breach?

Can reputation play a role?



Policy Interventions

“Indirect”: Improving the reputation mechanism

- Increase consumers’ willingness or ability to punish

“Direct”: Correcting the market failures

- Imperfect information
- Externalities

“Indirect” Interventions

	Impact on			
	Ability to Punish	Willingness to Punish	Investment Level	Consumer Surplus
Expelling Breached Merchants	·	+	+	+/-
Active Monitoring by Bank	+	·	+	+
Mandatory Breach Notification				

“Indirect” Interventions

	Impact on			
	Ability to Punish	Willingness to Punish	Investment Level	Consumer Surplus
Expelling Breached Merchants	·	+	+	+/-
Active Monitoring by Bank	+	·	+	+
Mandatory Breach Notification	Greater transparency			

“Indirect” Interventions

	Impact on			
	Ability to Punish	Willingness to Punish	Investment Level	Consumer Surplus
Expelling Breached Merchants	·	+	+	+/-
Active Monitoring by Bank	+	·	+	+
Mandatory Breach Notification	+			

“Indirect” Interventions

	Impact on			
	Ability to Punish	Willingness to Punish	Investment Level	Consumer Surplus
Expelling Breached Merchants	·	+	+	+/-
Active Monitoring by Bank	+	·	+	+
Mandatory Breach Notification	+	Loss Mitigation		

“Indirect” Interventions

	Impact on			
	Ability to Punish	Willingness to Punish	Investment Level	Consumer Surplus
Expelling Breached Merchants	·	+	+	+/-
Active Monitoring by Bank	+	·	+	+
Mandatory Breach Notification	+	-	+/-	+/-

“Direct” interventions

	Impact on			
	Ability to Punish	Willingness to Punish	Investment Level	Consumer Surplus
Revealing Security Inv't or State	Imperfect information			
Liability Rule	Externalities			

“Direct” interventions

	Impact on			
	Ability to Punish	Willingness to Punish	Investment Level	Consumer Surplus
Revealing Security Inv't or State	.	.	+	+
Liability Rule	.	.	+	+

Policy Implications

“Direct” > “Indirect” interventions

Always good to improve information (about security and breaches)

Trade-off between protecting consumer ex-post and fostering investment incentives ex-ante