

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

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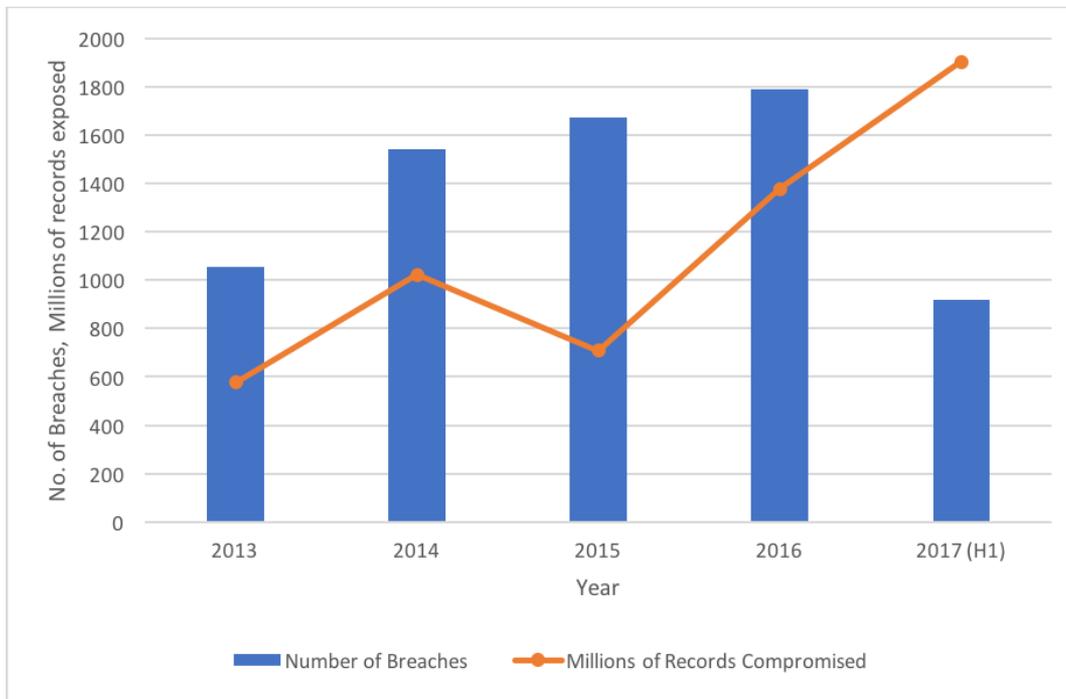
FTC PrivacyCon 2018, Washington D.C.

February 28, 2018



**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,

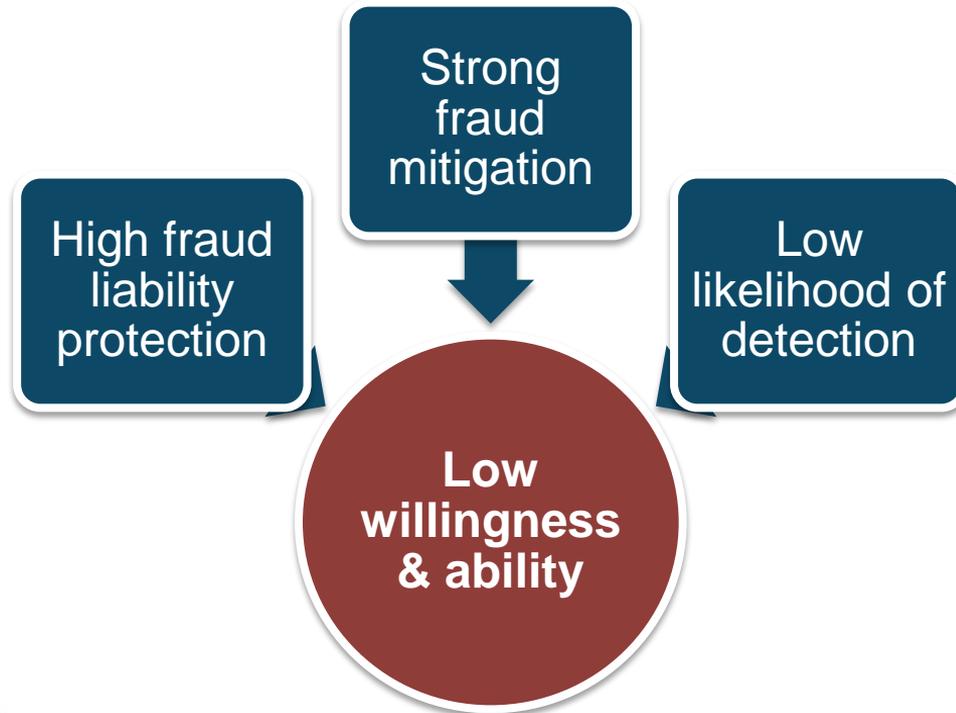
Are consumers *willing* to punish the firm?

- 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
<b>Expelling Breached Merchants</b>	·	+	+	+/-
<b>Active Monitoring by Bank</b>	+	·	+	+
<b>Mandatory Breach Notification</b>				

# “Indirect” Interventions

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

# “Indirect” Interventions

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

# “Indirect” Interventions

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

# “Indirect” Interventions

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

# “Direct” interventions

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

# “Direct” interventions

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

# 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