

Market Failures and the Stakeholders Left Behind

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Abstract

Information asymmetry, monopsony power, and the failure by a social group to provide public goods are market failures that harm stakeholders in a systematic way in capitalistic systems of the present day. Four interrelated market failures discussed in this paper include algorithmic wage discrimination in the labor markets of the gig economy, the exploitation of information asymmetry in financial and gambling markets, the collapse of journalism as an under-funded public good and the amplification of misinformation in the attention economy of social media. By examining algorithmic management practices, platform practices that have become predatory, and how this approach to the newspaper industry by disrupting the advertising-abundant model puts the newspaper industry at risk, this study is able to show how these failures generate reinforcing feedback loops to consolidate corporate power and at the expense of vulnerable stakeholders. The paper shows that algorithmic opacities can be used to exploit all industries, diluted journalism undermines accountability, and corporate cross-platform dominance speeds up system inequalities. The evidence suggests that without the transparency, fairness, and stakeholder-oriented practices being adopted by businesses and regulated by the government, the market mechanisms cannot stop the systematic extraction of value out of workers, consumers, and communities, which will require a radical shift in the corporate governance and the governmental policies.

Keywords

Market Failure, Information Asymmetry, Algorithmic Discrimination, Public Goods.

1. Introduction

Classical Economics believes that the market has an inherent mechanism of equilibrium at prices, which will allocate resources with maximum efficiency to the welfare of the society. The theory is based on main assumptions: the market players have perfect information, the rational actors make ideal decisions, the competitive markets with no dominant players, and the externalities have no influence on the third party. Based on this model, market players are steered in the right direction, as the invisible hand leads them to the best results with no government interference. Nevertheless, Classical Economics ignores the fact that critical reality markets often lead to inefficient, unfair, or destructive results to the society. These systemic failures, which are called market failures, occur when the required conditions of efficient work of the market are not followed. This can be achieved by an asymmetric distribution of information where one side of the information can take the other side as a victim by capitalizing on his ignorance. A monopsony can be created when one buyer is large and controls a specific market thereby capable of keeping prices below the competition. We find problems of under production of goods that are beneficial to the society since they may not be sold profitably. In both instances, the exploitation of social welfare by the quest of personal gain takes place, and susceptible stakeholders are the victims. Four interrelated types of market failure in modern capitalism are discussed in this paper. The Labor markets System of personalized wages formulated by Zephyr Teachout illustrates how technology facilitates monopsony of power in Labor markets, which allows companies to maximize surplus of workers by engaging in

personalized wage discrimination [1]. The analysis of the financial markets presented by Michael Lewis shows that there is an organized exploitation of the information asymmetry [2]. The research by Victor Pickard represents a classic example of the failure of journalism as a failure of a public good, the market incentives fail to adequately fund the production of news, which is a vital part of democratic governance [3]. The attention economy, as analysed by Paul Barrett in the discussion of social media platforms, creates a greater amplification of misinformation and then pushes the social costs to the outside [2]. These breakdowns create a self-reinforcing mechanism whereby this algorithmic non-transparency can be exploited in numerous spheres, weakened journalism can increase transparency to reveal exploitation, and concentrated corporate power can be used beyond technology platforms into Labor, finance, and media. This essay postulates that failures in the market due to information asymmetry, monopsony power, and provision of the public goods lead to unhealthy, ripple effects on stakeholders and businesses must focus on ensuring fairness, transparency, and social responsibility.

2. Algorithmic Management and Labor Market Monopsony

The algorithmic management has radically redefined the way wages are determined in the gig economy, which Dubal refers to as algorithmic wage discrimination [4]. Proactive algorithms that allow companies such as Uber, DoorDash, and Amazon to tailor wages to specific workers according to behavioral data now constantly monitor the rate of acceptance, response time, and location trends to calculate the minimum wage that individual workers will accept. It is a practice that is contrary to the traditional Labor markets where wages are negotiated freely and equally apply to both the workers of similar tasks.

Teachout explains how the algorithmic pay structures ruin transparency by a process (Black box) of operations management where they know what is happening and workers do not know how their pay changes. The algorithms take into account dozens of factors: historical acceptance trends, time of the day, local supply and demand, workers positions, time since the last job, and presumed financial need. Employees do not see what variables are most important and what behavioral adjustments have on further pay. This obscurity symbolizes monopsony authority the capacity to regulate the market rates in case of overtaking the purchases. Gig platforms are effective monopolies in most of the local markets. An employee in a medium-size city could not have a realistic choice in case of the necessity of flexible work. This gives platforms excessive authority to depress wages that are below the competitive wage rates.

Economic process is simple yet poisonous. Reservation wages are also determined through continuous worker surveillance, when, using algorithms, the minimum wage they are willing to accept is inferred and the only amount more than that specific minimum is being offered. Employees with a history of accepting lower offers are offered less. The workers who prove to be in dire need are paid suppressed wages. Traditional Labor economics had assumed that employers could not systematically and scalable price discriminate but algorithmic surveillance does just that. This model, according to Teachout, transforms Labor into a one-product commodity, and removes collective identity, which is necessary to create solidarity among workers. As every worker is treated very individually, the ground of collective action loses its foundation. When the experiences are personal, workers are unable to find common grievances. This individualization discourages union or cooperative organization of workers since it splits them.

Stakeholder is not just exploited directly in the economic sense. The disparity in racism is enhanced when algorithms use the proxies of race neighborhood, name patterns, or behavioral features to price discriminate as demonstrated in figure 1. Algorithms that are trained on historical data recreate and amplify the existing discriminatory patterns even without explicitly

taking into account race. The surveillance mechanisms which have facilitated wage discrimination can also be used to intimidate political freedom. Employees who are afraid of algorithmic retaliation can either self-censor political action or not organize [5].

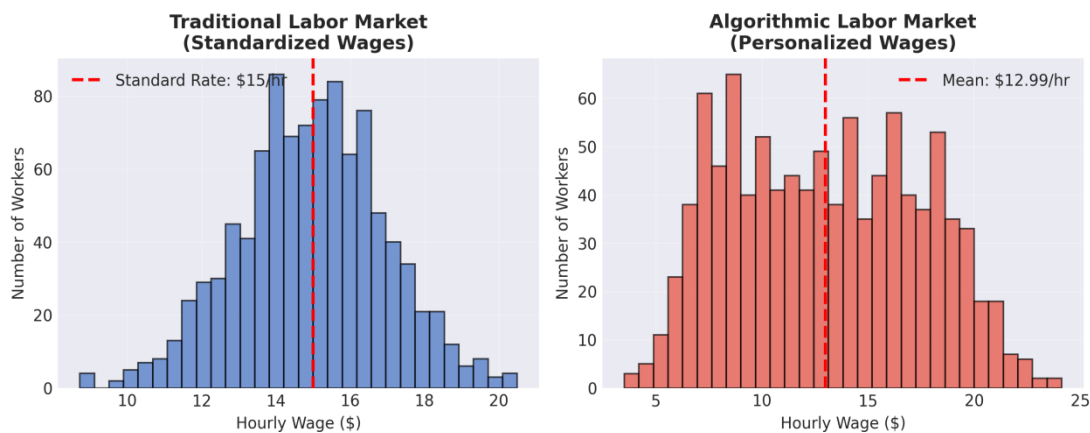


Figure 1. Traditional vs. Algorithmic Wage Distribution

3. Information Asymmetry in Financial Markets

The logic of algorithmic exploitation as applied to financial derivative markets and sports gambling platforms is carried into Michael Lewis lecture and shows how information asymmetry is turned into the systematic extraction of wealth [2]. FanDuel and other firms use advanced algorithms to classify users into two different categories: edge players who have advanced knowledge of probability and betting strategy, and stupid players who recreationally gamble and do not have analytical systems. The platforms then design anti-experiences to the two categories systematically. The business model is designed in a predatory manner. Edge players who only win because they possess superior information, analytical and structural discipline are found by algorithmic monitoring of betting patterns, win rates, and stake size. As soon as this is determined as advanced, these lucrative punters are either barred indefinitely out of the site or their maximum bets are drastically cut down to levels which render their advantage economically insignificant. The platforms virtually lock out anyone who can pose a threat to profitability due to informed betting.

In the meantime, the so-called stupid players the ones that are defined as not sophisticated and thus worth good business to the platform are actively nurtured in a variety of ways. They are offered promotional bonuses to encourage them to bet more, offered favorable odds on particular bets that obscure the platform real competitive advantage and algorithmic prodding in the form of app notifications and the design of its interface that would allow them to make larger and more frequent bets. The platforms make use of methods of behavioral psychology borrowed off the casino design and social media engagement optimization to lure as much lifetime customer value out of these less-informed players as possible. This generates a systematic information asymmetry, which systematically extracts wealth out of less-informed participants to the operators of the platform. In contrast to conventional casinos where the edge of the house is known and equally governs everyone whether they are sophisticated or not, algorithmic sports betting sites actively vary their treatment of each customer in accordance with constantly updated estimates of the extent of sophistication and profitability of that particular customer to the site. The net effect is an inherently rigged market where the informed are locked out and the uninformed exploited to the point of being opaquely and personally manipulated.

Lewis decries this as a gross negligence on the part of government and observes that our society is not looking after people in scenarios whereby the advanced commercial organizations are

taking advantage of information advantage, over the average citizens, through the use of algorithmic weapons [2]. The regulatory reaction has been deplorably poor most states have legalized sports betting with no real consumer protection against manipulation by algorithms, but with an eye to getting tax revenue and performing only a thin veneer level of age checks. The similarities to financial derivative markets are educative and alarming. Stock markets High-frequency traders exploit speed advantages, which are in the range of microseconds, to front-run slower traders, i.e. take advantage of time information advantages to get value out of the slow traders in the market. These companies are spending billions in fiber-optics cables, microwaves towers and proximity of their data centers in order to reap the benefits of milliseconds advantage they capitalize a thousand times per second millions of times [6].

Regular retail traders that buy or sell based on the information publicly available are always defeated by the institutional traders that have better data feeds, able to execute faster and have privileged information about the order flows through payment of order flow arrangements. Conventional financial economics presupposed that markets are efficient in collecting information and that prices reflect all the available information according to the efficient market hypothesis as shown in figure 2. However, once certain players possess systematic informational advantages either by improved technology markets, special access or by aided computer processing markets are no longer mechanisms to allocate wealth efficiently but instead become wealth transfer mechanisms.

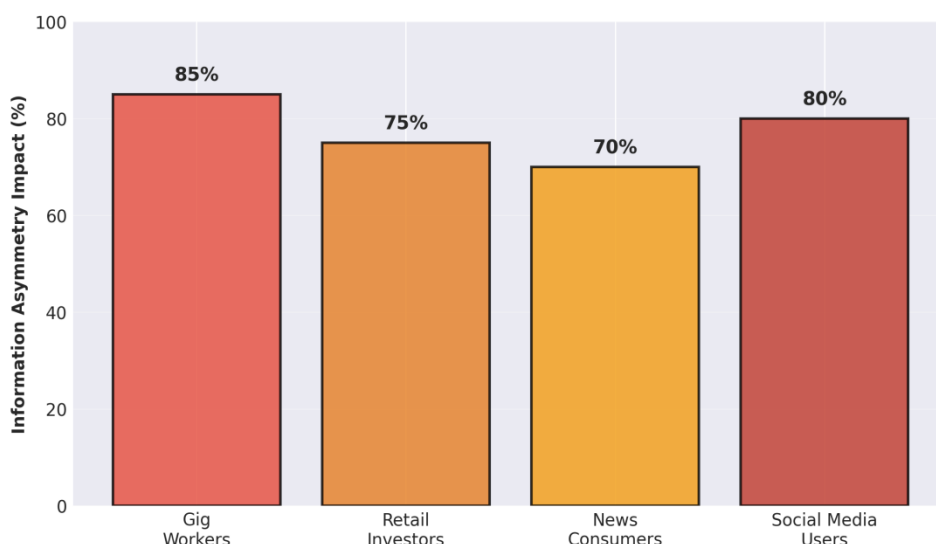


Figure 2. Stakeholder Vulnerability to Information Asymmetry

4. Journalism's Market Failure

Another type of market failure which Victor Pickard examines is of a completely different nature, namely, the under-provision of journalism as a public good. The business model of the newspapers is that they used to generate nearly 80 percent of revenue through advertisers and just 20 percent through subscribers [3]. This model that relied on advertising was quite good in the twentieth century when the sole effective means through which advertisers could reach mass audiences in particular geographical markets was through newspapers. The print classified advertising, retail display advertising and national brand advertising all proved to be dependable sources of revenue that cross-subsidized costly investigative journalism and civic reporting.

Nevertheless, this paradigm was built on the basic inconsistency between the purpose of advertisers and the demands of democracy. The primary goal of advertisers, as Pickard points out, was not to get the democratic society enough journalism. Advertisers pursued audiences and newspapers were a handy means of doing so. Advertisers were simply buying the right of

access to the attention of readers, not journalism as such. Newspapers delivered journalism as a form of building audiences that can then be sold to advertisers. This implied that the quality of journalism was considered to be important to the extent that it generated readership which advertisers were interested in reaching.

The emergence of internet service providers such as Google and Facebook essentially shook this model, which was already shaky. Such platforms provide advertisers with access to audiences in a dramatically cheaper and narrower fashion. The cost of digital advertisement is a tiny percentage of the print advertisement, and it provides the ability to target patients with unprecedented demographic, behavioral, and psychographic targeting. Depending on user profiles that are detailed, advertisers can target specific groups of people, real time monitoring of ad performance and dynamically changing campaigns. To the advertisers, the digital platforms are a pure product that is even better than newspapers. Accordingly, tens of billions of dollars of advertisement revenues have been lost by the newspapers during the last twenty years as advertisers moved to online platforms. The inability to offset this enormous loss of revenue by subscriptions alone particularly in the face of the demand of the internet users to free content has caused newspapers to react with catastrophic layoffs, reduction of publication rates, the abolishment of whole news sections, shutdown of foreign and regional bureaus, and bankruptcies on a grand scale. In accordance with the data collected by Pickard, more than half of employment at newsroom in the United States has dropped since 2008 [7]. Journalism, in terms of economics, has typical features of a public good. The social benefits associated with quality journalism investigative reporting exposing corruption, government accountability reporting, and exhaustive civic reporting on local matters would greatly outweigh, in value, what individual consumers will want to pay by subscriptions. An uncover involving corruption by the municipal government is useful to the people in that society not just the subscribers of the newspaper. Extensive election coverage enlightening voters is not only good to democracy but also to those who buy newspapers.

Since these benefits can be accessed by the majority of the citizens without any payments using social media sharing, summaries in search engines, word of mouth, or just the social value of having a more informed electorate and a more responsible government newspaper can not be fully realized. This is the typical case of free rider in the provision of public goods. People get positive motivation to consume the good without paying since they are sure that it will be financed by others. However, when every person does this rationale the good will be under-produced compared to social optimum. There are especially drastic impacts on the local communities. The growth of news deserts' geographic locations where no local newspaper is available or extreme low local news coverage provides people with no essential information on local government decisions, school board activities, local budgetary allocations, local crime trends, or civic issues. Studies have strictly recorded that the communities that lose local newspapers report quantifiable decreasing voter turnout in local elections, more corruption in the government since no one can closely check the government and a great boost in the cost of municipal borrowing as bond markets grade on less transparency and a significantly diminished civic engagement that is measured by everything as the attendance at municipal council meetings to membership in local organizations as mention in figure 3.

Local communities are particularly affected. "News deserts" geographic areas with no local newspaper leave residents without information about local government, schools, crime, or civic issues. Research documents that communities losing local newspapers experience declining voter turnout, increased government corruption, higher municipal borrowing costs, and weakened civic engagement.

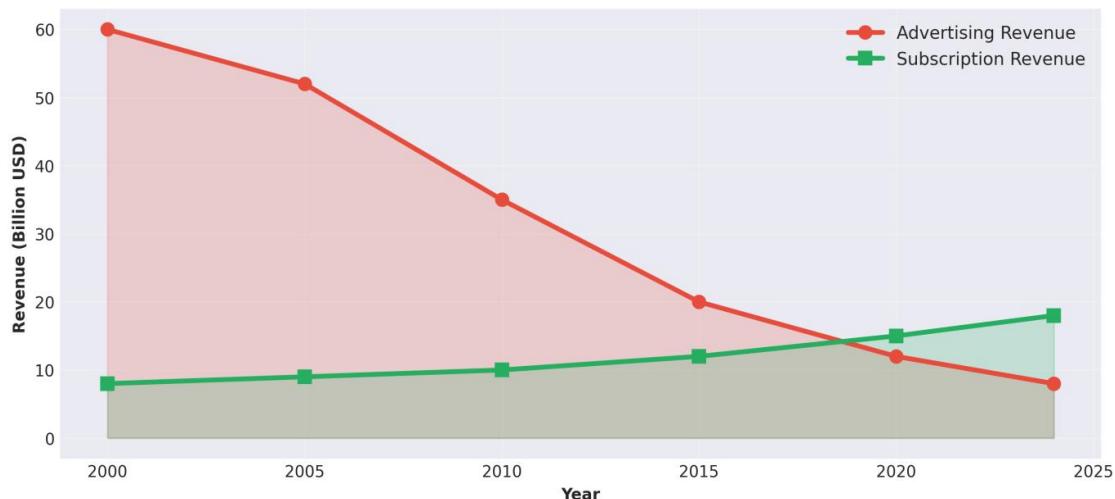


Figure 3. U.S. Newspaper Revenue Trends (2000-2024)

5. Interconnected Failures and Systemic Analysis

The fourth discussed market failures are a reinforcing system that increases harm to the stakeholders as shown in figure 4. The enabling mechanism is algorithmic in nature and is used in all domains. The same computation methods that have enabled Uber to customize pay can be applied to FanDuel to help it rank the bettors, Facebook to increase misinformation and websites to reduce quality journalism. The black-box algorithms make decisions opaque, and these exploitative practices cannot be challenged or understood by the stakeholders.

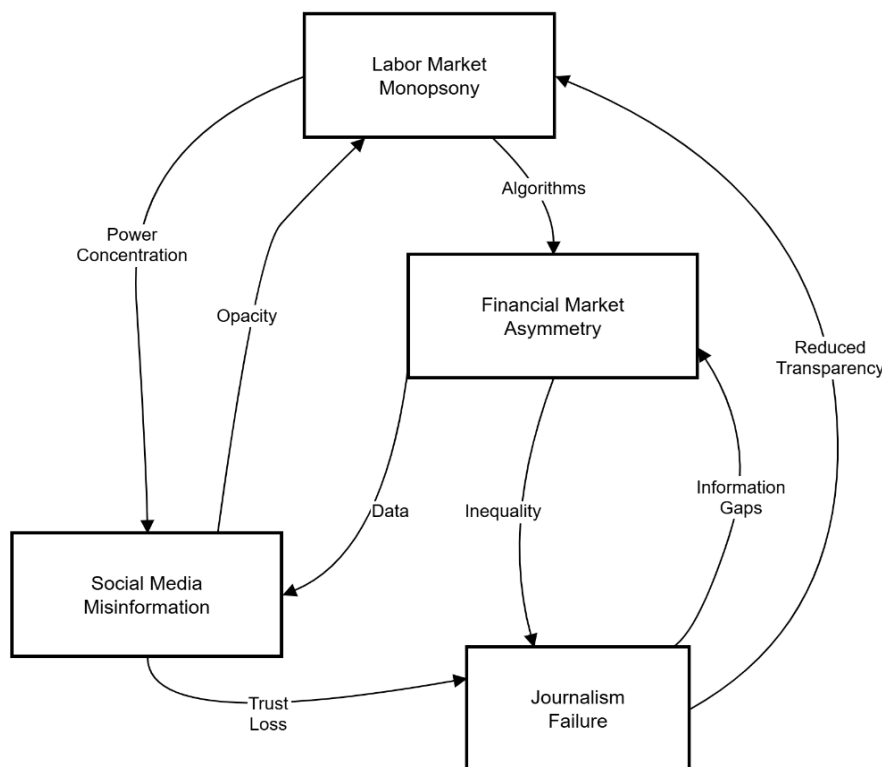


Figure 4. Interconnected Market Failures - Reinforcing Feedback Loops

The failure of journalism decreases the transparency required to report on exploitative actions in other areas. The history of investigative journalism exposed corporate vices and institutional exploitation. With newsrooms minimalized and local journalism vanished, algorithmic wage manipulation, monetary fraud, and action on the platform become less questioned. The journalism market failure is therefore facilitating and perpetuating market failures.

Corporate power is becoming more centralized in technology platforms that exist in a variety of fields. Such companies as Amazon use gig workers at the same time as they offer financial services, run content platforms, and advertising channels. This cross-sector availability implies that algorithmic exploitation tools created in one field are used right away in a different field. Platform power predisposes the network effects that establish dominance of the firms and restrict competition forces [10]. One failure in a market creates inequalities that make one vulnerable to others. Employees with stifled salaries lack monetary buffer to take any loss caused by predatory monetary items. Weakened journalism communities possess less civic power to mobilize a response or regulation.

6. Business Implications and Solutions

The discussion of the interdependent market failures has some direct implications to business practice. Markets cannot be presumed to produce the results automatically. With systematic exploitation generated by information asymmetries, monopsony power, and public goods problems, business organizations have two options: to continue to engage in practices which lack fairness, transparency, and stakeholder value, or to embrace ethical frameworks that value fairness, transparency and stakeholder value. The transparency and accountability measures should be adopted in the Labor markets where algorithmic management is applied by the companies. The workers should understand the algorithms used in wage determination. Business organizations must institute independent algorithmic audits that inform companies that systems are not discriminative in relation to race, sex or other covered features. Employing collective bargaining rights over workers should be acknowledged by the platforms along with effective consultation modalities.

Firms in the financial markets need to embrace disclosure requirements and the standards of investor protection that are beyond what is required by the law as in figure 5 is showing Market Failure Impact Severity on Stakeholder Groups. The financial advisors and trading platforms must be active in describing fee structures, conflicts of interest, and product risks to the retail investors in advance. The sports betting sites ought to put in place consumer safeguards such as deposit limits, compulsory cooling off, and the ban on approaching problem gamblers.

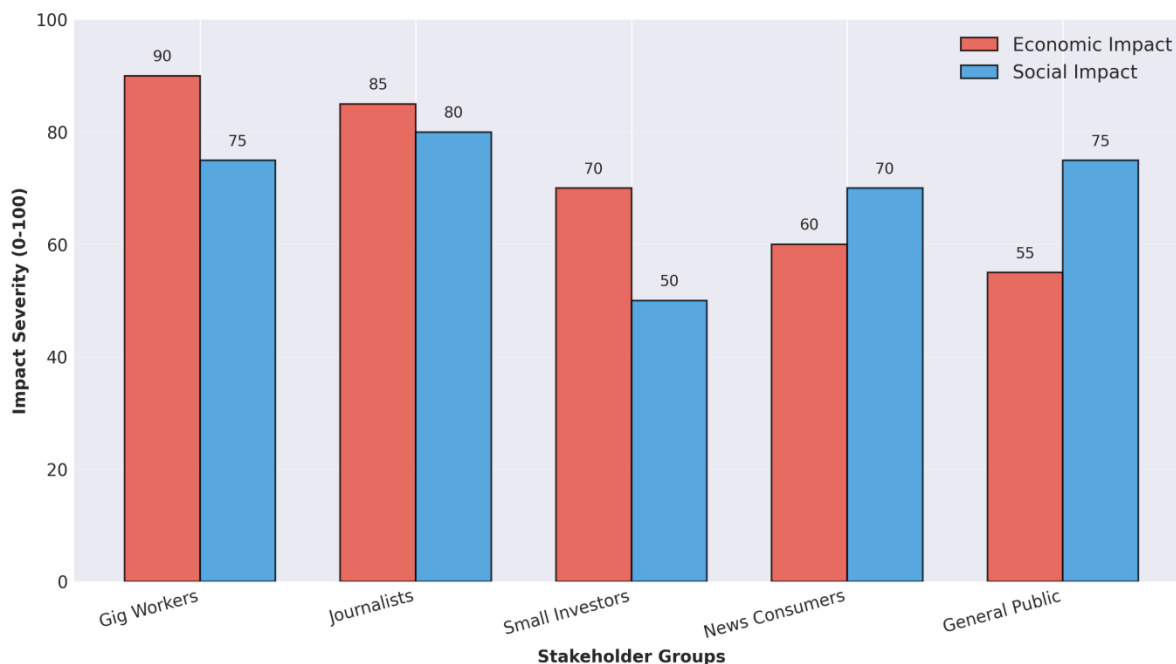


Figure 5. Market Failure Impact Severity on Stakeholder Groups

Technology platforms must acknowledge their stake in supporting quality journalism in the media and introduce ability to share revenue collecting advertising monies with the original news producers through revenue-sharing models [8]. The platforms need to change the recommendation algorithms to focus on journalistic credibility, rather than engagement. Companies that rely on informed consumers and sound democratic institutions ought to encourage other forms of funding journalism such as direct funding of non-profit news media. Social media have a specific duty to combat misinformation with balancing consideration towards the freedom of expression. This will entail the transition of engagement-based algorithms to include content credibility and social value signals. When using platforms, the policy should be based on transparent content moderation, give users an algorithmic choice, and promote digital literacy efforts [9]. In every business field stakeholder capitalism presents a model that can help put business activities and social welfare in balance. Regulatory frameworks are still important. Self-regulation has also been shown to be insufficient when the competitive forces encourage exploitative tendencies. Good rules ought to provide a minimum threshold in terms of algorithmic disclosure, financial market fairness, journalistic financing, and platform responsibility.

7. Conclusion

This discussion has explored four systemic market failures that have been damaging to stakeholders in the modern capitalism. An example of monopsony power facilitated by information asymmetry is algorithmic wage exploitation. The manipulation of the financial markets shows us how asymmetric information can be used by those with more complex players to squeeze money out of the retail players. The collapse of journalism is an example of under-provision of the information as a public good. The Social Media misinformation demonstrates that platform profit maximization leads to negative externalities imposed on the democratic society. The following characteristics are common in these failures: they are structural conditions and not caused by bad actors, they generate feedback that increases harm over time, and they focus costs on vulnerable parties and profits on powerful firms, and they cannot be fixed by using market systems. Of particular importance is the inter-relationships of these failures. Algorithms can be used to exploit in many areas due to their algorithmic obscurity. Diluted journalism lessens transparency that is required to uncover maltreatments. In the business practice, it is evident. The decisions made by the corporations are affecting not just the share prices but also the quality of information, distribution of power and social cohesion. Ethical practice in Labor markets refers to open pay framework and acknowledgment of employee collective rights. In finance, it is the principle that the protection of the investors should be taken first, rather than the arbitrage benefits. In media, it implies taking responsibility in regard to information ecosystems. These failures cannot be dealt with urgently. The way to go involves integration of regulatory, corporate governance, and ethical business leadership. Regulation should also provide minimum standards in terms of transparency, fairness and protection to stakeholders and laying flat level playing grounds to avert race to bottom competition. Corporate governance must change into a stakeholder capitalism, where the companies are given duties other than the shareholder returns. The net effect of such market failures is that capitalism as it is today inherently contradictory and is weak in the legitimacy and stability of its existence. Business leaders are faced with a decision to continue with exploitative operations that will yield short-term profits or adopt the aspect of stakeholder responsibility as the means of sustainable capitalism.

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