Misfire:
How the Digital Markets Act Will Unwittingly Hurt European Small Businesses

A policy analysis informed by the
Catalyst Research Digital Markets Act Working Group

June 2021

CATALYST RESEARCH

Executive Summary

Digital business transformation has been underway for more than a decade. However, it became an urgent matter during the COVID-19 pandemic when many restaurants, retail stores, and offices were forced to shut down or severely reduce operations. Research conducted during the crisis has documented digital tools' positive impact on European small businesses' ability to survive COVID-19, as aggressive digital adoption led to 60% more revenue, 40% improved customer retention and 300% more hiring by small businesses.

Against this backdrop, as small businesses adopt and benefit from digital technologies (platforms, services, and tools), the European Commission is considering the Digital Markets Act (DMA). The DMA is a legislative proposal intended to promote opportunities for new digital companies and services that presumably would benefit SMEs by delivering creative innovation and price competition. But there is an undercurrent of unacknowledged risk and concern that as the DMA inhibits the growth or reduces the size and scale of digital incumbents that are so valuable to SMEs, there won't be any substitute companies or services that serve SMEs as well.

To consider the DMA's impact on small businesses, Catalyst Research convened a panel of experts with deep understandings of the European economy, small businesses, technology and innovation, and public policy. We asked a series of critical questions about the DMA's goals, its intended and potentially unintended consequences, and how these could affect small businesses - in particular, digitally-empowered small businesses that survived the pandemic and are looking optimistically (but warily) toward a stronger future.

Working Group:
The DMA and Small Business

The following participants joined under Chatham House Rule:

Maksim Belitski

Associate Professor in Entrepreneurship and Innovation at Henley Business School and member of the Henley Centre for Entrepreneurship, University of Reading (Reading, UK)

Richard Geibel

Dean of Master's Program in Digital Management and Director of E-Commerce Institut Cologne, University Fresenius of Applied Sciences (Cologne, Germany)

Aurelien Portuese

Director, Antitrust and Innovation Policy, Information Technology and Innovation Foundation (Brussels, Belgium)

Liad Wagman

Professor of Economics, Stuart School of Business, Illinois Institute of Technology (Chicago, Illinois)

Joakim Wernberg

Research Director of Digitalisation and Tech Policy at the Swedish Entrepreneurship Forum, and affiliate with the Institution for Technology and Society at Lund University. (Sweden)

Following a thoughtful discussion and additional consideration, we conclude that the DMA could - at the worst possible time - unintentionally put European small businesses on a path of "digital regression" rather than advancement. Under the DMA, businesses that embraced digital tools and took advantage of the highly developed Digital Single Market will be burdened by more digital complexity and uncertainty, reduced efficiency, and higher costs of digital products and services. In effect, SME access to markets via large platforms will be restricted in real and meaningful ways, not just minor inconveniences to SMEs owners who are already stretched thin as they scramble to recover from the pandemic.

One can imagine that the additional frustrations and costs could substantially reduce SME efficiency and growth and force some small businesses already on the edge to close. That is worrisome when small firms are 99% of European businesses and form the core of so many communities. Ultimately, no matter one's perspective on the merits and potential efficacy of the DMA, experts agree that it should not hamper European small business growth and innovation. Efforts must be undertaken by policymakers to ensure that unintended harms are avoided at such a critical point in time for the European small business community.

Introduction/Background

On 16 December 2020, the European Commission released the Digital Markets Act proposal. This legislation is intended to prohibit monopolistic and abusively anticompetitive behaviour of digital "gatekeepers" -- those that operate in numerous European countries, have substantial annual revenue or valuation, serve as important gateways for businesses to reach customers, and have or are likely to have persistent long-term market share. When these standards are met, the "gatekeepers" are subject to several regulatory limitations and obligations.

Notwithstanding its broad and quite general definition of "gatekeeper," the DMA is commonly believed to be aimed at a small number of very large companies, such as Amazon, Apple, Facebook, Google, and Microsoft. By punishing or regulating companies based on their size and success, and without any reference to monopolization or unlawful or abusive behavior, the DMA is an extraordinary reversal of many decades of legal and economic policy. One common perspective is that this policy revision and the DMA are due largely to the efforts of large, influential European companies such as Spotify, News Corporation, and Axel Springer that are levering the government to attack the world's even larger technology companies.

However, tens of millions of SMEs work with and rely on gatekeeper software, media, advertising, and commerce tools. Importantly, these SMEs rely on gatekeeper platforms largely because of their size and scale, as these attributes help small businesses reach very large and also very targeted audiences. Thus, DMA impacts on the approximately 25 million European small businesses are inevitable and worrisome, and deserve policymakers' attention.

European SMEs and Digital Technologies: An Overview

The European Commission describes SMEs as "the backbone of Europe's economy." The Commission has noted that SMEs employ about 100 million people, represent 99% of businesses, and account for more than half of Europe's GDP. It is no exaggeration to say that small businesses represent the lifeblood of not just the EU economy overall, but the economies of every state and region as well.

Small Business Digital Adoption

Digitally Advanced

42%

Digitally Evolving

40%

Digitally Uncertain

18%

Millions of these small businesses faced massive upheaval throughout the COVID-19 pandemic. According to another study from the Connected Commerce Council, Digitally Driven: Europe, 90% of SMEs reported significant disruption during COVID, with 44% being so disrupted that they changed products, services, or business models in order to stay afloat. Fortunately, in advance of the pandemic, many small businesses had already incorporated digital tools and technologies into their business to varying degrees.

The report first asked small businesses about the number and types of digital tools they use and grouped them into three categories: Digitally Advanced (42%), Digitally Evolving (40%) and Digitally Uncertain (18%). For the Digitally Advanced and many Digitally Evolving, representing about 20 million European small businesses, digital tools are a necessity as they pay off in every important aspect of business: revenue, growth, hiring, and profitability. This is because SME access to affordable digital tools, often via very large technology companies, significantly increases the reach SMEs have to new customers and markets, and facilitates sales and order fulfillment.

Perhaps most important is the linkage between digital adoption and pandemic resilience. During the pandemic, Digitally Advanced small businesses in Europe enjoyed 1.6x more revenue, 1.4x better customer retention, and hired 3.3x more people compared to Digitally Uncertain small businesses, plus emerged from the year with much more optimism about their futures. Without regard to DMA, the study concludes that an important government role is to promote small business adoption of digital tools and technologies to help the entire SME sector – particularly Digitally Uncertain businesses – become more resilient and more optimistic.

The Unintended Impact of the DMA on European SMEs

Current Dependence of Small Businesses on Large Tech Companies

Millions of small businesses in Europe and globally use products and services offered by Amazon, Apple, Facebook, Google, and Microsoft for simple and practical reasons - these digital tools are effective, user-friendly, and affordable. In essence, the platforms earned their success through many years of delivering quality products and services at customer-friendly prices to the smallest businesses with the tightest budgets.

Extrapolating from the Digitally Driven: Europe study, 42% of European SMEs - or about 10.5M - view digital tools as an integral part of their business and use at least 10 different categories of digital tools. Another 40% of European SMEs are in the midst of their digital transformation, adopting additional digital tools during the COVID pandemic. These typically are the very types of business-to-customer connection services that DMA could disrupt through forcing the disaggregation of a critically important stack of services offered by large tech companies -- e-commerce, digital marketplaces, social media, digital advertising, and business analytics - but they are precisely the affordable yet powerful tools that deliver extraordinary results to small businesses and so their regulation is potentially very harmful.

It is also significant that the DMA will regulate large companies because they integrate several different software tools and functionalities into a single affordable and efficient offering, and DMA will inhibit acquisitions by large integrated firms. Millions of European SMEs prefer and enjoy the benefits of integration because it simplifies operations. Integrated customer data, email, e-commerce, and payment systems are easier for small business owners to learn, which reduces frustration and mistakes and increases digital optimism and adoption. Increased SME productivity and performance that results directly from using integrated tools at scale produces greater success, and makes SMEs stronger competitors against each other and against larger competitors that otherwise would win market share based on sheer size and capital.

Imagining an Alternative Future of "Smaller Big Tech"

Consider an alternative future in which large technology companies are smaller, less integrated across business units, and have diminished reach. Even assuming product quality is the same, SMEs with limited budgets and limited or no technology staff:

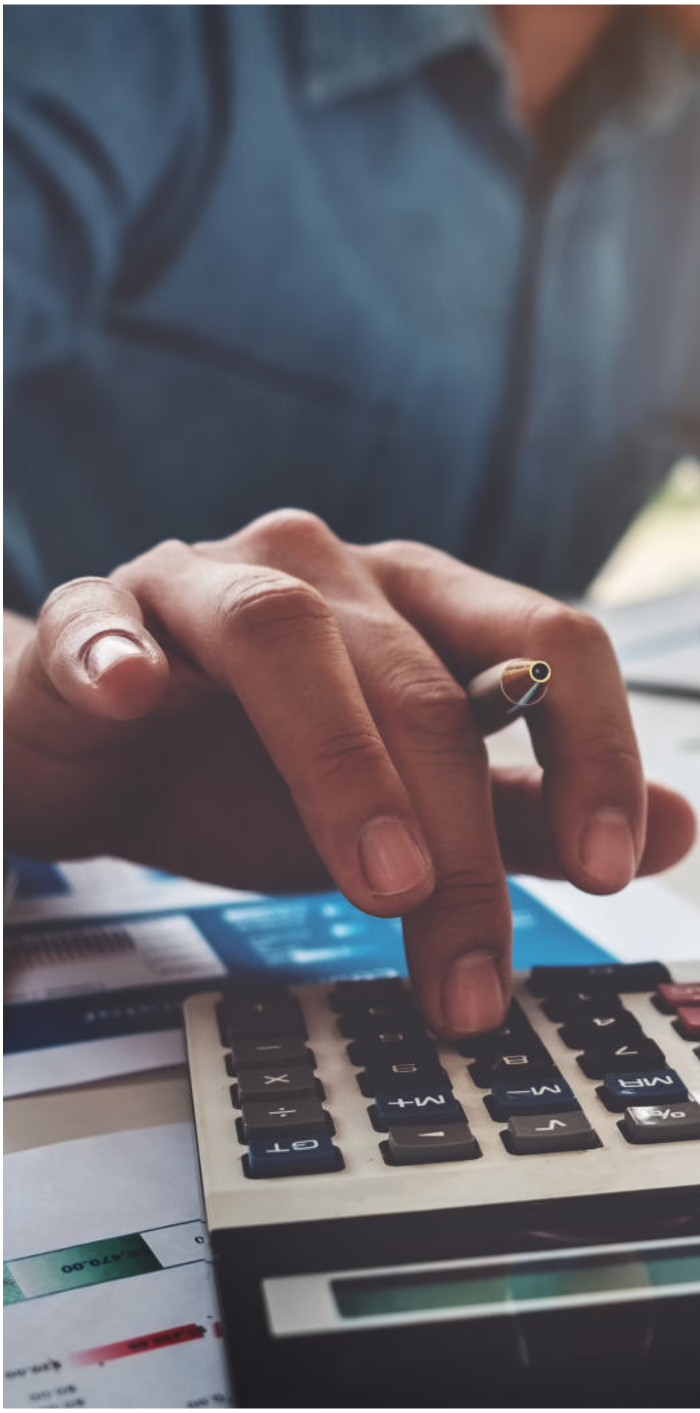
- will have to increase their number of technology vendors, resulting in more user agreements, more data sharing with different companies, more passwords, and frustration,
- will pay more for services because each vendor will have to recoup its own transaction costs and overhead,
- will make more mistakes with customer and business data and experience more frustration when each service upgrades independently and causes problem with other services, and
- will spend more time on technology and less time on the core business of developing products, selling and servicing customers, and training employees.

How would that actually happen to SMEs in practice? Here are two fictional examples that illustrate the point:

- If the DMA forces Facebook and Instagram into separate entities that are prohibited from unifying logins and sharing data, a French winemaker that today uploads marketing photos and customer stories to both platforms will have to manage two accounts instead of one. Additionally, tech companies may charge fees or higher fees for business accounts that are free or inexpensive today. If the winemaker chooses to promote posts on two platforms, it will likely cost more as each platform must be paid separately for data collection, analytics and targeting services.

- If the DMA forces large companies to disaggregate functions that are now integrated, then a Portuguese leather footwear firm that currently advertises and sells only locally will struggle to expand internationally because Google Translate may not be integrated with Google Ads and Google My Business. It is simply inefficient for a small design or manufacturing firm to connect different advertising, e-commerce, and translation services compared to using a combined offering from one firm that saves time and money.

It's a basic rule of economics that when suppliers' costs increase, those increases are passed down to their customers. Take the fictional but realistic example of a small business that pays $5/month per employee to license each of 10 digital tools. If DMA-related costs to large technology companies result in even a $1/month increase (20%) over time, that would result in an extra cost per year of $120 per employee on top of the $600 they were already paying. Assuming that the average SME employs 20 people, that is an additional $2,400 per year, which is substantial for a small business operating on a modest margin. Extrapolated across Europe's approximately 25 million SMEs, that is an extra cost of roughly $60 billion per year to SMEs - for access to the same data and digital tools that they have today.



Scenarios such as these will occur individually, but the collective impact will be broad SME digital regression that will inhibit growth, reduce resiliency and hurt communities. Small business owners will be frustrated by inconvenience, confusion, too many passwords, and too many mistakes - not to mention the additional time and cost associated with all of this - and the impact across all SMEs will be a substantial drag on SME recovery and growth. Instead of promoting European SME growth and competition, the DMA will backfire and do the opposite, as one of our Working Group experts suggested.

Alternatives For Consideration

Millions of community-based SMEs consider large digital platforms to be sources of solutions and opportunities that provide access to customers and markets, help businesses grow, and business owners and employees feed their families. In contrast, some European Commissioners and MEPs consider large digital platforms to be natural predators that must be restrained because abusive opportunities are widely available and irresistible. Is it possible to accommodate both of these perspectives?

The DMA approach is to define potential troublemakers in advance and restrain them from the opportunity to harm—to be a predictive judge and jury in the realm of the hypothetical. And the primary mechanism for determining this is size (users, revenue). This approach carries with it the significant risk that the European small business economy - already on its heels due to the pandemic - will have a slower and less efficient recovery.

An alternative approach would be to identify “gatekeeper” companies and develop an oversight regime, but impose regulatory prohibitions and obligations on each gatekeeper independently and only after measuring the economic benefits that may be lost as a result. Regulating based on performance instead of arbitrary metrics would create a pathway to success for large and growing companies, while also looking out for Europe’s competition and broader economic interests. Admittedly this alternative is slower, but in practice it will be more rigorous, more balanced, more likely to conserve the innovation potential of large incumbents, and offers the best opportunity to balance two competing and quite divergent perspectives.

For months, the DMA debate has focused on sweeping macroeconomic and geopolitical concerns - the U.S. vs. Europe vs. China, or gigantic companies (Apple and Google) vs. merely huge companies (Spotify and Axel Springer). But in the same way that policymakers are attentive to songwriter and recording artists (i.e., small business) concerns with respect to Spotify and other creative industry platforms, so should they be attentive to small local businesses in the DMA debate about platforms. As the European Commission and Parliament determine whether to enact the DMA, it is critical that SMEs and local government officials - particularly economic development officials - participate in the deliberations and have a voice equal to those focused on grand sweeping reforms and battles among economic giants.

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About Catalyst Research

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Catalyst Research solves problems from a different perspective. The intersection of technology, public policy and market trends today will define every aspect of society for the next century. It is against this backdrop that Catalyst Research seeks to better understand, elevate and mobilize the data that allows leaders to think creatively and advocate successfully for a sustainable, safer and more equitable future enabled by technology.

Our firm is organized around critically important practice areas including:

- The Digital Safety Net and Small Businesses
- Digital Innovation as a Threat and Opportunity
- The Microeconomics of the Digital Economy
- Digitally Driven National Competitiveness

We are not generalists, and we come with a formed opinion on these matters. At Catalyst Research, we believe that these topics should be commonly understood and easily accessible to leaders and those in a position to shape society's future.

To do this, we bring together the sharp and deeply sourced experts from across a wide array of topic areas and perspectives, enabling the Catalyst Research team to create engaging conversations, unique insights and relatable stories and publications which can be found on www.catalystresearch.com and our sister organization the Data Catalyst Institute www.datacatalyst.org.