Digital Markets Act, Venture Capital and Startups:

A report-essay with analysis and recommendations on a crucial, yet unexplored, topic

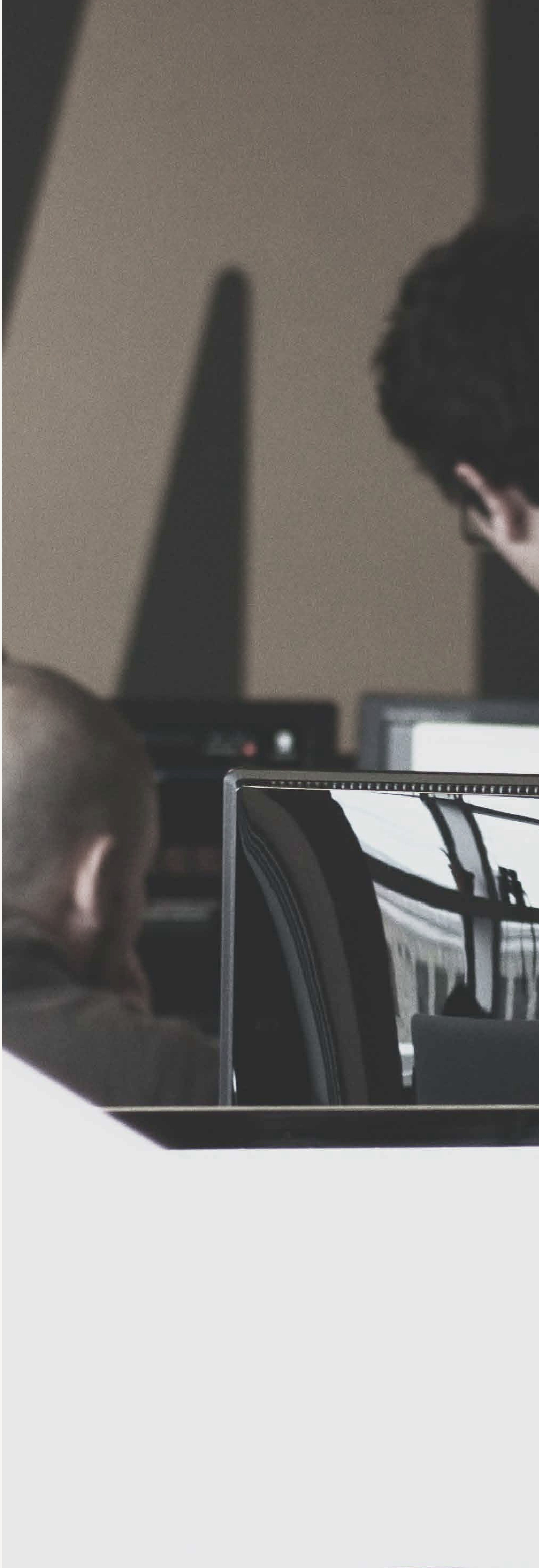
beta·i collaborative innovation

June 2021

Introduction

Following the presentation of the progress report at the end of May by the Portuguese Presidency on the Digital Markets Act (DMA), Beta-i is sharing its reflections about the DMA.

This report focuses on the DMA' systemic impact on the European startup and scale-up community, with special emphasis on the direct or unintended consequences on venture capital investment.



Credits

Research and writing:
Alisson Avila, Communications & Knowledge Principal, Beta-i
International Federation of Journalists (IFJ) BR17908
alisson.avila@beta-i.com

Proofreading:
Cristina Tomé

Design:
Diego San Pedro

Produced by Beta-i for the European digital
and tech community and their Policy-makers.

Commissioned by Google

www. beta-i.com

What is the DMA about, and how can it impact European scale-ups' growth?

Submitted by the European Commission to the Council of the European Union and the European Parliament in December 2020, **the DMA is a legislative proposal that intends to ensure competitive markets in the European Union.** Expected to be implemented around 2023, after public consultation and the approval of the Parliament and the Council, the DMA focuses mainly on the regulation of so-called "gatekeepers".

The DMA could potentially impact scale-ups by discouraging growth and acquisitions.

The term encompasses a very particular set of companies that meet certain criteria. The currently proposed criteria include digital platforms that, over the last three financial years, have provided core services to over 45 million monthly active EU consumers, and over 10,000 yearly active EU business users; annual turnover of 6.5 billion euros or more in the European Economic Area in the last three fiscal years; or must have offered core platform services in at least three member states while being part of an undertaking with an average market capitalization of at least 65 billion euros in the last fiscal year.

Even though it seems that very few EU businesses will meet the criteria as gatekeepers, **the DMA could potentially impact scale-ups by discouraging growth and acquisitions.** This happens thanks to rather complex compliance requirements. The DMA establishes a list of obligations which includes:

prohibitions on combining data collected from two different services belonging to the same company;

provisions for the protection of platforms' business users, including advertisers and publishers legal tools against the self-preferencing methods used by platforms to promote their own products;

articles concerning the pre-installation of some services;

regulation related to bundling practices, and provisions to ensure interoperability, portability, and access to data for businesses and end-users of the platforms;

non-compliance enforces sanctions mechanisms, including fines of up to 10% of the turnover.

We believe that, as it is, **the DMA is based on specific past cases.** Also, there is an almost exclusive emphasis on the size and reach of digital players' operations. By doing so, **the proposal skips some necessary guiding principles for the single market's future competitiveness.** Combined, this places industrial balance as the central motivation for regulators, something that has consequently led to a focus on big American tech companies in the short term, and which tends to ignore the potential systemic effects on the European ecosystem in the short to mid-term.

We believe that the DMA could better anticipate ways to support and prepare European startups' journey towards a "gatekeeper" position within Europe's digital single market.

EU regulators should take a broader perspective, as market leadership and business expansion is the mission of any startup and scale-up: their work is based on international growth either through organic means or additional acquisitions. **We believe that the DMA could better anticipate ways to support and prepare European startups' journey towards a "gatekeeper" position within Europe's digital single market.**

With investment surging, VC's and Startups should properly be identified

Given the huge European investment in economic recovery already underway, precisely in the name of an ambitious digital and green transition, **we can expect an increasing number of new European gatekeepers over the next few years.** The investment scenario already suggests that: according to Crunchbase data and reporting, global venture funding has hit an all-time high in the first quarter of 2021, with Europe presenting a stellar performance that positions the region as a VC + startup emerging market towards competitive maturity.

Investment in European startups has tracked at $21.4 billion in the first quarter of 2021, a record amount that represents a doubling in just over a year. Financial backing at every stage was up, with late-stage funding growing the most. In 2010, Europe had 8 "unicorns"; in 2020 it had 92, with over half of these companies joining the list in just the past 18 months as a result of tech businesses blooming during the Covid-19 pandemic.

The DMA could highlight the importance of Europe's startups and prepare the field for them to comply with the Act, something that now seems far from reality.

If Europe truly believes in the transformative power of startups, **the long tail effect of DMA on newly invested companies - even if not all of them may turn out to be platform gatekeepers - cannot be ignored** and should be acknowledged in the proposal. The European Commission's expert group on competition policy in the digital era has said that **"the chance for startups to be acquired by larger companies is an important element of venture capital markets.** It is among the main exit routes for investors and it provides an incentive for the private financing of high-risk innovation".

Without prejudice to the terms"SME" and "platform" used in the proposal, it is worth noting the total absence of the expressions "European startups", "venture capital investment" and "European scale-ups" in the DMA's initial text and the recent Council progress report. Given the all-time-high investments in startups and their transformative power, we believe these agents should be named and considered in the proposal, both for economic or symbolic reasons. **The DMA could highlight the importance of Europe's startups and prepare the field for them to comply with the Act, something that now seems far from reality.**

European startups' growth journey remains unseen

In its current version, the DMA disregards the growth journey of European startups and the importance they have for Europe's digital single market. although they are an intrinsic part of the digital market's future puzzle. As it stands, the DMA will create barriers to the ubiquitous presence of large, non-European gatekeepers in the name of regional economic interests. However, **focusing too much on controlling "others" ends up devaluing policy designed "for us"**, thus making it clear that **it is necessary to anticipate internal growth scenarios for the upcoming European digital players.** Rules should make sure that EU businesses have no additional costs to scale quickly and offer services in the EU and the world.

Focusing too much on controlling "others" ends up devaluing policy designed "for us"

If projections point out that a more decentralized platform economy will certainly increase EU27 GDP, generate new jobs and boost consumer surplus, then European innovation interests could be more explicit in the text, or at least more balanced with the "external" concerns. We know that, besides increasing VC investments, European R&D will receive a significant boost until 2027 with the €95.5 billion budget from Horizon Europe, the EU's key funding program for research and innovation. But **by being mainly focused on existing large players rather than unleashing innovation from within, the DMA proposal lacks the connection with other EU initiatives to reinforce Europe's entrepreneurial vision.** Again, rules should ensure that EU businesses don't have extra costs to be able to scale quickly and offer services in the EU and abroad.

Participatory democracy through co-innovation methods

This point seems crucial when it comes to stakeholders' adherence and commitment. **Public policies perceived as something distant from daily reality, or created "only" to become a control measure, will always be challenged by their targets.** Not only because of the lack of a two-way conversation but especially because new business models tend to be based on unique, relevant value propositions that legislation tends not to keep pace with. **Policy-makers will increasingly face the challenge of keeping up with the digital innovation guiding principle: the agility to react, adapt and move on.** This is the path all high-performance future European gatekeepers will take: expansion, market reach and new categories of discovery based on ever-evolving consumer needs.

> *Policy-makers will increasingly face the challenge of keeping up with the digital innovation guiding principle: the agility to react, adapt and move on.*

We believe that **it will be less exhausting for the European Commission if the DMA debate could explore the topic from a more positive perspective, establishing a competitive and inclusive vision, capable of foreseeing scenarios based on collaboration between different business stakeholders of different sizes.** A constant regulatory dialogue could rely on more and easily accessible methods, for instance within business innovation's co-design best practices, to help policy-makers gain a full understanding of the breadth of perspectives amongst digital businesses across the EU. These would allow European startups, venture capital investors and other stakeholders to provide concrete examples of where regulation may act as an additional burden that hinders their growth. It would also help underline the point that **a one-size-fits-all solution is not the best outcome for Europe's digital marketplace.**

A B2B debate is at the forefront

From Beta-i's perspective, **the DMA can be viewed through the prism of a B2B debate,** where "the second B" (SMEs, startups, scale-ups, platforms) represents the entrepreneurial community of European citizens who operate in and want to grow within the digital single market -and beyond. By first focusing on this, we could have a deeper debate of rights and duties between gatekeepers and the business partners who rely on their services.

We propose a further exploration of the B2B aspects of DMA, based on evidence and data, so that the potential gains and losses of the "second B" become more visible. We would then be able to move the equation further and place citizen's needs and concerns at the centre of the debate.

> *We propose a further exploration of the B2B aspects of DMA, based on evidence and data, so that the potential gains and losses of the "second B" become more visible.*

It will of course be important to strike a balance between maximising digital competitiveness and the needs of end-users. **It will therefore be necessary for the European Commission to be open and transparent about this specific challenge when communicating with the digital ecosystem.**

Is every acquisition a killer one?

The theme of mergers, acquisitions and the so-called killer acquisitions should not be framed under a “one size fits all” logic in the DMA. Each merger and acquisition is the result of differing sets of circumstances which means that not every acquisition is a to-be-controlled killer one.

Context is everything: **any type of venture capital investment, exit, and acquisition is a tangible sign that a given tech ecosystem is flourishing and thriving beyond speculative capital and public subsidies.** The new economic principles, where M&A (mergers and acquisitions) tend to be much more granular and fragmented, do not always reflect traditional market economic practices. And if it is up to businessmen, entrepreneurs and citizens to understand their rights and duties within the contemporary socio-economic fabric, then it is also up to the policy-makers to better understand the scenario and, as in any journey of innovation, adapt -without ever neglecting the common good.

> *Any type of venture capital investment, exit, and acquisition is a tangible sign that a given tech ecosystem is flourishing and thriving beyond speculative capital and public subsidies.*

We believe it is possible to promote a free market alongside regulatory tools to ensure fair, equitable access to B2B opportunities while giving consumers choice. For the DMA, this means that the proposed catch-all rules on mergers and acquisitions don’t work. Cases have to be assessed individually and should hear from the founders who built the startup as well as the employees, who are often shareholders in the startup. This is the same for investors, who early on take risks on investing in European startups and driving European innovation.

> *European companies may choose to fragment themselves to avoid reaching the “gatekeeper stage”, which will inhibit their ability to compete on the global stage.*

Europe needs improved antitrust rules and due to its eternal correlation between the single market and the EU's inner diversity. In this sense, **the proposal of centralizing within the DMA gatekeepers’ deliberations in the European Commission is interesting and pragmatic. We support that, though we would suggest that the Commission set up minimum instruments for the Member States to provide timely context and information.**

However, as it stands the European Commission’s proposal is still too vague, increasing the risks of over and under inclusiveness. Such vagueness also opens a gap in terms of competitive fragmentation: **European companies may choose to fragment themselves to avoid reaching the “gatekeeper stage”, which will inhibit their ability to compete on the global stage.**

Will VC's leave Europe thanks to the DMA?

It is possible to assume that attractive and promising business models coming from European startups might continue to be of interest to VC funds, even with the growth limitations suggested by the gatekeepers logic in the DMA. Venture Capital funds tend to be crystal-clear on their goals and metrics, supporting startups that provide innovation, create new markets and have strong value propositions where they know their investments will pay off.

However, **net VC numbers could plunge in Europe for a period still to be estimated, as the impact of the DMA on the ecosystem and the uncertainty it can generate keeps under assessment.** If VC's feel that they will have to jump through extra hoops to invest in EU startups, or that the startups themselves will be burdened with even more regulation than in Asia, Africa or North America, then they will quickly take their investment elsewhere. **The European Commission should have this transition in mind while clarifying the current proposal in terms of time needed for due diligence, gatekeeper recognition, costs and related taxes, and non-compliance consequences.** Furthermore, while the secondary and tertiary impacts of these measures are not fully clarified yet, the DMA's impact could be greater and deeper in more risk-averse investment models such as corporate venture and regular M&A.

> *Net VC numbers could plunge in Europe for a period still to be estimated, as the impact of the DMA on the ecosystem and the uncertainty it can generate keeps under assessment.*

We'd also like to highlight to the European Commission policy-makers that **the DMA entry rules or consequences for international startups wishing to enter the European market are still not clear.** The majority of startups aiming at a global market take the EU geography into account, and one unintended consequence of the DMA might be VC companies assessing market entry differently in Europe versus the rest of the world. The possibility of being regulated ex-ante is potentially a serious obstacle, for example in the case of European entrepreneurs deciding to build companies outside the EU.

More clarity on data capturing & usage is key for DMA's long-term goals

In the end, everything is about data - a core revenue trigger for most businesses today, and a key topic for European citizens when "data" is, in practical terms, translated into topics such as "privacy", "intellectual property" or "transparency".

> *Data mutualism can't be ignored, so we suggest a greater focus on what happens at the very beginning of commercial relations between the current gatekeepers and their business users, and then with final consumers/users.*

For the digital platforms, it is the third-party market data, combined with their own, that gives gatekeepers an advantage. On one hand, this is what makes it difficult for smaller players to catch up with them; but on the other hand, this relationship is what makes the platform economy expand. **Such data mutualism can't be ignored, so we suggest a greater focus on what happens at the very beginning of commercial relations between the current gatekeepers and their business users, and then with final consumers/users.**

Transparency is important and there should be an incentive for companies that agree to go under rigorous independent audits, regardless of - but adapted to - their size. The DMA should heavily reinforce the need for a clearer, more explicit communication about information capture and use practices in B2B2C trading, while ensuring the protection of businesses' secrets and the protection of users, as well.

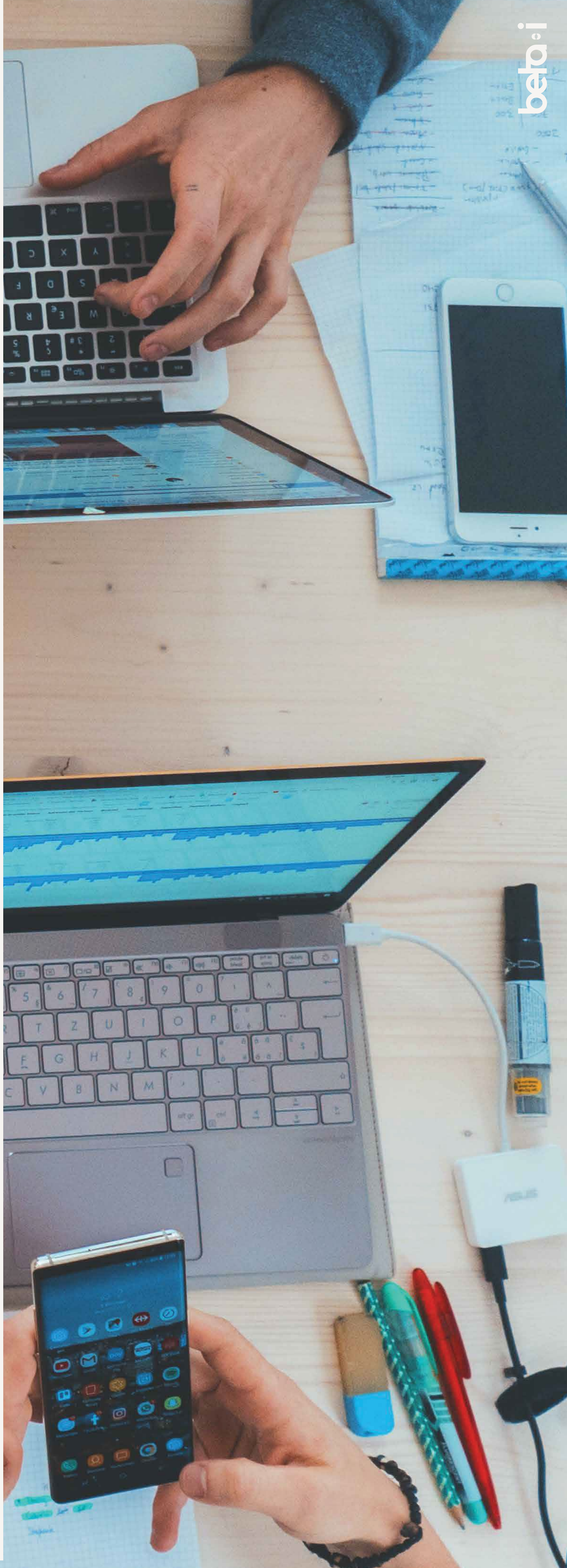
Now what?

The European Commission is aware of the great importance of the EU market for many global digital players: being present in its footprint is almost unavoidable. At the same time, the European Union is based on a motto that expresses the strength of its differences: “United in diversity”. Besides being an important consumer market, it also has singular characteristics that make it a very attractive one.

VC investors understand that there is only one Silicon Valley with that very specific DNA and startups that decide to develop their business concept in the EU must consider the reliability of a stable and predictable regulation. Once an EU regulation is approved, it is applicable in all Member States, and that is not the case with other geographies. However, **the DMA’s message that growing too much will come at the cost of being regulated ex-ante is not enough for Europe's ambitious digital and green transformation goals over the next decade.**

The single market is a deeply intertwined ecosystem, and the DMA is a necessary tool to shape Europe’s future competitiveness. **Beta-i suggests to the European Commission to double-down in a systemic economic consultation to further preview and anticipate its consequences on the investment market and the impact it will have on up-and-coming European players in the digital marketplace.** All the impacted stakeholders could be more involved in the DMA debate to actively share their own experiences and concerns, providing examples where regulation may act as an additional burden that minimizes their growth process.

> *The DMA’s message that growing too much will come at the cost of being regulated ex-ante is not enough for Europe's ambitious digital and green transformation goals over the next decade.*



References

Bertuzzi, Luca: Euractiv Digital Brief. June 2021. www.euractiv.com

Broadbent, Meredith: The Digital Services Act, the Digital Markets Act, and the New Competition Tool - European Initiatives to Hobble U.S. Tech Companies. CSIS - Center for Strategic and International Studies, November 2020.
https://www.csis.org/analysis/digital-services-act-digital-markets-act-and-new-competition-tool

Cabral, Luís; Haucap, Justus; Parker, Geoffrey; Petropoulos, Georgios; Valletti, Tommaso; Van Alstyne, Marshall: The EU Digital Markets Act - A Report from a Panel of Economic Experts, European Commission, 2021.
https://ide.mit.edu/wp-content/uploads/2021/02/jrc122910_external_study_report_-_the_eu_digital_markets_act.pdf

Caffarra, Cristina; Scott Morton, Fiona. The European Commission Digital Markets Act: A translation. VOX EU portal, January 2021.
https://voxeu.org/article/european-commission-digital-markets-act-translation

Castaignet, Arnaud.DSA and DMA: Can the EU take on Big Tech? Social Good Accelerator, March 2021.
https://socialgoodaccelerator.eu/2021/03/23/editorial-dsa-and-dma-can-the-eu-take-on-big-tech-march-2021-by-arnaud-castaignet/

Diane Coyle, Stephanie; Diepeveen, Julia Wdowin; Lawrence Kay, Jeni Tennison. The Value of Data Summary Report. Bennett Institute for Public Policy, Open Data Institute and Nuffield Foundation, 2020.
https://www.bennettinstitute.cam.ac.uk/media/uploads/files/Value_of_data_summary_report_26_Feb.pdf

Franzen, Jim: 1:1 interview with Didimo Marketing Director, May 2021 https://www.didimo.co/

Leslie, William; Prompers, Lodewick; Michailidou, Asimina. The European Commission's Digital Markets Act Proposal: Regulating systemically important digital platforms. Linklaters, December 2020.
https://www.linklaters.com/pt-pt/insights/publications/2020/december/european-commissions-digital-markets-act-proposal-regulating-systemically-important-digital

de Pree, Jolling; de Rijke, Bart; Gornall, Helen; Potjewijd, Geert; Arnbak, Axel: Digital Services Act and Digital Markets Act: Commission flexes its muscles. De Brauw Blackstone Westbroek website.
https://www.debrauw.com/articles/digital-services-act-and-digital-markets-act-commission-flexes-its-muscles#experts%20december%202020

Sette-Câmara, Eduardo: 1:1 interview with Beta-i Head of Acceleration, May 2021

de Streel, Alexandre; Feasey, Richard; Krämer, Jan; Monti, Giorgio. Making the Digital Markets Act more resilient and effective. CERRE, Centre on Regulation in Europe, May 2021. https://cerre.eu/publications/european-parliament-digital-markets-act-dma-resilient-effective/

Sunderland, Joe; Herrera, Facundo; Esteves, Sofia; Godlovitch Ilsa; Wiewiorra, Lukas; Kroon, Peter; Tas, Serpil; de Streel, Alexandre; Kalliala, Janne; Huerta Bravo, Javier; Maxwell, Winston; Renda, Andrea. Digital Markets Act - Impact Assessment support study Executive Summary and Synthesis Report. ICF, Wiki consult, Cullen international and CEPS for the European Commission Directorate-General for Communications Networks, Content and Technology, December 2020. file:///Users/md101/Downloads/KK0620190ENN.pdf

Teare, Gené: Allocation To European Private Companies Will Grow, Says LocalGlobe Founder Saul Klein. Crunchbase article, May 2021.
https://news.crunchbase.com/news/allocation-to-european-private-companies-will-grow-says-localglobe-founder-saul-klein/

Teare, Gené: European Venture Reaches All-Time High In The First Quarter Of 2021. Crunchbase article, April 2021.
https://news.crunchbase.com/news/european-venture-reaches-all-time-high-in-the-first-quarter-of-2021/

Valente, Paulo: 1:1 interview with Eupportunity Sénior Consultant, May 2021. https://eupportunity.eu

various: Digital Markets Act position paper, DIGITAL EUROPE, May 2021.
https://www.digitaleurope.org/wp/wp-content/uploads/2021/05/FINAL-DIGITALEUROPE-DMA-position-paper.pdf

various: Proposal for a Regulation of the European Parliament and of the Council on contestable and fair markets in the digital sector (Digital Markets Act) - Progress report. European Commission Permanent Representatives Committee, May 2021.
https://data.consilium.europa.eu/doc/document/ST-8807-2021-INIT/en/pdf

various: Venture Capital: Internal Market, Industry, Entrepreneurship and SMEs. European Commission website.
https://ec.europa.eu/growth/access-to-finance/funding-policies/venture-capital_en

About Beta-i

Beta-i is a Lisbon-based collaborative innovation consultancy which has shifted two years ago from an entrepreneurship and innovation association to a private company with a global reach. Beta-i had held one of the Top 10 Acceleration programs in Europe for years (Lisbon Challenge), not to mention a key business-oriented gathering between corporates, investors and startups (Lisbon Investment Summit). Its 10-plus-years track record on the tech ecosystem is currently deployed to modulate business relationships between large companies and thousands of startups, I&D institutions and doers from around the world.

Responsible for managing open innovation, pilot-oriented projects and ecosystem development programs for clients based in almost 20 countries in the five continents, Beta-i has extensive experience in the world of digital transformation and corporate / startup acceleration, being one of the key agents behind Lisbon's well-known tech and entrepreneurship case. Over time, its contribution involves more than 250 projects for 150 partners in 14 different economic sectors, and about 300 collaborative pilot developments.

With a team of 50 people from 15 different countries, Beta-i manages the most important open innovation program for the Energy industry in the world (Free Electrons); launched the first fintech regulatory sandbox in Angola, alongside Angola National Bank; through its new Brazilian office, it's currently developing a platform to connect tech startups with MSMEs; and was recently appointed by the North American magazine Global Finance, as one of the best fintech innovation centres in the world according to the annual ranking Best Financial Innovation Labs 2020.

beta-i.com/

Avenida Duque de Loulé 12, 6th Floor - 1050-090 Lisbon – Portugal