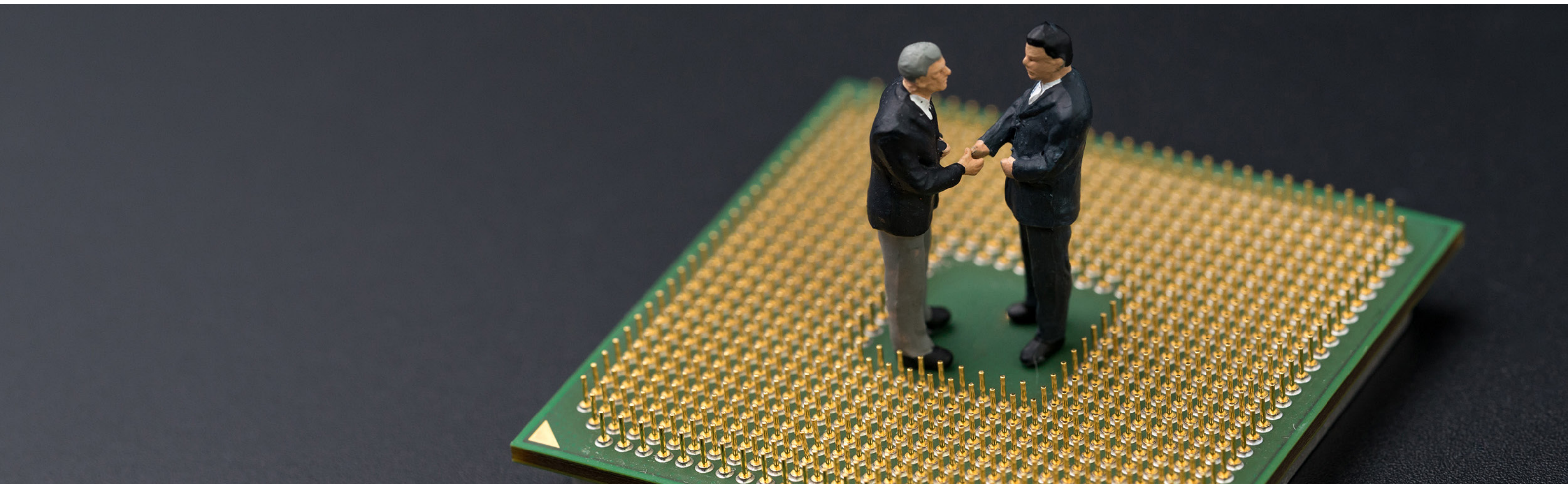

The UK's competition authority is ready to regulate big tech

by Zach Meyers, 26 May 2023

The UK competition authority has decided Microsoft cannot acquire games company Activision. This should reassure politicians that the authority wants dynamic and competitive markets – and it is less willing than the EU to rely on intrusive rules which could stifle innovation.

Competition regulators across the West are focused on the dominance of a small number of American firms in digital markets. But only the UK's Competition and Markets Authority (CMA) has blocked acquisitions by the largest tech firms. It unwound Meta's acquisition of Giphy, a library of animated clips. Then, it blocked Microsoft's $69 billion acquisition of gaming company Activision. That will probably defeat the deal globally – despite the European Commission approving the deal based on commitments from Microsoft that would regulate its future behaviour. Commentators dispute whether the CMA's approach will help or hinder tech innovation – and many worry about giving the CMA broad new powers to regulate big tech. The EU's approach would have led to ongoing supervision of Microsoft's behaviour. The CMA's decision should reassure parliamentarians that the UK regulator has little appetite for overly intrusive regulation of big tech.

Corporate mergers often benefit consumers. For example, they can give smaller firms more resources to disseminate their technologies. However, all Western authorities worry that tech mergers might also reduce competition. Tech markets are often dominated by one or two players, which can be disrupted only by radical innovation, in the way that Google disrupted Yahoo 20 years ago, and Bing might use artificial intelligence to disrupt Google today.

EU and US authorities are therefore increasingly hostile to big tech acquisitions of potential disruptors. Yet in the US, judges typically approve mergers where the two parties' products do not compete directly – which means most tech deals go ahead. EU courts similarly require the Commission to show a "strong probability" that a merger could harm competition before blocking it. The Commission therefore cannot easily block tech deals on the basis that the firm being acquired might one day become a disruptor.

Post-Brexit Britain has emerged with the more aggressive regulator. In 2021, the CMA ordered Meta to reverse its acquisition of Giphy, on the basis that part of Giphy's business could have grown into a competitor to Meta's online advertising. The CMA took a similar future-looking approach in the

Microsoft/Activision deal. The CMA feared that acquiring Activision would help Microsoft dominate cloud gaming, a nascent gaming technology. The EU, on the other hand, allowed the deal – on the basis that Microsoft made commitments which would make life easier for competing cloud gaming companies. The Commission rightly said this would be an "improvement" over the status quo. The CMA argues that the promises made by Microsoft would lock in a particular business model, and could not replicate the benefits of "a free, open and competitive market" where different business models compete.

According to Microsoft, the CMA is being too dogmatic: its refusal to accept Microsoft's commitments signals that the UK is "closed for business" and will scare start-ups away from the UK. This is not a well-founded criticism. First, tech firms cannot simply move outside the UK to avoid CMA review. The CMA can block deals regardless of whether the firm being acquired is physically present in the UK – so long as both firms have sufficient market share in Britain. For example, Giphy had no real commercial presence in the UK. Nor did the software firm Farelogix – yet the CMA blocked its merger with another software provider, Sabre, recently. Tech start-ups would have to take extraordinary steps (like blocking their services from being accessed from the UK) to eliminate the risk of CMA review. Second, the UK is not alone in reviewing deals between two offshore companies – for example, the EU has similarly expanded the scope of mergers it can review. Like the UK, the EU has also prohibited deals that involve little current investment in Europe. Global deals simply face a greater risk of being blocked, wherever their parties are located. In that uncertain environment, the UK still continues to punch well above its weight in attracting start-ups, easily outperforming the rest of Europe in terms of venture capital and the number of 'unicorns' (tech firms valued above $1 billion). That pattern has continued despite the CMA's past controversial decisions in the Giphy and Farelogix cases.

The more important question is whether – rather than harming the UK tech scene in particular – the CMA's inflexible approach harms incentives for disruptive innovation generally. A start-up's ability to 'cash out' provides incentives to innovate in the first place, and allows business founders to move onto new business ideas. If the CMA is too unpredictable in identifying risks to competition, and too inflexible in negotiating commitments like those Microsoft offered to address its concerns, the ability to 'cash out' will become uncertain. This poses a problem: nascent future disruptors are extremely difficult to identify. After all, some experts are still unsure whether even the most controversial tech deals, like Facebook's acquisition of Instagram, were anti-competitive – perhaps, without Facebook's support, Instagram would never have achieved its current size. Some academics have proposed 'checklists' to reduce uncertainty, such as requiring a start-up to have a monetisable business model before competition authorities treat them as a disruptor. But these are mostly unrealistic. For example, Google succeeded by growing its customer base first, and only much later commercialised it – yet it is one of the web's great disrupters.

Microsoft is therefore right to complain that if the CMA is too rigid and unpredictable, some types of innovation could suffer – and the EU might look more attractive for entrepeneurs. However, so long as start-ups have other options than being acquired by large tech firms, other forms of innovation might improve. If start-ups' best option is to sell out to giants, this may steer start-ups' innovation efforts towards being attractive targets – for example, by complementing existing larger firms' products – rather than being disrupters. This produces some incremental social value, helping large tech companies expand and improve their innovative services. But in the long run, by expanding ecosystems of firms which are already dominant in particular areas, these incentives reduce the scope for genuine competition. In particular, this dynamic steers innovation away from 'kill zones' – activities big tech platforms might copy or quash. That might explain why, for example, so many of the UK's and Europe's most successful tech firms are fintechs. Fintechs supplement the major mobile ecosystems. But they do not usually intrude onto big tech firms' turf: those larger firms are generally uninterested in becoming embroiled in financial services regulation.

Policy-makers therefore need to ask two questions. Why are start-ups mostly dependent on being acquired rather than scaling up? And why are larger technology firms the most attractive acquirers?

Blocking mergers cannot by itself address these problems – rather, it will just give start-ups even fewer options than they have now. Instead, governments need to foster larger pools of capital ready to make long-term bets in high-risk companies that have the potential to disrupt markets. They must also help that capital access the most promising opportunities. Across Europe, the amount of venture capital available for innovative start-ups to grow is decreasing. European stock markets, including the London Stock Exchange, are unattractive for high-tech companies, who can secure higher valuations in the US. The UK's stock market has lost many tech firms in recent years, including Arm, Aveva, Micro Focus and Avast. Europe's most established firms are also relatively slow to innovate and are mostly uninterested in nurturing start-ups' innovations. That perhaps explains why Europe performs badly at scaling up tech businesses: Europe produces 36 per cent of the world's start-ups but only 14 per cent of the world's tech firms valued above $1 billion.

Competition authorities need to roll up their sleeves too. Start-ups are keen to sell their ideas to big tech firms because tech giants have power over many start-ups. Start-ups often rely on large tech platforms to reach customers – such as Apple's app store, Google's search engine, or Amazon's marketplace. And big tech firms have the ability to copy a start-up's service and then cross-promote that copied service, driving the start-up out of business. An independent investor would have to accept these risks – even if they are only theoretical – and so would demand a lower price for the start-up than a big tech firm might offer.

Pro-competitive regulation can help address this problem – and in this way, competition authorities can help give start-ups more choices, rather than only narrowing them by blocking deals. If regulation provides more assurances that larger tech firms will treat smaller tech firms fairly, then start-ups will be more attractive to a range of other potential acquirers and investors. Anti-competitive acquisitions could still occur. But they would be more costly for big tech firms – since start-ups would have alternatives. That means anti-competitive acquisitions are likely to happen less often, and to be more easily identifiable by their high price tag. That should help address worries about merger authorities acting unpredictably, and justify a more aggressive approach if merger authorities do identify an anti-competitive deal.

An EU law, the Digital Markets Act, will soon start addressing this problem. After much delay, the UK government has now tabled its own bill which would deliver this type of regulation: its Digital Markets, Competition and Consumers Bill. The Bill would give the CMA power to design new rules for big tech firms, in particular to give users more choice between different firms' services and to force large firms to act more transparently. This would allow the CMA to foster competition where none currently exists. Unlike the EU's Digital Markets Act, which will require long-term intrusive regulation, the UK Bill will give the CMA powers to make sharper, more incisive short-term interventions.

The right of British politics is convinced that the CMA has gone rogue by stopping the acquisitions of Giphy and Activision, and wants to water down the CMA's proposed new powers, fearful the CMA will over-regulate and stifle innovation. Their worries are not entirely misplaced. Detailed and intrusive rules pose risks. They can prompt companies to obey the letter rather than the spirit of the law, and they can stifle innovation and experimentation by locking in particular market structures. That is a particular risk in fast-moving markets where a technology is nascent and the future is unpredictable.

The Activision decision should reassure sceptics of the Bill. By rejecting Microsoft's commitments, the CMA showed it understands these disadvantages of intrusive regulation. For example, Microsoft's commitments would have promoted a single commercial model for cloud gaming content. But in a genuinely dynamic market, cloud gaming firms would have incentives to experiment with many different options to work out which consumers like the most. Blocking the merger was a one-off intervention that would keep the market free to innovate and experiment – rather than forcing the CMA to supervise Microsoft's behaviour for years to come, using rules that might quickly look outdated. The CMA needs to adopt a similar approach when it uses its new powers. Rules that dictate how tech markets should develop, or how different tech products are designed, may take years to pay off and risk locking in suboptimal outcomes. Quick one-off interventions to unlock consumer choices could open up competition and empower consumers. For example, the CMA could ensure app developers have the right to give consumers information about different (and cheaper) ways they can pay for content, without using large tech firms' payment services with their high fees. In doing so, the CMA can ensure innovation is driven by competition and consumers' choices – not detailed, innovation-stifling rules.

The uproar over the CMA's decision in Microsoft/Activision is of little relevance to most start-ups, who are more likely to worry about their survival than being acquired for billions of dollars. Nevertheless, the deal ought to reignite the debate about the EU and UK's dearth of tech giants. Competition policy is one part of the solution – but it is an important part. The CMA's decision in Activision suggests it will use any new powers responsibly. Rather than being a restrictive and intrusive regulator, it should continue to make bold decisions that allow the CMA to get out of the way quickly – leaving tech firms free to innovate freely. The Commission's decision to accept commitments from Microsoft would improve competition in a predictable way. The CMA's approach will be less predictable and more dynamic – just as tech markets should be.

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A number of technology companies including Amazon, Apple, Meta, Microsoft and Google are corporate members of the CER. The views expressed here, however, are solely the author's, and should not be taken to represent the views of those companies.