

<b>Title:</b> Impact Assessment - A new pro-competition regime for digital markets <b>IA No:</b> N/A <b>RPC Reference No:</b> RPC-DCMS-5078(1) <b>Lead department or agency:</b> Department for Business, Energy and Industrial Strategy <b>Other departments or agencies:</b> Department for Digital, Culture, Media and Sport	<h2 style="margin: 0;">Impact Assessment (IA)</h2>
	<b>Date:</b> 20/07/2021
	<b>Stage:</b> Consultation
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Primary Legislation
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<b>Summary: Intervention and Options</b>	<b>RPC Opinion:</b> Informal (no rating provided)

Cost of Preferred (or more likely) Option (in 2019 prices)			
Total Net Present Social Value	Business Net Present Value	Net cost to business per year	Business Impact Target Status
N/Q	N/Q	N/Q	
<b>What is the problem under consideration? Why is government action or intervention necessary?</b> <p>The characteristics of some digital markets lead them to quickly tip in the favour of one, or a few, firms. The market power held by a small number of firms is undermining effective competition, stifling growth and innovation, and giving rise to consumer harms in these markets. Existing pro-competition tools, and consumer protections, are not well suited to address the unique and novel challenges posed by these complex, fast-moving digital markets. The proposed regime aims to tackle these issues by addressing both the sources of market power, and the economic harms that result from the exercise of this power. Government intervention is necessary as the concentration of market power and weak contestability in these markets is unlikely to be rebalanced through market forces or existing regulatory tools.</p>			

<b>What are the policy objectives of the action or intervention and the intended effects?</b> <p>The overarching objective is to establish a new regime, promoting competition and competitive outcomes, to further the interests of consumers in digital markets. This would be achieved through the dual action of targeting the effects of the exercise of market power (i.e. consumer harms), and the underlying sources of this market power (e.g. market characteristics that act as barriers to entry). This would allow for harms to be remedied in the shorter term, and for market power to be effectively rebalanced in the long term. The intended outcome is an improvement in consumer outcomes in digital markets (including lower prices, higher quality, greater choice) and increased growth and innovation in the digital economy.</p>
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<b>What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)</b> <p>The policy options considered within this analysis were as follows:</p> <ul style="list-style-type: none"> <li>● <b>Option 0: Do Nothing (No new action)</b>- The continuation of the current state of regulation - including the recently established non-statutory Digital Markets Unit (DMU) and existing Competition &amp; Markets Authority (CMA) tools.</li> <li>● <b>Option 1: Alternatives to regulation</b> - Self regulation by firms within digital markets and the provision of information to consumers by government</li> <li>● <b>Option 2: A DMU with power to implement a code of conduct for firms with Strategic Market Status (SMS firms)</b> - A regulatory approach that would see the implementation of a dedicated regulator for digital markets, within the CMA. This body would be able to enforce a set of principles onto firms deemed to have substantial and entrenched market power providing them with a strategic position.</li> </ul>
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- **Option 3: A DMU with powers to implement a code of conduct and PCIs for SMS firms only** - In addition to the powers outlined in option 2, the regulatory body would be granted the power to implement pro-competitive interventions (PCIs) onto firms with substantial and entrenched market power providing them with a strategic position.
- **Option 4: A pro-competition regime with powers to implement a code of conduct, PCIs and a merger regime for SMS firms only** - In addition to the powers outlined in option 3, this option would include a more stringent mergers regime for firms deemed to have substantial and entrenched market power providing them with a strategic position.
- **Option 5: A DMU with powers to implement a code of conduct and PCIs for all firms in digital markets** - This option would extend the powers outlined in option 3 to all firms within digital markets, not just those deemed to have substantial and entrenched market power providing them with a strategic position.

The potential alternatives to regulation considered within this consultation IA were not deemed to be suitable given the substantial market power currently enjoyed by large firms within digital markets. It is unlikely that a non-regulatory approach, identified in this IA, would generate significant changes that would be in line with the overarching policy objectives of promoting competition and competitive outcomes.

Our preferred option at this stage is **Option 3: A statutory DMU with powers to implement a code of conduct and Pro-Competitive Interventions (PCIs) on Strategic Market Status (SMS) firms only**. This is a regulatory option that would grant new powers in statute to the recently formed Digital Markets Unit (DMU) to oversee and enforce a code of conduct and pro-competitive interventions on a small number of the most powerful and strategically positioned digital firms that the DMU will designate with Strategic Market Status (SMS). This option most closely aligns with identified policy objectives and is expected to return the greatest value for money. Limiting this intervention to large firms, through the SMS designation process, reduces the risk of over-regulating and of increasing the burdens on smaller firms.

*The government is supportive of a dedicated SMS merger regime. However, a detailed policy position in relation to the mergers regime is not proposed at this stage. Not including the SMS merger regime in the preferred option, does not mean that the inclusion of this policy option is rejected.*

Is this measure likely to impact on international trade and investment?					Yes				
Are any of these organisations in scope?			Micro: No	Small: No	Medium: No	Large: Yes			
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			Traded: N/A		Non-traded: N/A				
<b>Will the policy be reviewed?</b> Yes. Date of post-implementation review TBC									

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits, and impact of the leading options.***



Signed by the responsible Minister: \_\_\_\_\_

Date: \_\_\_\_\_

21/06/21

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** This option considers potential alternatives to regulation. Namely self-regulation by firms within digital markets, and provision of information about digital markets to consumers in an effort to alter consumption decisions.

## FULL ECONOMIC ASSESSMENT

Price Base Year 2019	PV Base Year 2020	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: N/Q	High: N/Q	Best Estimate: N/Q

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

### Description and scale of key monetised costs by 'main affected groups'

There is no formal quantification of costs for this option in this IA.

### Other key non-monetised costs by 'main affected groups'

Large firms: Any (potential) impacts on revenue as a result of agreed regulations as surplus may be transferred from producers to consumers.

All firms: Costs of coordination for self-regulation.

Government: Cost of producing and distributing information to consumers.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

### Description and scale of key monetised benefits by 'main affected groups'

There is no formal quantification of benefits for this option within this analysis.

### Other key non-monetised benefits by 'main affected groups'

There may be some benefit to consumers through a transfer from businesses to consumers as a result of regulatory measures. However, it is deemed that this option would not be successful in returning significant benefits. However, there could be some agreement between firms to limit certain behaviours, which would result in a reduction in consumer harms relative to the counterfactual, bringing about a wellbeing benefit in the short term.

<b>Key assumptions/sensitivities/risks</b>	<b>Discount rate (%)</b>	N/A
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The assessment of this option assumes that market power is significant enough that a non-regulatory approach would not be sufficient to effectively change the behaviour of large firms in order to generate long term change within digital markets.

## BUSINESS ASSESSMENT (Option 1)

<b>Direct impact on business (Equivalent Annual) £m:</b>				<b>Score for Business Impact Target (qualifying provisions only) £m:</b>	
<b>Costs:</b>	N/Q	<b>Benefits:</b>	N/Q		<b>Net:</b>

## Summary: Analysis & Evidence

## Policy Option 2

**Description:** The DMU, with new statutory powers, would be able to enforce a code of conduct for firms it has designated with SMS.

### FULL ECONOMIC ASSESSMENT

Price Base Year 2019	PV Base Year 2020	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: N/Q	High: N/Q	Best Estimate: N/Q

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

#### Description and scale of key monetised costs by 'main affected groups'

The indicative estimate for the potential annual cost of the DMU (including both one-off set up costs, such as purchasing IT and initial recruitment processes, and ongoing operational costs, such as salaries for employees) is presented as a wide range. The estimate for this option is between £4m and £20m per annum.

There are also some indicative estimates of familiarisation and compliance costs borne by businesses, based on our own assumptions, that we hope to refine and formalise using evidence gathered through consultation. Our estimate of familiarisation costs is around £425k in the first year, with an annual compliance cost estimate of £625k per designated platform per annum.

#### Other key non-monetised costs by 'main affected groups'

SMS firms: Reduced profits (transfer to consumers)

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

#### Description and scale of key monetised benefits by 'main affected groups'

There is no formal quantification of benefits within this analysis. It is estimated that this option would return short term wellbeing benefits through reducing the existence of consumer harms relative to the counterfactual, as firms change their behaviour in order to comply with the code of conduct.

#### Other key non-monetised benefits by 'main affected groups'

Non-SMS firms: lower costs associated with unfair treatment (e.g. exclusionary behaviour) by SMS firms.

Consumers (including business and end users of digital markets): Reduced prices; Increased quality; Increased choice; Reduced harm.

<b>Key assumptions/sensitivities/risks</b>	<b>Discount rate (%)</b>	N/A
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Use of powers - We assume that the DMU will use the powers granted to them in an effective and proportionate way to achieve its objectives.

Efficacy of DMU powers - We assume that the new pro-competition regime will have a material impact on competition and contestability within and across digital markets.

SMS compliance - We assume that SMS firms will comply with new regulations.

### BUSINESS ASSESSMENT (Option 1)

<b>Direct impact on business (Equivalent Annual) £m:</b>				<b>Score for Business Impact Target (qualifying provisions only) £m:</b>	
<b>Costs:</b>	<b>N/Q</b>	<b>Benefits:</b>	<b>N/Q</b>		<b>Net:</b>

## Summary: Analysis & Evidence

## Policy Option 3 (preferred option)

**Description:** The DMU, with new statutory powers, would be able to enforce a code of conduct, and pro-competitive interventions for firms it has designated with SMS.

### FULL ECONOMIC ASSESSMENT

Price Base Year 2019	PV Base Year 2020	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: N/Q	High: N/Q	Best Estimate: N/Q

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

#### Description and scale of key monetised costs by 'main affected groups'

The indicative estimate for the potential annual cost of the DMU (including both one-off set up costs, such as purchasing IT and initial recruitment processes, and ongoing operational costs, such as salaries for employees) is presented as a wide range. The estimate for this option is between £5m and £25m per annum.

There are also some indicative estimates of familiarisation and compliance costs borne by businesses, based on our own assumptions, that we hope to refine and formalise using evidence gathered through consultation. Our estimate of familiarisation costs is around £845k in the first year, with an annual compliance cost estimate of £1.25m per designated platform per annum.

#### Other key non-monetised costs by 'main affected groups'

SMS firms: Reduced profits (transfer to consumers)

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

#### Description and scale of key monetised benefits by 'main affected groups'

There is no formal quantification of benefits within this analysis. In addition to the short-term wellbeing benefits outlined in option 2, it is estimated that this option would return more significant, long term, benefits through an increase in competition within and across digital markets. The addition of PCIs should target the sources of market power and facilitate more effective competition against incumbents.

#### Other key non-monetised benefits by 'main affected groups'

Non-SMS firms: lower costs associated with unfair treatment (e.g. exclusionary behaviour) by SMS firms.

Consumers (including business and end users of digital markets): Reduced prices; Increased quality; Increased choice; Reduced harm; Increased innovation; Increased economic activity.

Non-market participants: Positive spillovers to adjacent, dependent sectors (e.g. increased revenues to press sector).

Key assumptions/sensitivities/risks	Discount rate (%)	N/A
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Use of powers - We assume that the DMU will use the powers granted to them in an effective and proportionate way to achieve its objectives.  
 Efficacy of DMU powers - We assume that the new pro-competition regime will have a material impact on competition and contestability within and across digital markets.  
 SMS compliance - We assume that SMS firms will comply with new regulations.

**BUSINESS ASSESSMENT (Option 1)**

<b>Direct impact on business (Equivalent Annual) £m:</b>				<b>Score for Business Impact Target (qualifying provisions only) £m:</b>	
<b>Costs:</b>	<b>N/Q</b>	<b>Benefits:</b>	<b>N/Q</b>	<b>Net:</b>	<b>N/Q</b>

# Summary: Analysis & Evidence

# Policy Option 4

**Description:** The DMU, with new statutory powers, would be able to enforce a code of conduct, pro-competitive interventions for firms it has designated with SMS. Firms with SMS would also be subject to a separate, more stringent, mergers regime.

## FULL ECONOMIC ASSESSMENT

Price Base Year 2019	PV Base Year 2020	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: N/Q	High: N/Q	Best Estimate: N/Q

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

### Description and scale of key monetised costs by 'main affected groups'

The indicative figure for the potential annual cost of the DMU (including both one-off set up costs, such as purchasing IT and initial recruitment processes, and ongoing operational costs, such as salaries for employees) is presented as a wide range. The estimate for this option is between £7.5m and £38m per annum.

There are also some indicative estimates of familiarisation and compliance costs borne by businesses, based on our own assumptions, that we hope to refine and formalise using evidence gathered through consultation. Our estimate of familiarisation costs is around £930k in the first year, with an annual compliance cost estimate of £1.38m per designated platform per annum.

### Other key non-monetised costs by 'main affected groups'

SMS firms: Reduced profits (transfer to consumers)

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

### Description and scale of key monetised benefits by 'main affected groups'

There is no formal quantification of benefits within this analysis. In addition to the short- and long-term impacts outlined in the options above, this option would go further to reduce anti-competitive behaviour by large firms, result in further improved competition, and a reduced ability for firms to act in anti-competitive ways in the future.

### Other key non-monetised benefits by 'main affected groups'

Non-SMS firms: lower costs associated with unfair treatment (e.g. exclusionary behaviour) by SMS firms.

Consumers (including business and end users of digital markets): Reduced prices; Increased quality; Increased choice; Reduced harm; Increased innovation; Increased economic activity.

Non-market participants: Positive spillovers to adjacent, dependent sectors (e.g. increased revenues to press sector).

Key assumptions/sensitivities/risks	Discount rate (%)	N/A
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Use of powers - We assume that the DMU will use the powers granted to them in an effective and proportionate way to achieve its objectives.  
 Efficacy of DMU powers - We assume that the new pro-competition regime will have a material impact on competition and contestability within and across digital markets.  
 SMS compliance - We assume that SMS firms will comply with new regulations.

**BUSINESS ASSESSMENT (Option 1)**

<b>Direct impact on business (Equivalent Annual) £m:</b>				<b>Score for Business Impact Target (qualifying provisions only) £m:</b>	
<b>Costs:</b>	<b>N/Q</b>	<b>Benefits:</b>	<b>N/Q</b>	<b>Net:</b>	<b>N/Q</b>

# Summary: Analysis & Evidence

# Policy Option 5

**Description:** A DMU with powers to implement a code of conduct and PCIs for all firms in digital markets

## FULL ECONOMIC ASSESSMENT

Price Base Year 2019	PV Base Year 2020	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: N/Q	High: N/Q	Best Estimate: N/Q

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

### Description and scale of key monetised costs by 'main affected groups'

There is no indicative figure for the potential annual cost of the DMU for this option. The assumptions underpinning the estimates for the cost of regulation only extend to SMS firms. It is reasonable to assume that the cost would be significantly greater given the significant widening of scope.

There are some indicative estimates of familiarisation and compliance costs borne by businesses, based on our own assumptions, that we hope to refine and formalise using evidence gathered through consultation. Our estimate of familiarisation costs is around £1.27m in the first year, with an annual compliance cost estimate of £1.25m per designated platform per annum.

### Other key non-monetised costs by 'main affected groups'

SMS firms: Reduced profits (transfer to consumers)

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/Q	N/Q	N/Q
High	N/Q	N/Q	N/Q
Best Estimate	N/Q	N/Q	N/Q

### Description and scale of key monetised benefits by 'main affected groups'

There is no formal quantification of benefits within this analysis. This option contains the code of conduct and PCIs, meaning that the impact would be similar to that outlined within option 3. The extended scope of this option could mean that the scale of these impacts could be greater. However, there is a possibility that extending the scope to more firms would add to the burden experienced by small firms, and therefore limit their ability to take advantage of the positive impacts on competition.

### Other key non-monetised benefits by 'main affected groups'

Non-SMS firms: lower costs associated with unfair treatment (e.g. exclusionary behaviour) by SMS firms.

Consumers (including business and end users of digital markets): Reduced prices; Increased quality; Increased choice; Reduced harm; Increased innovation; Increased economic activity.

Non-market participants: Positive spillovers to adjacent, dependent sectors (e.g. increased revenues to press sector).

<b>Key assumptions/sensitivities/risks</b>	<b>Discount rate (%)</b>	N/A
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Use of powers - We assume that the DMU will use the powers granted to them in an effective and proportionate way to achieve its objectives.

Efficacy of DMU powers - We assume that the new pro-competition regime will have a material impact on competition and contestability within and across digital markets.

SMS compliance - We assume that SMS firms will comply with new regulations.

**BUSINESS ASSESSMENT (Option 1)**

<b>Direct impact on business (Equivalent Annual) £m:</b>				<b>Score for Business Impact Target (qualifying provisions only) £m:</b>	
<b>Costs:</b>	<b>N/Q</b>	<b>Benefits:</b>	<b>N/Q</b>		<b>Net:</b>

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## Background

1. The digital sector<sup>1</sup> contributed over £150 billion to the UK economy in 2019.<sup>2</sup> The sector's economic contribution has grown rapidly, increasing by almost 30% since 2010, outpacing most other sectors. It has driven opportunity, productivity, and creativity across the economy. The various markets that comprise the digital sector have played a significant part in delivering huge benefits for businesses, citizens, and the economy.
2. Beyond their contribution to the economy, digital technologies play an increasingly important role in our everyday lives. They are re-defining the way we work, access information and news, and stay in touch with loved ones. The widespread reliance on digital services, further intensified by the Covid-19 pandemic, demonstrates the substantial benefits they offer. Ensuring that digital markets remain dynamic and competitive, so that they continue delivering these benefits, is central to the government's ambition to drive growth and build a world-leading digital sector.
3. However, where digital markets<sup>3</sup> were previously characterised by innovative start-ups competing vigorously for the market, some have now become increasingly concentrated with the same large, global tech companies. The International Monetary Fund (IMF), for example, found that market power in the tech industry has increased significantly between 1995 and 2016, including an increase of over 30% in markups (i.e. firms' "prices" over marginal costs) and an increase over 10% in concentration, globally.<sup>4</sup> There is now a growing consensus – in the UK and internationally – that this unprecedented concentration of power amongst a small number of tech companies is undermining effective competition, restraining growth and innovation, and causing harm to the consumers that rely on them.
4. In 2019, the Digital Competition Expert Panel ('The Furman Review')<sup>5</sup> concluded that some digital markets can be prone to 'tipping' in the favour of a small number of companies, and that this can lead to consumer harm. The Furman Review report proposed a new pro-competition regime for these digital markets, and its six strategic recommendations – including to establish a new Digital Markets Unit (DMU) – were accepted by the government in 2020.
5. Since the Furman Review, reports and recommendations from governments, regulators, and experts in the UK and around the world<sup>6</sup> have contributed towards international momentum on the need for action in digital markets (see Annex A). Other jurisdictions globally, including the EU and the US, are now moving quickly to introduce measures to address competition concerns in digital markets.
6. In November 2020, the government announced that the DMU will be established within the CMA from April 2021, to build on the work of the Digital Markets Taskforce and begin to operationalise key elements of the new pro-competition regime. This will be a non-statutory arrangement until its functions and objectives are finalised in statute.
7. Implementing a new pro-competition regime, to be overseen by the newly established DMU, aligns with the government's commitment in the Plan for Growth to design regulation which supports innovation, to help unlock the full potential of digital services and bring benefits to all regions and

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<sup>1</sup> DCMS [Sectors Economic Estimates 2018 \(2020\)](#), p11, defines the 'digital sector' in accordance with the definition developed by the OECS using the UN Standard Industrial Classifications (SICs). The definition includes a series of sub-sectors that mainly create value through the direct use of digital technologies.

<sup>2</sup> DCMS, [Sectors Economic Estimates 2019 \(provisional\) Gross Value Added](#), December 2020.

<sup>3</sup> The treatment of the definition of digital markets for the purpose of this IA is outlined in paragraphs 12 and 13.

<sup>4</sup> IMF, [Rising Corporate Market Power: Emerging Policy Issues](#). March 2021.

For the purposes of this analysis, the IMF define the technology industry as industry ICB = 9 ("Technology") and its subsector ICB = 953 ("Software & Computer Services"). Markups are firms' prices over their marginal costs as estimated by the IMF.

<sup>5</sup> Digital Competition Expert Panel, [Unlocking Digital competition, Report of the Digital Competition Expert Panel](#), March 2019.

<sup>6</sup> For example: CMA, [Online platforms and digital advertising market study](#), July 2019; Digital Markets Taskforce, [Advice of the Digital Markets Taskforce](#), December 2020; EU Commission, [EU Digital Services Act Package](#), December 2020; US House Judiciary Subcommittee on Antitrust, [Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations](#), October 2020; and, [Stigler Committee on Digital Platforms: Final Report](#), September 2019.

communities.<sup>7</sup> This also complements a wider range of initiatives related to digital markets such as the Online Harms White Paper,<sup>8</sup> and the National Data Strategy.<sup>9</sup>

8. The government has outlined the proposed approach to establishing a new pro-competition regime for digital markets to be overseen by the DMU, and is publicly consulting on this from July 2021 to October 2021. This includes proposals for the final legislated form, objectives, and powers of the DMU. The consultation also seeks views on the introduction of a separate merger regime for SMS firms.<sup>10</sup>
  9. This consultation-stage IA provides evidence and analysis to support the government's case for intervention, accompany the consultation, and help guide consultation responses. The IA outlines the problem under consideration, and evaluates, at a high level, the options for the scope and powers of the statutory DMU and the pro-competition regime it will oversee.
  10. Through the consultation process, we intend to gather evidence to further develop the analysis of impacts of interventions. As the shape of the regime is finalised, and further evidence is gathered, the appropriate level of impact appraisal will be undertaken. We intend to provide a more detailed qualitative and, where possible, quantitative assessment of impacts in the final IA.
  11. To this end, we have included questions throughout the IA (and summarised in Annex D) to seek views on the assumptions used and inviting further evidence on potential impacts.
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## The Case for change

### Problem under consideration and rationale for intervention

12. The scope of the Digital Markets Unit (DMU) will likely be focused on 'digital activities'. A wide range of activities can be classified as 'digital', and the government is seeking views in the consultation on what activities should be included within its regulatory perimeter. Government is also considering the potential for overlap with the regulatory remits of existing regulators such as Ofcom and the ICO, and the way in which bodies can work together in order to maintain an effective and proportionate regulatory landscape. We consider the implications of different scopes, including capturing a broad range of digital activities, in the options appraisal of this IA.
13. Existing literature has typically focussed on the challenges posed by a subset of digital markets described as 'digital platform markets'.<sup>11</sup> There is no consistent or legal definition for 'digital platforms'. However, for the purpose of this IA, and in line with the Furman Review,<sup>12</sup> we use the term 'digital platform markets' to describe markets that display a unique combination of characteristics that make them prone to 'tipping' (see 'Market characteristics' section below), and where firms use information and communication technologies to facilitate interactions between multiple users (often, but not exclusively, on opposite sides of the market), such as Search Engines and Social Media.<sup>13</sup> As discussed in the following sections, it is markets with these characteristics that tend towards concentration and for which the existing competition regime is not best placed to address competition concerns. Therefore, as outlined in the consultation, it is these markets that should be the focus of the DMU.<sup>14</sup> In the consultation, the government is exploring the merits of

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<sup>7</sup> HM Treasury, [Build Back Better: our plan for growth](#), March 2021.

<sup>8</sup> Department for Digital, Culture, Media & Sport and Home Office, [Online Harms White Paper](#), April 2019.

<sup>9</sup> Department for Digital, Culture, Media & Sport, [National Data Strategy](#), (updated December 2020).

<sup>10</sup> Government consultation: [A new pro-competition regime for digital markets](#), July 2021. [henceforth 'consultation document']

<sup>11</sup> For example: [Unlocking Digital competition, Report of the Digital Competition Expert Panel](#) ('The Furman Review'), March 2019.; [Stigler Committee on Digital Platforms: Final Report](#), September 2019.

<sup>12</sup> European Commission, Digital Single Market: Online Platforms, May 2018. via The Furman Review, p22, March 2019.

<sup>13</sup> 'Consumers' in digital platform markets can sometimes be used to collectively refer to both business users and end users (i.e. households), since both can be consumers of multi-sided digital platforms. For this reason, in this IA we attempt to differentiate 'business users' from 'end users/consumers' where relevant.

<sup>14</sup> See consultation document Part 3 paragraphs 55 - 59, p.17-18.

focusing the DMU's remit on 'digital platform activities', but acknowledges there may be a risk of unintentionally excluding some markets and firms given the legal ambiguity of this term. The definition for digital platforms we have set out here is not widely agreed upon, and its use within this IA is not intended to cut across the government's consultation on the appropriate scope and regulatory perimeter of the DMU.

14. There are three key drivers of weak competition leading to suboptimal outcomes for consumers<sup>15</sup> in some digital markets, such as digital platform markets:
- i. **Market characteristics** - The unique combination of fundamental market characteristics inhibits the ability of potential rivals to enter and/or grow, thereby undermining effective competition. Hence these markets, such as digital platform markets, tend to 'tip' towards one, or a few, extremely powerful firms.<sup>16</sup>
  - ii. **Firms' anti-competitive behaviour** - These powerful firms have the ability, and sometimes the incentives, to exploit their market power by engaging in anti-competitive behaviour, often to the detriment of consumers.
  - iii. **Ineffective regulation** - The existing 'ex-post' regulatory system can be slow and backward-looking, and so is not optimal for fast-moving digital markets. Even once harm has been identified, traditional competition remedies are not always effective at remedying harm or preventing/deterring future offences.

These three 'theories of harm' (which we address in turn in the following subsections) suggest these markets tend towards concentration, giving rise to poor consumer outcomes, and that neither the free market (i.e. self-correction), nor regulators with their existing pro-competition tools, will rectify the poor outcomes if these markets are left as they are. Change is therefore needed to correct underlying market failures, remedy harms, and unlock the benefits of open and dynamic competition.

### Market characteristics

15. Table 1 below outlines that some digital markets, specifically digital platforms markets, have a unique combination of specific structural features that distinguish them from other markets.

**Table 1:** Characteristics of digital platform markets

Characteristics	Description	Explanation / Impact
<b>Network effects (direct and indirect)</b>	Value of a service to each user increases as the total user base increases	<p>Some digital markets exhibit <b>network effects</b>, where users get more value from the service as the total number of service users grows.</p> <p><b>Direct network effects:</b> The value to users on the same side of the market increases as the number of users on that side increases (E.g. social media platforms, such as Facebook, are more valuable to individuals when more of their friends are also using them).</p> <p><b>Indirect (or 'cross-side') network effects:</b> The value of the service to users on one side of the market increases as a new user on a different side joins the network (E.g. the value to retailers of selling on an e-commerce platform, such as Amazon, increases as more end users use the platform).</p> <p>These effects reduce the incentive for business users and end users (collectively 'consumers') to switch to rival platforms, or</p>

<sup>15</sup> See footnote 13 on defining consumers in digital platform markets.

<sup>16</sup> Katz and Shapiro, (1994), Systems Competition and Network effect, Journal of Economic perspective. These authors define "tipping" as "the tendency of one system to pull away from its rivals in popularity once it has gained an initial 'edge'".

In some digital markets, even if the incumbents do not engage in any "strategic" behaviour, there is a tendency to grow and gain a persistent market power (M. Motta, 2019).

		'multi-home' with several smaller platforms, making new entry challenging and hence reducing market contestability.
<b>The use and importance of data</b>	Data is essential to the business models of digital platforms. They collect, store and use (monetise) user data	Services in digital platform markets are often free at the point of consumption for end users. However, rather than pay monetary costs, users pay to access a service with their data ('data costs') which is then monetised by firms. The <b>collection of data</b> by firms allows them to personalise user experiences and target their product offering (e.g. advertising), increasing the value of the service to both business and end users. This allows a feedback loop to form, where the largest incumbents use their ever-increasing access to data (which can be described as 'data monopolies' <sup>17</sup> ) to further entrench their advantage over rivals who do not have the same access.
<b>Economies of scale</b>	Average costs decrease with size due to low/zero marginal costs	With high fixed set-up costs and low marginal operational costs, large firms benefit from <b>economies of scale</b> . This gives a natural market power to incumbent firms and can act as a barrier to entry/expansion for potential entrants.
<b>Economies of scope</b>	Average costs decrease as firms increase the variety of goods and services supplied	Due to the transferable nature of the valuable technology and data digital firms use, they can often easily operate across several markets. By diversifying their offering in this way, firms can benefit from <b>economies of scope</b> that new entrants in any one market cannot immediately rival.
<b>Ecosystems / Vertical Integration</b>	Ecosystem: A network of complementary products or services spanning different markets  Vertical integration: the presence of one firm at multiple stages of the supply chain in which it operates	Some firms have built large ' <b>ecosystems</b> ' of integrated complementary products and services around their core service. These products and services are designed to interoperate with one another such that users are kept on their network.  In some cases, these ecosystems can span different stages of the supply chain as large digital firms become <b>vertically integrated</b> (e.g. an e-commerce platform that sells its own retail products on its platform). This can give rise to conflicts of interest and the potential for these firms to leverage their power in one activity, to undermine competition in other stages of the chain.  The interaction of these features with economies of scope also strengthens a firm's prevailing market power.
<b>Global reach</b>	Although the nature of markets may differ slightly across countries, digital markets are not subject to geographical constraints	The nature of digital platforms means they are not constrained by physical location and can be used simultaneously by consumers all around the world (globally non-rivalrous). This allows firms to gain large, global customer bases. This characteristic amplifies economies of scale, data collection, and network effects.
<b>Consumer decision making and power of defaults</b>	End consumers make decisions quickly, and they have immediate impacts.  Default positions are powerful due to 'default bias' and 'status quo bias'.	Digital platform markets are increasingly fast-moving, and decisions at the click of a button have immediate impact. End users have also developed a reduced tolerance for delay leading to 'default behaviour' (a propensity to accept whichever default option is presented to save time), and are prone to 'status quo bias' (a preference for remaining with the existing option even where this is not the rational choice). For example, consumers may be more likely to accept the default search engine on a new computer they have purchased.

<sup>17</sup> [Power to the People: Independent report on competition policy](#) ('The Penrose Review'). February 2021.



		This reduces the likelihood of users switching to new/rival firms' services, even where they might offer better value.
<b>Information asymmetries</b>	Firms collect significant amounts of information on users, leading to asymmetries they can leverage	Firms collect significant amounts of personal data from end users, which they monetise. Users are often unaware of how much data they are giving away and how it is being used. If users had knowledge of the magnitude of their 'data cost', and its value to firms, they might demand a better return in exchange or else switch to rival services.

16. Many of the features detailed in table 1 are not necessarily undesirable in their own right. For example, economies of scale provide a beneficial cost efficiency, and ecosystems can offer a seamless digital experience for end consumers. However, they can act as barriers to entry/expansion and undermine effective competition. As a result of their cumulative effect, the 'winner takes most/all' dynamic is accentuated. As such, some digital markets, such as digital platform markets, are prone to 'tipping' quickly in the favour of one, or a small number of, extremely powerful firms.<sup>18</sup>
17. This 'tipping', and the subsequent lack of market contestability<sup>19</sup>, can give rise to harm and undesirable outcomes for consumers and society in two key ways:
- i. Once the market has tipped, and 'winners' (incumbent firms to whom the market has tipped) are shielded by the barriers to entry/expansion, they can behave somewhat independently of competitive pressures. This freedom to act with little threat of losing market share to rivals or new entrants can be described as 'market power'.<sup>20</sup> Market power is not inherently bad, and can sometimes be the deserved reward for 'winning' a market on merit (e.g. through investing in R&D to develop a superior product). However, excessive and entrenched market power is an indicator of market failure, particularly when the market power results from anti-competitive behaviour, is incontestable by new entrants, and is exploited to the detriment of other market participants (e.g. consumers).
  - ii. New entrants are unable to overcome the 'incumbency advantage' that barriers to entry provide, even when their offering could lead to an improvement in consumer or societal outcomes. For example, a start-up with a high-quality, innovative service and more efficient (lower unit cost) operations might still struggle to compete with a data-rich incumbent boasting a vast user network across its self-preferencing ecosystem of services.

### *Incumbents' anti-competitive behaviour*

18. Large incumbents in some digital markets face limited competition and benefit from substantial market power. When these firms exert their market power in the pursuit of supernormal profit, it can often result in suboptimal outcomes for consumers, the economy, and our society.
19. There is an increasing body of evidence, both in the UK and internationally, that some of the largest tech companies are exploiting their market power in a way that is causing persistent material harm to their business and end users, and to our society. Evidence of some of these harms (e.g. reduced quality, higher prices, reduced choice, and reduced innovation) is outlined in the 'Evidence of harm' section below.

<sup>18</sup> See for example, Unlocking Digital Competition: Report of the Digital Competition Expert Panel ('The Furman Review'), 2019.

Or Digital Markets Taskforce, [Advice of the Digital Markets Taskforce](#), December 2020.

<sup>19</sup> Contestability refers to the threat of challenge by new entrants. In theory, incumbents can feel competitive pressures even where existing competition *in* the market is relatively weak, providing potential competition *for* the market, or contestability, is sufficient.

<sup>20</sup> Market power is typically measured in relation to the prices 'powerful' firms are able to charge. In the context of digital services that are often free at the point of consumption, this price-related definition of market power is more difficult. However, we consider the ability to freely alter non-price characteristics, often to the detriment of consumers, as similarly indicative of market power in this context.

20. This exploitation of market power can often include the use of anticompetitive practices. Most commonly, though not exclusively, these practices can be categorised as either:
- **Exclusionary behaviour** - conduct by a firm with the intention of preventing competitors from entering, growing, or remaining active in a market.
  - **Exploitative behaviour** - conduct by a firm to extract additional rents at the expense of other market agents - typically consumers - who are reliant on it. Unlike exclusionary abuses which harm consumers indirectly by reducing competitive offerings in the market, exploitative abuses directly harm consumers.
21. Some types and examples of exclusionary behaviours include:
- **Exclusivity** - powerful firms can take advantage of their critical position in the market (for example, as the main distributor to their vast user network) to make their purchase or distribution conditional on the supplier not dealing with its competitors, or dealing preferentially with itself ahead of other competitors.

### Case Study: Amazon e-books - Most Favoured Nation clauses

The European Commission investigated potentially anti-competitive 'Most Favoured Nation' (MFN) clauses in contracts between Amazon and e-book suppliers in the European Economic Area. Through these clauses, Amazon required suppliers to inform it of any more favourable terms they were offering to other retailers, and to also make these available to Amazon. The case was settled with commitments.

*Source: European Commission, 'CASE AT.40153 E-book MFNs and related matters (Amazon)'<sup>21</sup>*

- **Self-preferencing** - with their market power often including strategic control over routes to market, firms can preferentially supply other divisions of their own corporate group. This is common where firms are also active in related, adjacent markets, such as where firms have built ecosystems. In these instances, the firm can leverage their position in one market to provide access advantages to its own products in the adjacent markets and foreclose competitors.

### Case Study: Google Search - Comparison shopping

The European Commission investigated Google's use of its Google Search platform to direct users to its own comparison-shopping service over those of competitors. The outcome of this investigation was a fine of €2.42 billion to Google for abusing its market dominance in Search.

*Source: European Commission Press Release: Commission fines Google €2.42 billion. June 2017.<sup>22</sup>*

- **Refusal to deal** - at its extreme, self-preferencing can result in a 'refusal to deal', where firms refuse to supply downstream rivals with key inputs, or upstream rivals with key distribution to market. For example, large firms benefit from large networks of existing users. By constraining the interoperability of smaller, nascent platforms with their own, these large firms limit access to their wide user base. As they are deprived of consumers and visibility in the market, this makes it harder for smaller firms and new entrants to compete.

### Case Study: Facebook, Vine and APIs

In 2013 Twitter acquired video sharing platform, Vine. Prior to the acquisition, Vine users were able to find friends they already knew on Facebook through its 'Find Contacts' feature. However, following Vine's acquisition by Twitter, Facebook removed Vine's access to this API. In doing so, Facebook was able to degrade users' experience of Vine and reduce the platform's competitive threat. Vine was discontinued by Twitter in 2016.

*Source: CMA Market Study (p.141)*

22. Exploitative behaviour is often framed in the context of monopolists charging 'excessive' or 'unfair' prices to its consumers who have few alternatives to which they can switch consumption. In many

<sup>21</sup> European Commission, [CASE AT.40153 E-book MFNs and related matters \(Amazon\)](#). May 2017.

<sup>22</sup> European Commission Press Release: [Commission fines Google €2.42 billion for abusing dominance as search engine by giving illegal advantage to own comparison shopping service](#), June 2017.

digital platform markets, where end users enjoy a service that is free at the point of consumption, this phenomenon is less obvious. However, business users are still prone to exploitative pricing, and firms can and do exploit end users through various non-price aspects.

23. Some examples of types of exploitative behaviour in digital platform markets include:
- **Degrading quality of service** - End users of digital platforms typically 'pay' for the service with their attention and data. Increasing the number of adverts served to users relative to organic content, whilst maintaining the same price ('data cost'), degrades the service's price/quality ratio. Decreasing the quality of a constantly-priced service could be argued as exploitative.
  - **High prices for business users** - Business users (e.g. advertisers and third-party retailers) typically have to pay to use digital platforms. Therefore, they can be subjected to exploitative prices, and will often pass higher prices through to their own consumers.
  - **Discriminating between customers** - Firms can use data to uniquely tailor the experience of each consumer, meaning they are more able to offer differing prices or services. This can sometimes be deemed an exploitative practice as certain consumers, or consumers in certain circumstances, will inevitably be faced with a 'worse' service or higher price. For example, social media platforms can tailor ad load by user, such that end users assessed to have a higher tolerance for advertising are shown more adverts.
24. Firms can also learn and exploit the behavioural biases of end consumers:
- End users are prone to behavioural biases that can be exploited by firms. They can use choice architecture to nudge users towards outcomes that benefit themselves but may not necessarily be in the user's own best interest. For example, users are prone to 'default bias' and 'status quo bias', meaning they are less likely to switch away from the default search engine on an internet browser.<sup>23</sup> This means dominant cross-market firms could leverage their high market share in the browser market to direct traffic to their own search engine.
  - Firms' ability to influence user decision-making through choice architecture is amplified by the asymmetry in information between the two parties. Large firms collect and hold a lot of information about users, but users are far less informed regarding their interaction with firms and how their data is used.

### *Ineffective regulation in digital platform markets*

25. The existing regulatory system is not equipped to quickly and effectively assess, address and prevent anticompetitive practices and harm.
26. Traditional regulatory tools are not well suited to quickly identifying and remedying competition concerns in digital platform markets. 'Ex-post' regulation, which refers to intervention following a finding of abuse of market power, can mean a long time lag between harms first being experienced and remedies being implemented. As a result consumers can often experience prolonged, irreversible harms. As digital platform markets are prone to tipping quickly, this delay can have significant long-term implications on competition.

### **Case Study: U.S. v Microsoft**

In 1996, the US Department of Justice received a complaint about Microsoft regarding its internet browser, Internet Explorer, in relation to Microsoft leveraging its monopoly power over operating systems into the browser market. The main antitrust complaint was not officially filed until 1998 and then took more than four years to finally conclude all court procedures. During this entire period from 1996 to 2002, Microsoft's share of the browser market rose from less than 20% to above 90%. Although Microsoft's market share declined again after the conclusion of the case, this did not help Microsoft's initial competitors, such as Netscape which lost most of its market share between 1996 and 2002.

<sup>23</sup> CMA, [Online platforms and digital advertising market study Appendix H: default positions in search](#), July 2019.

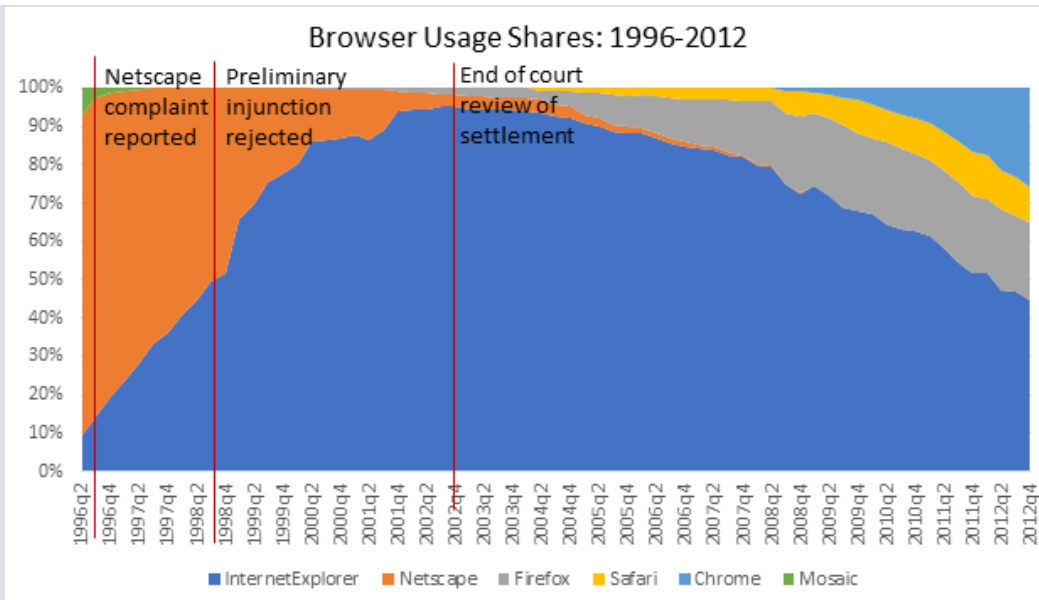


Chart source: Ennis calculations based on data from EWS Web Servers at UIUC, WebSide Story, The Counter and StatOwl.

**Source:** Sean Ennis, 'U.S. v Microsoft: Where did the time go?' CCP Working Paper 21-05, UEA. (2021)<sup>24</sup>

27. For instance, the CMA has powers to monitor and intervene in markets through its markets regime, including to impose a wide range of structural and behavioural remedies. Since these tools were not designed with fast-moving digital markets in mind, they are not currently well equipped to deal with the unique challenges these complex markets pose. For example, the prevalence of digital ecosystems that span multiple adjacent markets can often require intervention with a focus that is wider than a single market. Equally, markets prone to quickly tipping and to rapid technological change may require a more proactive and dynamic approach to regulation than can be achieved through static studies and one-off interventions.
28. It can also be difficult for regulators to effectively assess and prove breaches of competition law in digital platform markets given their novel and rapidly evolving nature, and the opaque business models of large platforms. For example, in relation to digital mergers, under the current system there needs to be more than a 50% likelihood of a 'substantial lessening of competition' before remedial actions can be undertaken. This threshold could be difficult to prove for early development acquisitions where their ability to challenge the acquirer in the future is uncertain.
29. Even once harm and a breach of competition law have been established, traditional regulatory remedies are not always effective at remedying harm or preventing future repeat offences. There exists limited robust, systematic evidence of the effectiveness of fines and other remedies as a deterrent in digital markets. There is also a risk that powerful firms may see regulation as something to mitigate against, rather than promoting 'fair' behaviour or deterring 'harmful' behaviour.

### Case Study: E.U. v Google Search

The European Commission case against Google Search was opened 9 years after the harm first took place and took a further 3 years to conclude. The largest fine imposed by the Commission to date was approximately £3.9bn on Google in 2018 - equating to just 4% of Alphabet's (Google's parent company) 2018 revenue. As allegations of anticompetitive practices persist, particularly in other jurisdictions,<sup>25</sup> it is possible that previous sanctions have not proved effective deterrents.

**Sources:** European Commission (2018)<sup>26</sup>  
CMA analysis of Alphabet 10-K forms 2018, CMA Market Study Appendix D (2019)

<sup>24</sup> Ennis, S. (2021). "[U.S. v. Microsoft: Where did the time go?](#)" CCP Working Paper 21-05, UEA.

<sup>25</sup> U.S. Department of Justice, [Justice Department Sues Monopolist Google For Violating Antitrust Laws](#), October 2020.

<sup>26</sup> Antitrust: Commission fines Google €4.34 billion for illegal practices regarding Android mobile devices to strengthen dominance of Google search engine (2018).

30. Once markets tip, and by the time breaches of competition law have been proved, it is difficult for competition to be rebalanced with existing regulatory tools. Therefore, ex-post regulation is akin to 'shutting the stable door after the horse has bolted',<sup>27</sup> and is unlikely to impact the market power already well-established by some incumbents.

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<sup>27</sup> Andreas Mundt, President of the Bundeskartellamt. [Statement on the Amendment of the German Act against Restraints of Competition](#): "In future we will be able to prohibit big tech companies from engaging in certain types of conduct much earlier and, so to speak, shut the stable door before the horse has bolted", January 2021.

## The case for a new digital mergers regime

The specific case for a new, distinct digital mergers regime is considered separately here. Policy proposals in this area are not yet as developed as in other areas considered, and so an SMS mergers regime does not form part of the preferred option in this IA. However, the government *is* supportive of a dedicated SMS merger regime. Hence, it is important to outline the issues with the current regime and rationale for intervention to inform, and invite useful information through, the consultation process.

31. The extensive merger activity of the large digital firms may be seen as another anti-competitive behaviour. Large digital firms take part in a number of mergers and acquisitions, the effects of which on competition can be difficult to evaluate but are widely considered to be contributing to the entrenched market position of the largest digital firms in a way that is harmful to competition.
- Google, Amazon, Facebook, Apple and Microsoft (GAFAM) together purchased close to 300 companies over the last five years.<sup>28</sup> However, only 2% (7) of these transactions were investigated, either by the CMA or the European Commission.<sup>29</sup> Over the same period, none of these mergers were notified voluntarily to the CMA and of those that were investigated, none were blocked.
  - It is now argued that some of these mergers may have had unforeseen long-term impacts on competition, consumer welfare, and innovation. Through mergers, the powerful digital firms can further entrench their dominant market positions, raise barriers to entry and expansion, and expand their digital ecosystems by creating a ‘moat’ around their core services. For example, though cleared by competition authorities at the time, it is now suggested that the acquisition of Instagram by Facebook in 2012 may have deprived the social media market of the positive effects of two separate services competing over time.<sup>30</sup>
  - Mergers and acquisitions can drive positive outcomes where knowledge/resource sharing and other synergies yield efficiencies and innovations. However, it has been proposed that some acquisitions of smaller companies may have been deliberate ‘killer’, or ‘reverse killer’, acquisitions aimed at neutralising competitive threats before they could grow, or at reducing innovative efforts in markets.<sup>31 32</sup>
  - Although it can be difficult to prove that ‘killer acquisitions’ occur and are under-enforced, US authorities are currently investigating the actions of GAFAM firms in relation to previous mergers, including Facebook’s acquisition of Instagram and WhatsApp.<sup>33 34</sup>
  - As well as directly discontinuing innovative projects, ‘killer’ and ‘reverse-killer’ acquisitions can distort the incentives for new entry and innovation. This is because innovators and their investors understand that the biggest payoff is through creating something that complements the status quo, that is then bought-out by a large firm (known as ‘entry for buyout’), rather than by seeking to disrupt or replace incumbents. Some investors in the US have indicated that they avoid funding entrepreneurs or companies that compete directly or indirectly with dominant firms in the digital economy.<sup>35</sup> These dynamics may not result in the optimal form of investment or innovation to maximise consumer welfare.<sup>36</sup>

### **Case Study: Google/Waze price increase following acquisition**

In 2013 Google purchased mapping service Waze. Since completing the Waze acquisition, Google has reportedly come to capture 81% of the market for navigation mapping services. For years, Google offered a free tier of its Maps API, incentivising developers to build their apps with Google Maps. In 2018, however, Google Maps introduced a single “pay-as-you-go” pricing plan for the core mapping APIs, which dramatically reduced the number of free Maps API calls a firm could make. Developers stated that the change amounted to a price increase of 1,400%.

*Sources: US House Judiciary Subcommittee report, p.239 (2020).*

32. There may historically have been underenforcement against merger and acquisition activity in digital markets. This is important as merger control allows for ex-ante intervention and the prevention of harm before it arises, as opposed to other forms of regulation. As mentioned above, ex-post regulation can only be used once harm (e.g. higher concentration, lesser competition) or

anti-competitive behaviours has been proved and after firms have already established dominant positions, meaning markets are not working well for consumers and society.

33. The Furman Review and the CMA's Digital Markets Taskforce raised concerns about the scale and type of acquisitions made by the large digital firms.<sup>37</sup> A few past mergers in particular have since been suggested to have had a negative effect on competition in the UK (e.g. Google/DoubleClick),<sup>38</sup> with a review by consultancy LEAR finding that competition authorities in the past have ignored important theories of harm in transactions involving digital markets (including the Facebook/Instagram and Google/Waze transactions).<sup>39</sup> In recent years the CMA has been more active in opening investigations into GAFAM mergers and pursuing forward-looking theories of harm (e.g. Google's acquisition of Looker and Facebook's acquisition of GIPHY). This demonstrates growing understanding amongst regulators that merger activity by the most powerful digital firms should be more closely scrutinised. Internationally, there have also been significant policy proposals to reform merger control, including of large digital firms.<sup>40</sup>
34. Despite the recent increase in scrutiny by the CMA of mergers involving large digital firms, there are certain limitations to the current merger system, designed in a pre-digital age, that may affect the CMA's ability to review and intervene effectively in potentially harmful mergers.

### **Limitations of the current merger regime for assessing mergers involving large digital firms**

35. **An overview of the current merger system:** The UK merger regime is voluntary<sup>41</sup> and features two jurisdictional tests. Broadly, these may be met when two businesses 'cease to be distinct' and either i) the target business has UK turnover of £70 million or more, or ii) the acquirer and the

<sup>28</sup> BEIS analysis of MergerMarket data. 296 completed transactions during this period (January 2016 – December 2020).

<sup>29</sup> Prior to 1 January 2021, the European Commission would have had exclusive jurisdiction over certain cases instead of the CMA. The cases included in the count are: Microsoft/LinkedIn, Apple/Shazam, Microsoft/Github, Amazon/Deliveroo, Google/Looker, Google/Fitbit, and Facebook/GIPHY.

<sup>30</sup> US House Judiciary Subcommittee on Antitrust, [Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations](#), October 2020.

<sup>31</sup> 'Killer acquisitions' describe acquisitions, typically by larger firms of smaller firms, done with the intention to discontinue the target's innovative projects and pre-empt future competition.

'Reverse killer acquisitions' describe acquisitions, with the intention of adopting the target firm's innovations. These are considered detrimental to competition as the acquirer 'kills' its own organic innovation in favour of absorbing a developed technology, depriving consumers of potential future competition between two innovative services.

<sup>32</sup> Deller, Doan, Mariuzzo, [Competition and innovation in digital markets](#), p.24. 2021. Report by University of East Anglia Centre for Competition Policy on behalf of BEIS. 2021.

<sup>33</sup> Documents presented in Congressional hearing, and discussed in this Wired article: [The Facebook and Amazon Documents That Captivated the Hearing](#). July 2020.

<sup>34</sup> US House Judiciary Subcommittee on Antitrust, [Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations](#), pp 150-160, 164-165. October 2020.

<sup>35</sup> US House Judiciary Subcommittee on Antitrust, [Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations](#), October 2020.

<sup>36</sup> Deller, Doan, Mariuzzo, [Competition and innovation in digital markets](#), p.24. 2021. Report by University of East Anglia Centre for Competition Policy on behalf of BEIS. Published alongside consultation and Impact Assessment.

<sup>37</sup> A new pro-competition regime for digital markets – Advice of the Digital Markets Taskforce (CMA135), December 2020 (the [Taskforce Advice](#)). Details of the SMS merger regime proposals are set out in [Appendix F](#). Unlocking Digital Competition – Report of the Digital Competition Expert Panel, March 2019 (the [Furman Review](#)).

<sup>38</sup> [CMA Market Study](#), p 20. July 2020

<sup>39</sup> LEAR consulting, via Stigler Center, [Competition in Digital Markets: A Review of Expert Reports](#). October 2020.

<sup>40</sup> There is a substantial overhaul of US merger control proposed by Senator Klobuchar in the Antitrust Law Enforcement Reform Act 2021. Senator Hawley has recently introduced a different bill that would ban all mergers by firms with a market value greater than \$100 billion, a measure that would effectively block the five largest US digital firms from making any acquisitions. ([Reuters article](#), 13 April 2021). Similarly the European Commission has recently indicated a tougher stance on digital mergers including introducing reporting requirements for gatekeeper firms, and wider use of the Article 22 referral mechanism.

<sup>41</sup> Although the CMA has the discretion to 'call in' mergers for investigations if these are not voluntarily notified to it.

target supply or procure 25% or more of a certain type of goods or services in the UK and there is an increment to this 'share of supply'. The CMA's merger process has two phases – the first being a shorter review to assess whether the merger has a 'realistic prospect' of resulting in a substantial lessening of competition (SLC), and the second being a longer, in-depth review to assess whether the merger results in an SLC on the balance of probabilities (i.e. more likely than not). At the end of the second phase, the CMA has the power to block a merger or to require remedies if it believes the merger raises competition concerns. The CMA may also accept remedies in lieu of referring a case to an in-depth review if suitable solutions are offered by the merging parties.

36. **Limitations to the CMA's ability to review:** There is a risk of potential limitations to the ability of the CMA to review certain transactions if they do not meet one of the two jurisdictional tests. This may be more common due to the nature of mergers undertaken by large digital firms, which often involve small newly established firms and purchases outside of the core markets of the acquirers,<sup>42</sup> meaning:

- Targets generating low (or zero) revenues in the UK will not be captured by the current (£70 million) turnover test. This could include, for example, businesses that may have recently been established, businesses with many active users in the UK who access the service for free, or businesses who are expanding and yet to monetise.
- The share of supply test may fail to capture vertical or conglomerate merger activity because of the requirement for the merger to result in an increase in the market supply. The large digital firms often make acquisitions in new areas where there may not be a direct overlap with their current offering, or invest early before a target business has developed and expanded its offering to compete head-on.<sup>43</sup>

37. **Limitations to the CMA's ability to intervene:** The targets of the large digital firms tend to be young and fast-growing and operating in nascent markets. As such, developments are often uncertain or unpredictable, especially when there is likely information asymmetry between the authority and the merging parties. This poses particular challenges when assessing the competitive impact of these mergers (e.g. in relation to the appropriate counterfactual to the merger or how competition might develop). These challenges may make it difficult to prove it is 'more likely than not' (the current legal test at the in-depth review stage) that a substantial lessening of competition would arise. This means even in cases where the expected potential harm is very high (as may be common in digital markets involving services used by millions of consumers and businesses) the CMA is unable to block a merger because it is not considered likely enough.<sup>44</sup> Over time and across multiple mergers, this tendency towards clearance could be resulting in significant harm.

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<sup>42</sup> Lear Consulting (2019) analysed the publicly disclosed acquisitions carried out by Amazon, Facebook and Google between 2008 and 2018. They found that most transactions occurred outside of the acquirer's core market and that targets are typically very young firms (four-year-old or younger in nearly 60% of cases).

<sup>43</sup> [Lear Consulting \(2019\)](#) analysed the publicly disclosed acquisitions carried out by Amazon, Facebook and Google between 2008 and 2018. They found that most of transactions had a non-horizontal nature (with a limited definition of the core business), and that targets were typically very young firms (four-year-old or younger in nearly 60% of cases).

<sup>44</sup> Furman Review (2019), Unlocking Digital Competition, paragraph 3.87, and [CMA Digital Markets Taskforce Advice, Appendix F](#), paragraph 132.



38. Finally, any merger may currently be completed without notification as the UK regime is voluntary. This can cause significant issues where integration takes place prior to the CMA investigating a merger, resulting in increased burdens on both the CMA and the merging parties, particularly if these needs to be unwound. This is particularly acute for digital mergers, where the commercial value of the target often lies in its key staff, IP or data which could be relatively easily transferred to the acquirer at the point of completion. This means that if the transaction is later deemed anti-competitive, the harm to consumers could have already taken place, and the integration could limit the effectiveness of the potential remedial actions available to the CMA.

## Evidence of harm

39. Market power in many digital platform markets is concentrated amongst a few firms:
- Google generated over 90% of UK search advertising revenues, and Facebook generated over 50% of UK display advertising revenues, in 2019.<sup>45</sup>
  - Approximately one third of all UK e-commerce transactions went through Amazon in 2019.<sup>46</sup> The Furman Review suggests it is likely that Amazon is dominant in a meaningfully distinct sector of online retail - particularly for relatively low-value and/or homogenous products.<sup>47</sup>
  - 99% of smartphones worldwide run either Google or Apple operating systems.<sup>48</sup> In the app market these two companies control app developers' access to billions of end consumers.
40. As outlined above, market power is not inherently bad. For example, a firm's high market share may be indicative of more efficient operations, a novel business model, or innovations that are popular with consumers. However, evidence suggests the exploitation of substantial, entrenched, and relatively incontestable market power by these firms *has* led to material harms for consumers. The following evidence on poor outcomes that have been observed in digital platform markets is drawn from several sources, including the CMA's market study into digital advertising, international reports into app stores, and a survey of UK retailers that use third party e-commerce platforms.
41. **Reduced quality:**
- In digital advertising markets, end users are exposed to an increasing volume of adverts at the expense of organic content. Ad impressions per hour on Facebook rose from 40-50 in 2016 to 50-60 in 2019. Over the same period, ad impressions per hour increased 200% on Instagram.<sup>49</sup>
  - In the app store market, app developers claim that the user experience is worsened by both Apple and Google's interoperability restrictions and mandatory in-app purchase systems. For example, Match Group indicated they are unable to offer customer support services, or smooth payment, subscription, and refund processes.<sup>50</sup>
42. **Higher prices:**
- The prices charged by firms with market power for digital advertising are significantly higher than those of their competitors. For example, Google's revenue per search is 30-40% higher than Bing for identical search queries.<sup>51</sup> Even when controlling for the perceived higher quality of advertising, analysis of price-bid ratios still finds that Google extracts 10-30% more surplus from advertisers than Bing.<sup>52</sup> It is likely that increased advertising costs are passed through to households in the form of higher prices in sectors that make heavy use of digital advertising (e.g. hotels, travel, consumer electronics, insurance).<sup>53</sup>

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<sup>45</sup> CMA, [Online platforms and digital advertising market study](#), July 2019.

<sup>46</sup> Edge by Ascential report, via [UK Tech News](#). December 2019.

<sup>47</sup> [The Furman Review](#), p 30. March 2019

<sup>48</sup> Dutch Authority for Consumers and Markets (ACM), '[Market Study into Mobile App Stores](#)', April 2019.

<sup>49</sup> CMA, [Online platforms and digital advertising market study](#), p 313. July 2019.

<sup>50</sup> [Match Group response to Digital Market's Taskforce call for information](#). 2020.

<sup>51</sup> CMA, [Online platforms and digital advertising market study](#), pp 313-314. July 2019.

<sup>52</sup> CMA, [Online platforms and digital advertising market study Appendix Q](#), p Q24. July 2019.

<sup>53</sup> CMA find 100% pass-through to be a reasonable assumption as:

- Apple and Google charge some app developers up to 30% commission for in-app purchases. This has been described as “excessive” relative to the 1-5% typically charged for payment processing services (e.g. 2.9% by PayPal). These fees are typically passed on to end users. For example, a monthly Spotify Premium subscription for EU users is €9.99 on Spotify’s website, but €12.99 on the Apple App Store.<sup>54</sup> The EU Commission has sent Apple a Statement of Objections in relation to how its App Store rules have distorted competition in the music streaming market.<sup>55</sup>

43. **Lack of control over, and poor return for, data collection:**

- The CMA market study detailed how end users receive ad-funded services such as search and social media for free in exchange for their attention and data, which firms monetise, resulting in a trade-off between data privacy and access to a service. In a more competitive market, firms might compete for user data by offering improved quality (e.g. a better service with fewer ads), better privacy terms (e.g. requiring less data or giving users greater control over data collected), or even negative prices (e.g. rewarding users for their data and attention).<sup>56</sup>

44. **Reduced innovation:**

- In its market study into digital advertising, the CMA suggests that Google and Facebook are insulated from competitive threats, leaving them with reduced incentives to innovate both in their core and adjacent services. They also present evidence that both firms prevent new entry and expansion by potential disruptors by constraining interoperability and acquiring nascent firms. As a result, these markets suffer from reduced innovation, meaning less choice for consumers in the long-term.
- Evidence from the US House Judiciary Subcommittee and Dutch Authority for Consumers and Markets (ACM) market study suggests that both Apple and Google’s in-app purchase systems and self-preferencing deter entry into the app market and stifle competing developers, depriving end users of potential new, innovative apps.<sup>57 58</sup>

### Case Study: Google and Apple revenue-sharing agreements

In October 2020, the US Department of Justice filed an antitrust lawsuit against Google, targeting its revenue sharing agreements with companies like Apple in exchange for default search positions on its devices. Since the lawsuit, Apple has announced the development of its own rival search engine. This suggests the payments to Apple, estimated at \$8-12bn annually, had previously been restraining competition and innovation.

*Sources: US Department of Justice (October 2020)<sup>59</sup>*

*Financial Times, ‘Apple develops alternative to Google search’ (October 2020)<sup>60</sup>*

45. **Poor terms for business users:**

- Amazon’s terms, fees and treatment of third-party sellers have been described as “bullying tactics” in the US House Judiciary Subcommittee report. Similar negative experiences were reported in a survey of UK retailers who sell on third-party e-commerce platforms. Respondents that used Amazon marketplace were more likely than users of other platforms to experience

1. digital advertising is a variable cost for advertisers, and
2. empirical research suggests pass through is generally 100% in markets with many competitors, which describes many markets reliant on digital advertising.

See: ‘Cost pass-through: theory, measurement and potential policy implications, a report prepared for the Office of Fair Trading’, RBB Economics, February 2014

<sup>54</sup> Dutch Authority for Consumers and Markets (ACM), [‘Market Study into Mobile App Stores’](#), April 2019.

<sup>55</sup> European Commission, [Antitrust: Commission sends Statement of Objections to Apple on App Store rules for music streaming providers](#), April 2021.

<sup>56</sup> CMA, [Online platforms and digital advertising market study](#), p8. July 2019.

<sup>57</sup> US House Judiciary Subcommittee on Antitrust, [Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations](#), p99. October 2020.

<sup>58</sup> Dutch Authority for Consumers and Markets (ACM), [‘Market Study into Mobile App Stores’](#), p104. April 2019.

<sup>59</sup> United States Department of Justice, [Justice Department sues monopolist Google for violating antitrust laws: Google Complaint](#), October 2020.

<sup>60</sup> Financial Times, [Apple develops alternative to Google Search](#). October 2020.

issues with restrictions on communication or resolving disputes (53%), and suspension or removal of products/accounts (51%). 73% of businesses disagreed that they can influence or amend the terms and conditions on Amazon.<sup>61</sup>

- Business users of e-commerce platforms often must endure harms due to a lack of viable alternatives or high switching costs. Around one third of respondents to the survey disagreed that if the terms and conditions on their main platform are changed to the detriment of their company, they can easily switch to a different online platform.<sup>62</sup>
- Amazon has also been accused of abusing its dual role as a marketplace, and a retailer on the marketplace, to avoid the normal risks of retail competition. The European Commission found that Amazon uses non-public business data of third-party sellers to calibrate its own retail offers and business decisions.<sup>63</sup> While it could be argued this constitutes Amazon injecting healthy competition into the relevant product markets, the fees it charges third-party sellers simultaneously drives a wedge between their and Amazon's prices. This reduces the likelihood third-party sellers will be able to compete.

### Case Study: Amazon Books

Using Amazon's online fees calculator, UCL's Institute for Innovation and Public Purpose finds the platform takes 22% of third-party book sellers' revenue as fees. This does not include VAT charges, service fees, or the monthly £25 'Professional Seller' subscription fee without which sellers are not eligible for crucial 'Buy Box' status (it is estimated that 82% of sales go through the Buy Box). Clearly, even a third-party seller that would otherwise be able to compete on price with Amazon's own retail offerings, would now have to contend with an additional 22% in costs.

*Sources: UCL IIPP 'Theorising and Mapping Modern Economic Rents' (2020).  
The Booksellers Association response to Taskforce Call for Information (2020)*

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## Policy objectives

46. The objective of government intervention is to establish a new pro-competition regime, to be overseen predominantly by the Digital Markets Unit (DMU), to promote competition and competitive outcomes to further the interests of consumers in digital markets. By addressing both the sources of market power, and the economic harms that result from the exercise of this power, the pro-competition regime will improve consumer outcomes and drive growth and innovation in the digital economy.
47. Intervention should lead to a regulatory regime that can deliver improvements in market outcomes, including:
  - Lower prices - Decreases in price and non-price costs for digital market users, which may also be passed through as lower consumer prices in industries reliant on digital markets.
  - Higher quality - Improved quality of services/features in digital markets leading to increased consumer satisfaction.
  - Greater choice for consumers - Increase in number and variety of services/features available to consumers.
  - Increased innovation - For example: Increases in R&D expenditure by incumbent firms, increased rate of change in product offerings in digital markets, greater number of successful and disruptive new entrants. In turn leading to greater choice and quality of products available to consumers.

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<sup>61</sup> IFF Research, [Retailers' Experience of Using Digital Platforms Survey](#) conducted on behalf of BEIS. 2021.

<sup>62</sup> Ibid.

<sup>63</sup> EU Commission Statement of Objections to Amazon, November 2020.

48. The full list of specified indicators of success, against which policy options have been appraised, are fully detailed in Annex B.
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## Analytical approach to Impact Assessment

49. As per the Regulatory Policy Committee guidance,<sup>64</sup> where policy decisions will not be finalised until a later stage, impacts of the proposal are uncertain, and evidence/data is limited, the analysis in this IA is predominantly qualitative in nature.
50. We do refer to quantitative analysis of consumer detriment to demonstrate the potential scale of benefits that may result from intervention. We also provide some indicative cost estimates, where feasible. However, quantifying the expected impacts of the options is not proportionate or possible yet, for two main reasons:
- i. Whilst regulators can be guided by government objectives, it is at their discretion to use the regulatory powers granted to them. This leads to uncertainty on their future actions and subsequent impact.
  - ii. The proposals represent a novel approach to regulation in unique, dynamic, and relatively young markets. Even when considering the most likely regulatory actions, impacts can change based on the reactions of firms and consumers in these markets. This is also difficult to predict as causal data are limited.
51. As the shape of the new regulatory regime is finalised, and with further evidence, we intend to provide a more detailed qualitative and, where possible, quantitative appraisal in the final IA. Throughout the following sections of the IA, we have included questions (summarised in Annex D) to seek views on the assumptions used and invite further evidence on the potential impacts.
52. The main aim of the consultation-stage IA is therefore to present a compelling case for intervention, and a high-level assessment of policy proposals to help inform consultation responses and evidence gathering in support of the final IA, and the following sections in particular:
- Case for intervention: Evidence in the preceding sections demonstrates that there is a lack of competition in some digital markets, which can lead to harms for prolonged periods. This makes a strong argument for government intervention to rebalance competition in these markets and deliver improved outcomes for consumers.
  - Options appraisal: Current indicative estimates of costs, descriptions of the scale of benefits, and policy objectives are used to appraise options. The policy option that is most aligned with objectives, and is most likely to deliver greatest benefits relative to costs, is the 'preferred' option.
53. The direct costs of the pro-competition regime's operations are presented as a broad range, relative to the indicative scale of potential benefits, to illustrate that the case for intervention is not particularly sensitive to the potential cost of the regulator. However, as with estimates for compliance and familiarisation costs, these costs are illustrative only, and are not intended to anticipate any future decisions on funding.
54. Proposals for a new mergers regime for SMS firms are treated slightly distinctly from other policy options in this IA. We have set out the specific rationale for a dedicated mergers regime in the 'case for change' section above. The government is supportive of a dedicated SMS merger regime. However, as detailed policy proposals for the mergers regime are not yet fully developed, we do not include the SMS merger regime in the preferred option, but equally we do not formally 'reject' its inclusion at this stage. The government will use evidence collected during the consultation process to develop its proposals in relation to the merger regime.

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<sup>64</sup> RPC, (2019), [RPC case histories – assessment and scoring of primary legislation measures](#), scenario 2 in the primary legislation guidance.

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## Policy options considered

### Components of options

55. Aside from non-regulatory measures (Option 1), the regulatory options considered vary along two dimensions:
- The scope of regulatory intervention (i.e. only firms with SMS vs all firms within digital markets), and
  - The powers granted to the regulator (i.e. components of the regime that are included).

Table 2 shows how each option varies in these two dimensions.

56. Details of the proposed components that may comprise the pro-competition regime are listed below. How many and which of these are included varies by policy option considered. These constitute the various 'tools' that may make up the toolkit that the DMU could be given the power to implement in order to achieve its objectives. How the DMU implements these tools, and the specific details of its regulatory interventions, would vary on a case-by-case basis in response to the specific firm, market, and circumstances. The government is still consulting on the appropriate design of these proposed components/tools, hence some of the details below may be subject to change.
57. **Strategic Market Status (SMS) designation:** SMS would be a mechanism for ensuring that the new regime is appropriately targeted at a small number of digital firms that have substantial and entrenched market power providing them with a strategic position, and so where the risk of harm is greatest. For a firm to be included in the regime, and therefore subject to a code of conduct and/or PCIs, the DMU would be required to assess whether it meets a set of criteria that qualify it as having 'Strategic Market Status' and so being formally designated as an SMS firm. Although the government is still seeking views on the proposed SMS test in consultation, it would broadly consider whether the firm has, in at least one digital activity, i) substantial market power, ii) entrenched market power,<sup>65</sup> and iii) whether this market power provides it with a strategic position.<sup>66</sup> Rather than set quantitative thresholds for designating SMS, the DMU would be responsible for formally assessing if a firm meets these criteria using a range of qualitative and quantitative evidence (in line with approaches to assessment of market power typically used in existing competition law). See Part 3 of the consultation document for further detail on the proposed SMS designation process.<sup>67</sup>
58. **code of conduct:** An enforceable set of objectives and principles, with accompanying explanatory guidance, to govern the behaviour and activities of SMS firms. The code would seek to promote three overarching objectives of: fair trading, open choices, and trust and transparency. The aim of the code is to manage the harmful effects of substantial and entrenched market power, by setting out how firms with SMS are expected to behave, and thus protecting end consumers and businesses. It will offer clarity to users and firms with SMS, influencing their behaviour in advance and preventing negative outcomes before they occur. For example, it should prevent practices such as unfair leveraging of market power, exploitation of consumers, exclusionary behaviour towards competitors, and restriction of consumer choice. If SMS firms are not already compliant with principles set out in the code, they would be subject to code orders and interim code orders imposed by the DMU that would specify required conduct changes. See Part 4 of the consultation document for further detail on the proposed code of conduct.<sup>68</sup>
59. **Pro-Competitive Interventions (PCIs):** Specific behavioural and structural measures imposed on SMS firms, which complement the code of conduct, to tackle the underlying root causes of market power. These transformational measures would aim to address fundamental features of digital

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<sup>65</sup> 'Entrenched' means market power is well-established, long-standing, and unlikely to change in the foreseeable future.

<sup>66</sup> A strategic position is one where the effects of the firm's market power are likely to be particularly widespread or significant. For example, the firm may be a crucial access point for customers.

<sup>67</sup> See consultation document Part 3 paragraphs 60 - 78, p.18-23.

<sup>68</sup> See consultation document Part 4 paragraphs 79 - 101, p.24-31.

markets that can act as barriers to entry and expansion, and lead to markets ‘tipping’ (see Table 1: Characteristics of digital platform markets above), thus encouraging longer-term changes to the structure of markets and the conditions for dynamic competition. When markets are made more contestable, competitive pressures should naturally drive the market towards reduced harm and better consumer outcomes (e.g. lower prices, higher quality, greater innovation, and more consumer choice). Following an investigation into a suspected adverse effect on competition that the DMU concluded could not be appropriately addressed through the code of conduct, it would be able to impose proportionate PCI measures on SMS firms through enforcement orders. Examples of types of measure that may be implemented through PCIs include data-related interventions (e.g. personal data mobility, mandated data access), interoperability and common standards, consumer choice and defaults interventions, and certain separation remedies (e.g. data or operational separation). See Part 5 of the consultation document for further detail on PCIs and the proposed PCI process (including PCI investigations).<sup>69</sup>

60. **Mergers regime:** A separate merger regime only for firms designated as having SMS that includes the following key elements:
- a. Firms designated with SMS are required to report all transactions to the CMA via a short and simple form;
  - b. Clear-cut thresholds for jurisdiction based on a transaction-value test combined with a requirement that the transaction has a link to the UK (‘UK nexus’);
  - c. Certain transactions that meet clear-cut thresholds may be subject to mandatory reviews, with completion prohibited prior to clearance and penalties for failing to comply with this requirement; and
  - d. Competition concerns for the phase 2 review of mergers should be assessed using an amended probability threshold for transactions involving firms with designated SMS. This would increase the ability of the CMA to intervene in potentially harmful mergers.

## Options considered

**Table 2:** Illustration of regulatory options and their components

	Scope	code of conduct	PCIs	Mergers
<b>Option 2</b>	SMS firms only	✓		
<b>Option 3</b>		✓	✓	
<b>Option 4</b>		✓	✓	✓
<b>Option 5</b>	All firms in digital markets	✓	✓	

### **Option 0: Do Nothing (No new action) counterfactual**

61. This option is the baseline against which the expected impacts of other options are assessed.
62. The counterfactual assumes the continuation of the regulation currently in place: the enforcement of existing competition law, similar use of existing CMA regulatory tools (including market studies and market investigations), and the recent changes to platform to business regulation.<sup>70</sup>
63. It also takes into account the non-statutory DMU. The government has committed to funding the DMU, within the CMA, from April 2021 for one year, to build on the work of the Taskforce and where

<sup>69</sup> See consultation document Part 5 paragraphs 102 - 123, p.32-36.

<sup>70</sup> [The Online Intermediation Services for Business Users \(Enforcement\) Regulations, 2020](#)

appropriate, use the CMA's existing powers to investigate harm to competition in digital markets. The non-statutory DMU will not have any new powers beyond those of the CMA until its functions and objectives are finalised in statute. The role of this body is to:

- Carry out preparatory work to implement the statutory regime.
- Support and advise government on establishing the statutory regime.
- Gather evidence on digital markets.
- Engage stakeholders across industry, academia, other regulators, and government.

64. **Pros:** The non-statutory DMU is already up and running. This would not require any further action from the government, other than ongoing engagement. The ongoing work of the shadow DMU would help further understanding of issues within and across digital markets to support any future policy development.
65. **Cons:** Without enforceable intervention, it is unlikely that the issues currently observed within and across digital markets can be remedied, and consumers will continue to experience persistent harms.
66. **Risks:** There is potential that if the government were to choose the Do Nothing (no new action) option in response to the identified issues outlined above, there is potential for competition to worsen over time, as markets are prone to tipping and may potentially become even more concentrated.

### **Option 1: Alternatives to regulation**

67. We have considered a range of non-regulatory alternatives to promote competition in digital markets. For example:
- Self-regulation: Government could leave it to firms in digital markets to collaborate on self-regulation to develop rules or a code of conduct to help reduce consumer harm.
  - Information and education: The government could engage in campaigns to improve consumer awareness of the value and uses of their personal data. This could help end consumers to make more informed decisions when selecting which firms to engage with and on which terms, and to choose services with a lower 'data cost' more often.
68. **Pros:** The ability to bring about change is put into the hands of those within the market (firms and consumers). Firms should have the best idea of business models and arising issues, whilst consumers would have the ability to make their own, more informed, consumption decisions in an attempt to maximise their welfare.
69. **Cons:** It is unlikely that firms with substantial market power would make decisions that would disadvantage them. Therefore, it is unlikely that self-regulation would bring about the necessary rebalancing of market power within digital markets. In addition, even with the appropriate information, consumer decisions can still be somewhat restricted by a lack of alternatives, and the presence of strong network effects. This option could also mean that the DMU's contribution to the understanding of the problem would be lost.
70. **Risks:** As with the option above, if the government takes limited action in response to identified issues, there is potential for competition to worsen over time, as markets are prone to tipping and may potentially become even more concentrated.

### **Option 2: A DMU with power to implement a code of conduct for SMS firms only**

71. In this option, the DMU, with new statutory powers, would be able to enforce a code of conduct for firms it has designated with SMS. The code of conduct aims to limit the exercising of market power and reduce consumer harms.
72. **Pros:** The DMU would have the ability to set expectations for the behaviour of SMS firms in order to limit consumer harms. The code of conduct would be enforceable, meaning that this option will have a material impact on behaviour, and subsequent harms. This intervention will only capture SMS firms, meaning that it only targets large firms with significant levels of market power.

73. **Cons:** Whilst this option would have a material impact on the effects of market power (i.e. consumer harms), the impact on market power itself would be limited. The code of conduct will only target the behaviour of firms with market power through setting enforceable principles, and not the sources of the market power itself.
74. **Risks:** It can be expected that, whilst the harms experienced as a result of the exercising of market power are addressed, market power and the concentration of digital markets could become a larger issue over time. This could also mean that the resource required to remedy harms through the code of conduct increases as more harms are experienced.

#### **Option 3: A DMU with powers to implement a code of conduct and PCIs for SMS firms only**

75. In this option, in addition to the proposed powers in Option 2, the DMU would be able to impose PCIs on SMS firms to address the sources of market power and open markets up to greater entry and competition.
76. **Pros:** This option will allow the DMU to address short term consumer harms, whilst also targeting sources of market power in an effort to rebalance markets in the long term, which is in line with the proposed policy objectives. This intervention will only capture SMS firms, meaning that it only targets large firms with substantial and entrenched market power providing them with a strategic position.
77. **Risks:** The success of this option is dependent on the DMU's use of its PCI powers (e.g. which PCIs it chooses to implement).

#### **Option 4: A pro-competition regime with powers to implement a code of conduct, PCIs and a Merger regime for SMS firms only**

78. In this option, in addition to the proposed powers in Option 3, this option would also include the ability to further scrutinise the merger and acquisition activity of SMS firms. This will reduce the occurrence of mergers with anti-competitive outcomes, improving the options available to consumers and reduce potential consumer harm.
79. **Pros:** In addition to the impacts outlined in the option above, this option will help to further reduce potential anti-competitive behaviour through greater scrutiny of the potential impacts that SMS mergers and acquisitions have on consumers. Harmful impacts from mergers, such as powerful digital firms further entrenching their dominant market positions by eliminating competitors, raising barriers to entry and expansion, and expanding their digital ecosystems by creating a 'moat' around their core services. This intervention will only capture SMS firms, meaning that it only targets large firms with substantial and entrenched market power providing them with a strategic position.
80. **Risks:** There is potential that the inclusion of a merger regime for SMS firms could reduce M&A activity that might have a pro-competitive or pro-innovation effect. For example, it may discourage investment in start-ups because of a reduction in potential exit routes for investors, or it may restrict the valuable role the largest digital firms play in supporting young tech businesses in growing and innovating.
81. *Through this consultation, the government is seeking views on the potential for an SMS merger regime that will put transactions by SMS firms under closer inspection. The government is supportive of a dedicated SMS merger regime. However, a detailed policy position in relation to the mergers regime is not fully developed at this stage. Therefore, whilst the SMS merger regime is not included in the preferred option, we do not wish to 'reject' the inclusion of this policy option at this stage. The government will use evidence collected during the consultation process to develop its proposals in relation to the merger regime.*

#### **Option 5: A DMU with powers to implement a code of conduct and PCIs for all firms in digital markets**

82. This option includes the DMU with the same powers outlined in Option 3, but widens the scope of the regulatory regime. Under this option, the DMU could apply interventions to all firms within the determined regulated population,<sup>71</sup> as opposed to just SMS firms.

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<sup>71</sup> Policy decision on the regulatory perimeter (which will inform the ultimate regulated population) still to be taken.



83. **Pros:** This option would extend to all firms within digital markets, meaning that all firms that may be responsible for the issues outlined above would be captured, as opposed to focussing the regime on just a few. This could increase the scale of the expected benefits.
84. **Cons:** The scope of this option could be seen as 'over intervention' and does not align with the objective for the regime to be proportionate and targeted. As outlined above, the issues observed within these markets tend to arise from the concentration of substantial market power with a few large firms. Therefore, it seems unreasonable to implement regulations on all firms. In addition, it is possible that this could unnecessarily increase the burden on smaller firms and new entrants, and limit their ability to take advantage of any impacts the regime may have on competition (i.e. limit their ability to rival and challenge the most powerful incumbents).
85. **Risks:** If smaller firms are unable to take advantage of any impacts on competition, then it is possible that competition, and its related issues, could worsen over time despite the intervention.
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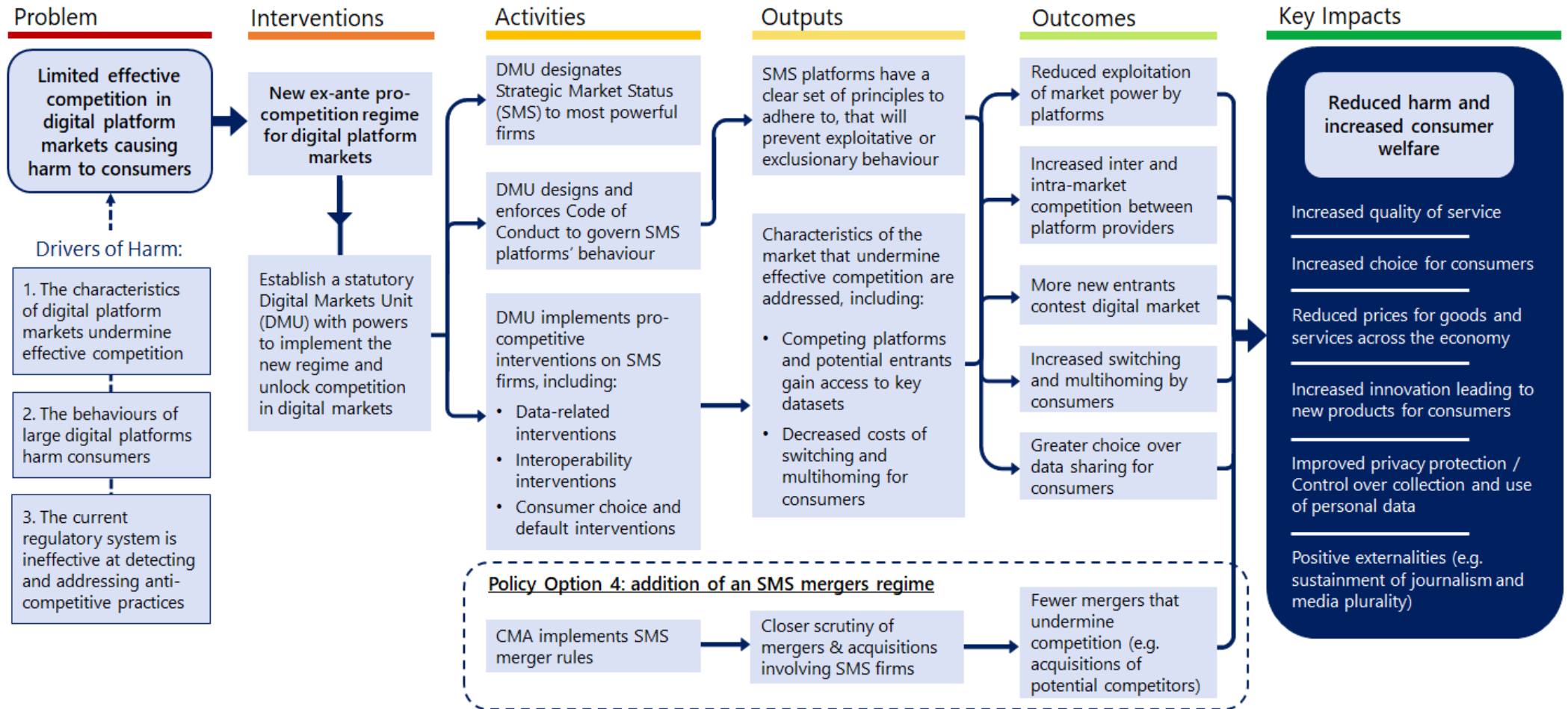
## Summary of preferred option and implementation plan

86. **The preferred policy option at this stage is Option 3: A DMU with powers to implement a code of conduct and PCIs on SMS firms only**
87. Under this option, the DMU would be granted powers to enforce a code of conduct on firms it has designated with Strategic Market Status (SMS). The code of conduct is expected to monitor and remedy consumer harms resulting from unfair (e.g. exploitative or exclusionary) practices by SMS firms to further entrench their market power. In addition, the DMU would have the power to implement pro-competitive interventions (PCIs), which would be used to target the sources of market power in digital markets (e.g. barriers to entry), reduce the incumbency advantage of SMS firms, and increase competition in and for the market.
88. The scope of this regulatory regime would be SMS firms, and the DMU would use the SMS designation process to capture only the firms with a strategic position and substantial, entrenched market power in certain digital markets prone to 'tipping'. This is expected to return greater benefits to consumers without disproportionately creating a burden on smaller digital firms.
89. The government intends to implement this via primary legislation when parliamentary time allows. A non-statutory Digital Markets Unit has been operational since April 2021, and will undertake transitional functions until it obtains statutory footing via primary legislation.

## Theory of change

90. Figure 1 below illustrates an indicative intended mechanism of the new ex-ante pro-competition regime in digital platform markets (as per the preferred option, Option 3), from the DMU's activities through to the expected positive impacts. Figure 1 also indicates how the SMS merger proposals, under Option 4, would lead to expected impacts.

**Figure 1:** Theory of change for an ex-ante regulatory regime in digital platform markets



## Monetised and non-monetised costs and benefits

91. In the following section, we consider potential impacts arising from the new pro-competition regime, at a high level. In some instances, we indicate which component of the regime might be expected to result in the respective impact. However, we do not include detailed analysis of the impacts of specific measures (e.g. particular example PCIs or code of conduct principles). We do not believe it would be appropriate to do this at this stage as the government is still seeking views on the appropriate powers and scope of these measures. In addition, even at the point of legislation, the exact measures imposed will be at the DMU's discretion and would vary depending on the market and circumstances.
92. We categorise impacts as direct or indirect costs/benefits. Direct costs refer to costs that are incurred directly from a regulatory action by the DMU, independent of action by any other party. Indirect costs stem from the DMU's actions but require certain intermediate responses by other parties to be realised. Similarly, direct benefits result from the DMU's intervention in a market/firm (treating compliance by firms as assumed rather than an active choice, as we have throughout this IA), whereas indirect benefits would result from the reaction of parties to the DMU's interventions.

### Costs

93. The implementation of the proposed regulatory regime is expected to result in direct and indirect costs. This section provides some indicative quantification of direct costs, where possible. Where this is not possible, expected costs are described qualitatively.
94. The figures in this section are indicative and are not used to assess the net present value of alternative options. These indicative monetised costs are in 2021 prices.
95. The DMU will attempt to minimise any costs to businesses by providing clear, detailed guidance for compliance.

### **Direct Costs**

#### *Costs of the Pro-competition regime*

96. There will be costs associated with the day-to-day operation of the Digital Markets Unit, and any additional components of the regime. These will include both one-off set up costs, such as purchasing IT and initial recruitment processes, and ongoing operational costs, such as salaries for employees.
97. As the direct costs of operation will vary depending on powers and functions (i.e. the components of the regime), these costs are estimated by policy option in the 'Options appraisal' section below. These figures should be considered as indicative only. These figures are not intended to anticipate or inform future government decisions on funding.
98. The costs outlined in the table below are estimated using a wide, conservative, range of assumptions regarding the FTE requirement of each option. The range of assumptions has been informed by information shared by the CMA regarding costs incurred for potentially comparable work.

**Table 3: Estimated indicative costs of the Pro-Competition Regime (per annum)**

Option	Option 1	Option 2	Option 3	Option 4 <sup>72</sup>	Option 5
Estimated (indicative) cost	N/Q - The non-regulatory option would likely be the	£4m-£20m	£5m-£25m	£7.5m-£38m	N/Q - Likely significantly larger

<sup>72</sup> The CMA has a legal duty to investigate mergers that are notified. The scale of these costs would depend on the design of the relevant thresholds and whether the regime involved mandatory notification for a subset of mergers.

	cheapest of all options considered				
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99. Decisions on the funding model for the regime are still to be taken. As such, it is not possible to clarify at this stage who these costs will ultimately be borne by.
100. Regarding the merger proposals specifically (in option 4), the government would likely be able to partially recover the cost of merger investigations through the current merger fee process.<sup>73</sup> The merger fee falls to the merging parties.
101. Without additional resources to operate the regime, there may be crowding out of other CMA discretionary activity. This could result in an opportunity cost of consumer benefit that could be delivered through enforcement or market interventions. The activities of the CMA will be decided in line with the CMA's prioritisation principles.

### *Compliance costs for SMS firms*

102. Firms designated with SMS would have to spend resources to read, disseminate, implement the necessary changes to become compliant and undertake any additional processes that may be required from the new regulation. The European Commission's Digital Markets Act (DMA) Impact Assessment appraised similar regulatory activities (i.e. a list of obligations for firms designated with 'gatekeeper' status resembling PCI-style measures and code of conduct principles).<sup>74</sup> Their appraisal estimates €1.41m (**around £1.25m**)<sup>75</sup> of compliance costs per gatekeeper firm per year. Given the implementation of roughly comparable measures, we assume this is a reasonable indicative benchmark for the compliance costs associated with the DMU. As the proposed UK approach would be more targeted than a list of obligations immediately applicable to all gatekeepers, it is possible that actual compliance costs may be lower. However, we still consider this a reasonable indicative estimate against which to benchmark. It is likely that compliance cost will vary throughout the appraisal period as the DMU decides to implement different measures. This is not considered within this analysis as these decisions will be made by the DMU, and the estimate presented is intended to be an indicative estimate of the annual cost to firms.
103. The proportion of the overall compliance costs associated with staff reviewing regulations is expected to be relatively small. For example, even if we assume that 20 members of staff at a large firm will read 50 pages of regulations per annum (300 words per page, 100 words per minute as per assumptions in a recent FCA publication)<sup>76</sup>, this would account for just 50 hours per firm, per annum. Given an appropriate hourly wage<sup>77</sup>, uprated for non-wage costs<sup>78</sup>, and assuming five firms were initially designated with SMS in one activity each<sup>79</sup>, we estimate **reading costs to be around. £10k per annum.**

$$\begin{aligned}
 & \text{(Time spent reading)} \times \text{(Number of people reading)} \times \text{(Uplifted hourly wage estimate)} \times \text{(Number of firms)} \\
 & ((300 \text{ words per page} / 100 \text{ words per minute}) \times 50 \text{ pages}) \times (20 \text{ workers}) \times (£39.11/\text{hour}) \times (5 \text{ firms}) = \mathbf{£10k}
 \end{aligned}$$

<sup>73</sup> The merger fee thresholds are based on the UK turnover of the acquired firm. As many digital acquisitions are of high value but low turnover it is likely that the applicable fees would be at the lower end of the current merger fee scale.

<sup>74</sup> [Impact assessment of the Digital Markets Act](#), 2021.

<sup>75</sup> Using the average exchange rate for 2020 of £1 = €1.13 (ONS),  $1.41 / 1.13 \approx 1.25$

<sup>76</sup> FCA (2021) [Changes to the SCA-RTS and to the guidance in 'Payment Services and Electronic Money – Our Approach'](#) and the Perimeter Guidance Manual, (FCA consultation paper)

<sup>77</sup> The hourly wage for 'Quality Assurance and Regulatory Professionals' role (closest matching occupation for compliance staff in the ONS ASHE data; 4 digit SOC), in the highest percentile. The corresponding hourly wage was £32.06 in 2020.

<sup>78</sup> [RPC short guidance note on 'implementation costs', August 2019](#)

<sup>79</sup> 5 SMS firms is a reasonable but arbitrary assumption used solely for the purposes of producing illustrative cost estimates. This assumption does not represent a view for how many firms or activities should/will be designated as having SMS; the actual number may be higher or lower.

104. Firms may also choose to use legal resources to review regulations. If we assume that 8 legal professionals<sup>80</sup> will read 50 pages of regulations per annum (300 words per page at 50 words per minute, given more detailed review than above), then this will account for just 40 hours per firm, per annum. Assuming legal costs of £480 per hour<sup>81</sup>, in line with the methodology used for the National Security and Investment Bill 2020<sup>82</sup>, we estimate **legal review costs to be around £95k per annum.**

$$(Time\ spent\ reading) \times (Number\ of\ people\ reading) \times (Uplifted\ hourly\ wage\ estimate) \times (Number\ of\ firms)$$

$$((300\ words\ per\ page/50\ words\ per\ minute) \times 50\ pages) \times (8\ lawyers) \times (£480/hour) \times (5\ firms) = \mathbf{£95k}$$

105. In addition to time spent by compliance staff reading enforcement orders and guidance, and legal review of these, there would be additional costs of implementing changes. We expect these would account for the majority of the indicative £1.25m overall compliance cost. This may comprise of additional staff hours, further/continued legal advice, or additional capital expenditure costs associated with structural changes required to comply with measures.<sup>83</sup> There may also be a cost of CEO sign-off and approval for these changes.

106. Within this analysis we assume firms will comply with regulations. We also assume that SMS firms will not submit appeals in relation to changes to regulation. Therefore we do not consider any potential costs associated with legal proceedings. These assumptions will be explored further in the Final Impact Assessment.

107. Compliance costs will naturally vary depending on the number, frequency, any relevant thresholds that are included and types of measures the DMU implements. For example, if more, or more significant, PCI measures are imposed on an SMS firm (proportionate to the adverse effect on competition they are aiming to address), the associated compliance costs are likely to be higher.

108. It should be noted that the assessment and principles of proportionality proposed as part of the DMU's processes (e.g. PCI investigation) would be designed to ensure the wider benefits of specific interventions outweigh the costs, including of firm compliance.

109. Compliance costs will vary by policy option based on the respective burden they place on firms. In order to demonstrate this variation, we can adjust a 'central estimate' (estimated above) based on perceived differences in the compliance burden. We believe that the central estimate best represents the costs associated with the proposals in Option 3. Therefore, the costs associated with other options can be scaled up or down by comparing the respective perceived compliance burdens with that of Option 3.

**Table 4: Estimated compliance costs by policy option (per platform per annum)**

Option	Option 1 (indirect)	Option 2	Option 3	Option 4	Option 5
Scaling factor	N/A	0.5	1	1.1	1
Compliance Cost	N/A	£625k	£1.25m	£1.38m	£1.25m

<sup>80</sup> FCA Report assumes 4 legal staff per large firm. As SMS firms are significantly larger than 250 employees, this assumption is doubled.

<sup>81</sup> HM Government, [Solicitors' guideline hourly rates](#). We conservatively assume London Grade 1, Class A: Solicitors and legal executives with over 8 years' experience working in London (uprated to 2020 prices).

<sup>82</sup> BEIS, [National Security and Investment Bill Impact Assessment](#), November 2020.

<sup>83</sup> We expect these 'capital expenditure' costs would most likely be related to PCIs, which might require more transformative changes to the SMS firm's operations. We make no attempt to estimate these due to the uncertainty around the types of PCIs the DMU might implement; it would be at the DMU's discretion when and on which SMS firms it imposes any PCI order, and what that PCI order might be.

110. The table above shows the estimated variation in compliance costs across options. The arbitrary scaling factors used are purely to demonstrate that there is expected to be a significant level of variation dependent on the burden on firms and should be treated as indicative.

**Question 1:** Do you agree with the assumptions used to give an indication of compliance costs, including potential legal costs? Are you able to provide evidence on the expected costs associated with complying with the new pro-competition regime?

(see relevant parts of the consultation for further detail on Strategic Market Status (SMS) and the specific measures SMS firms may be required to comply with)<sup>84</sup>

**Question 2:** Are you able to provide evidence on potential compliance costs that may be specifically associated with PCI measures?

(see the 'Policy options considered' section of this IA, Part 5 of the consultation,<sup>85</sup> or Appendix D of the Advice of the Digital Markets Taskforce<sup>86</sup> for examples of PCI-style measures)

**Question 3:** Are you able to provide evidence and information on the potential compliance costs that may arise as a result of the SMS merger measures?

### *Familiarisation costs to digital market firms*

111. We assume that there will be a one-off cost for firms to be aware of the changes in the regulatory environment, once the DMU has statutory powers. This will require employees to read about regulatory changes and reflect on how this may affect the firm.
112. We assume that certain very large firms, most likely to be in scope of the DMUs activities, would require time to familiarise themselves with regulations that *could* potentially alter their operation. By contrast, we assume small and medium firms, for whom the likelihood of being directly affected by the DMUs activities is very low, will not require any time to familiarise themselves with new regulations.
113. Since SMS designation involves an in the round assessment by the DMU, rather than meeting 'bright line' thresholds, there is a degree of uncertainty as to which firms would be designated. However, it would be reasonable for the largest and most profitable digital firms to assume that they could potentially be designated. If we assume just five firms would be designated with SMS initially (as above), we could assume that 20 firms would feel the likelihood of being designated was sufficient to need to familiarise themselves with the new regulations. It is not known how many would actually do this, however the assumption that for every 1 firm that is designated a further 4 were relatively close to being designated is an approximate, conservative estimate used to show due consideration of the potential familiarisation costs to businesses.
114. Using the same assumptions and hourly wage calculations used to estimate compliance costs for both internal staff and legal review above,<sup>87</sup> we estimate an indicative **one-off familiarisation cost of around £850k** in the first year of the appraisal period. This is made up of around £80k for internal compliance staff reading and around £770k for legal review.
115. It is likely that there is some overlap between compliance and familiarisation costs in the first year of the appraisal period. There will still be a cost to firms associated with compliance, however the initial review of necessary documents is likely captured by the familiarisation cost.
116. It is also possible that firms will incur familiarisation costs outside of the first year of the appraisal period as PCIs measures can be implemented at any time, and firms will need to understand the

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<sup>84</sup> See consultation document.

<sup>85</sup> See consultation document Part 5.

<sup>86</sup> Digital Markets Taskforce Advice [Appendix D](#)

<sup>87</sup> See footnotes 76-82

impact of these measures. These costs may already be captured through the overarching compliance costs outlined above.

<p>Total familiarisation cost = reading cost + legal review cost</p> <p><b>£850k = £80k + £770k</b></p>
<p><i>Reading cost = (Time spent reading) x (Number of people reading) x (Uplifted hourly wage estimate) x (Number of firms)</i></p> <p>((300 words per page/100 words per minute) x 100 pages) x (20 workers) x (£39.11/hour) x (20 firms) = <b>£80k</b></p>
<p><i>Legal Review cost = (Time spent reading) x (Number of people reading) x (Uplifted hourly wage estimate) x (Number of firms)</i></p> <p>((300 words per page/50 words per minute) x 100 pages) x (8 lawyers) x (£480/hour) x (20 firms) = <b>£770k</b></p>

117. Familiarisation costs will vary by policy option based on the respective burden they place on firms. In order to demonstrate this variation, we can adjust a 'central estimate' (estimated above) given perceived differences in required familiarisation. We believe that the central estimate best represents the costs associated with the proposals in Option 3. Therefore, the costs associated with other options can be calculated by comparing the perceived level of required familiarisation with that of Option 3.

**Table 5: Estimated familiarisation costs by policy option**

Option	Option 1	Option 2	Option 3	Option 4	Option 5
Scaling factor	N/A	0.5	1	1.1	1.5
Compliance Cost	N/A	£425k	£850k	£930k	£1.27m

The table above shows the estimated variation in familiarisation costs across options. The scaling factors used are purely to demonstrate that there is expected to be a significant level of variation dependent on the burden on firms and should be treated as indicative.

**Question 4:** Do you agree with the assumptions used to give an indication of familiarisation costs, including potential legal costs? Are you able to provide evidence on these costs (e.g. information on staff required for the familiarisation process), and how they may differ by policy option?

### Indirect Costs

118. The DMU will be required to be proportionate in its use of these new powers, meaning that the expected benefits of its interventions should be greater than their overall costs. However, within this net benefit there may be some 'indirect costs'.

119. **Reduced profits for SMS firms (transfer to consumers)** - The DMU's actions are expected to remedy consumer detriment, such as high prices charged to business users of digital platforms (which may then be passed through to end consumers). As we outline further in the 'Demonstration of the scale of potential benefits' section below, this is likely to involve an erosion of SMS firms' excess profits. While this may appear an indirect cost to SMS firms, it would result in savings for consumers. Hence this impact constitutes a transfer away from firms (producer surplus) to consumers (consumer surplus). As this is in line with the objectives of the regime, and given the

profits of SMS firms can currently be argued to be excessive, we consider the resulting increase in consumer surplus, relative to the counterfactual, to be beneficial overall (i.e. constituting an improved allocation of resources in the market).

120. **Investment chilling** - There may be a risk that increased regulation of the largest digital firms (which are mostly foreign-owned) might negatively affect their incentives to invest in the UK. Although regulation would apply to their services regardless of where operations are based (providing they are active in the UK market), and notwithstanding the discussion on regulatory coherence/fragmentation in the 'potential trade implications' section below, SMS firms *might* react to new measures by disinvesting in the UK or reconsidering future investment decisions. As an example, the proposed altering of the substantive test for merger reviews is likely to mean intervention in more merger cases. This could discourage competition-enhancing mergers from occurring, delay their completion or at least increase the costs of the transaction (e.g. through increased administrative costs). This could impact the overall level of investment, although the extent and longevity of this impact are uncertain. Regarding the SMS merger regime specifically, previous analysis conducted for the National Security and Investment Act found that merger regimes play a small part in wider transaction decisions and investors cited the need for a clear and focussed regime.

**Question 5:** Are you able to provide evidence of any additional direct or indirect costs that may arise as a result of the pro-competition regime that we have not captured in this subsection?

### **Wider justice costs**

121. The IA appraisal assumes compliance with regulation (i.e. firms the DMU regulates will comply with the rules and orders it sets out), as per guidance. However, in some cases, involvement from the UK justice system may be required to enforce non-compliance; and this would incur time and resource costs for the courts.
122. There may also be appeals by SMS firms against measures the DMU decides to implement or merger decisions. These may also result in an additional cost to courts.
123. These costs will be explored further in a separate Justice Impact Test, prior to legislation being introduced.

### **Benefits**

124. The proposals for a new regulatory regime in digital markets are expected to result in a number of benefits to market participants and wider society. As outlined above, we have not tried to fully quantify benefits at this stage. The expected benefits are described in qualitative terms below, with illustrative quantitative examples provided where possible.

### **Direct benefits from specific regulatory measures**

125. Specific interventions of the regime (e.g. PCIs, code of conduct, and merger rules) are expected to directly benefit various parties (Note: some benefits may arise both directly from the regulator's intervention and indirectly from increased competition stemming from the regulator's interventions).
126. **Reduced costs to business users associated with unfair terms and conditions** - some measures within the pro-competition regime should directly prevent unfair terms and conditions or other exploitative behaviour by firms that can be costly for their business users. A reduction in costs to business users may in turn be passed through to end consumers in those businesses' respective markets.



For example, SMS firms can and do currently self-preference their own retail products.<sup>88</sup> Limiting the ability of incumbents to self-preference (e.g. through the code of conduct) would remove the costs to business users associated with this practice (e.g. loss of revenue).<sup>89</sup>

127. **Reduced harm to end users** - The code of conduct would also set out principles in an effort to reduce the harms experienced by end users as a direct result of the exercising of market power by SMS firms. The compliance of SMS firms with these principles, such as offering 'fair and reasonable terms', should directly improve end user outcomes and reduce the severity and frequency of harms experienced by end users.
128. **Increased choice (e.g. greater data control)** - The DMU may decide to implement measures that directly increase the choices available to consumers. For example, PCI measures that increase the control users have over collection and use of their data. This would increase consumer control and potentially reduce the 'data cost' paid by end users in order to access services. Similarly, an interoperability PCI might directly increase the number of viable alternative services available for consumers to choose from, or enable them to choose multiple simultaneously ('multi-home').

### Indirect benefits from specific regulatory measures

129. Specific interventions of the pro-competition regime (e.g. PCIs, code of conduct and mergers) are expected to indirectly benefit various parties. This means the actions of the DMU require a response from another party for the benefits to be realised.
130. **Increased economic activity from previously excluded firms** - Measures such as the code of conduct are expected to reduce the frequency and severity of *exclusionary* practices by incumbents. As well as reducing harms to direct competitors, this should lead to an increase in the number of firms operating within digital markets as well as increasing the output of existing firms. Providing this increases total output, rather than replacing existing output, we would expect economic activity to increase.

### Indirect benefits from increased competitive pressure

131. Several of the regime's powers and functions are expected to tackle the incumbency advantage of SMS firms, lower barriers to entry, and increase competition in and for the market. Under increased competitive pressure, it is expected that incumbents would be driven to change their behaviour to compete more intensely with rivals and new entrants. With their position in, and share of, the market under greater threat, incumbent firms would have greater incentive to improve their offering to consumers and not behave in a way that harms them. Hence, these competitive pressures would be expected to naturally drive the market towards better consumer outcomes.
132. As an example, a proportionate SMS merger regime would protect consumers and businesses by intervening against any anti-competitive purchasing behaviour of large firms (including by stopping them from removing their potential rivals before they develop). This would encourage increased competition in these markets and reduce their ability to entrench their market positions, resulting in lower prices, better quality products and services, higher levels of innovation and more choice for consumers. While it is difficult to assess what would have happened in the absence of a merger, the CMA estimates that there has been significant consumer benefit as a direct result of the merger control activities it undertakes. In the financial years 2017/18 and 2019/20, the estimated average annual consumer benefit of merger control is £387 million.<sup>90</sup>
133. Some of these expected improvements in consumer outcomes stemming from improved competitive conditions are detailed below:

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<sup>88</sup> US House Majority Report

<sup>89</sup> This assumes that end consumers would choose products sold by other business users absent self-preferencing by SMS firms. Research into the impact of increased transparency in search suggests that this is reasonable as high placement in search results increases the probability of a product being selected. Veltri, Folkvord, Theben, & Gaskell (2020). [The impact of online platform transparency of information on consumers' choices](#). Behavioural Public Policy, 1-28.

<sup>90</sup> [CMA Impact Assessment 2019-2020](#) (2020)

134. **Increased economic activity** - Economic theory suggests that total output is higher in more competitive markets.<sup>91</sup> Therefore, an erosion of barriers to entry, increasing competition in and for the market, should increase output to the benefit of businesses, end consumers, and the wider economy. As this increased output may come from foreign-owned digital competitors, this does not necessarily mean UK production (GDP) would increase, but UK consumption would.
135. **Increased choice** - Certain market characteristics and anti-competitive behaviour hinder entry and expansion from potential new competitors in digital markets. SMS firms also discontinue their own innovative product developments in favour of those they have acquired. Both of these would likely reduce consumer choice in the long term.<sup>92</sup> Interventions that erode barriers to entry, encourage expansion, and facilitate greater market entry may therefore lead to increases in the choice and variety of services available to consumers.<sup>93</sup>
136. **Increased quality** - New entrants may offer higher quality products, and/or incumbents may be driven to improve quality in order to retain market share.<sup>94</sup>
137. **Reduced prices** - New entrants and existing competitors might offer a lower priced but equally good service, possibly driving incumbents to also compete on price in order to retain their market share. Given the prevalence of services that are free at the point of consumption, reduced prices may be seen on the business user side of the market, and then passed through to end consumers in the prices of consumer goods.
138. **Reduced costs to business users associated with poor terms** - Business users of online platforms can be strongly dependent on one platform. IFF's Platform Business Survey found that 1 in 5 UK retailers using third party digital e-commerce platforms rely on one platform for the majority of their turnover. Around 1 in 3 respondents to the survey disagreed that they could easily switch to another platform if the terms and conditions on their main platform changed to their detriment.<sup>95</sup> In a more competitive market, with more viable alternatives to switch to, business users would be less willing to accept poor terms, or otherwise endure unfair treatment, meaning platforms would be incentivised to offer them better terms and treat them more fairly in order to retain market share.
139. **Improved control over data** - Currently, end users must typically exchange their personal data in order to access certain digital services. A more competitive market may result in more alternative services differentiating themselves from incumbents by lowering 'data costs' (i.e. requiring less data from end users or offering greater choice over how much data they provide). This may drive incumbent firms to reduce their own 'data costs' in order to retain their market share.<sup>96</sup>
140. **Increased investment** - A stronger regulatory environment may reduce the cost of doing business for smaller businesses, particularly those dependent on SMS firms (e.g. SME retailers on large digital platforms). A protected and certain regulatory environment, as well as more competitive markets, may lead to increased investment, both domestically and via inflows from abroad.

**Question 6:** Are you able to provide evidence of any additional direct or indirect benefits that may arise as a result of the proposed interventions that we have not captured in this subsection?

<sup>91</sup> CMA Regulation and Competition report (2020)

<sup>92</sup> CMA Market Study

<sup>93</sup> This assumes that new entrants will offer heterogeneous services.

<sup>94</sup> This impact assumes that firms will choose to compete on quality rather than, or in addition to, some other aspect of their offering (e.g. price).

<sup>95</sup> IFF Research, [Retailers' Experience of Using Digital Platforms Survey](#) conducted on behalf of BEIS. 2021.

<sup>96</sup> This impact assumes that end users are aware of the data they provide when using online services, would prefer to provide less data, and would be willing to switch to alternative platforms to do so if given the opportunity.

## Case Study: Potential Impacts in digital advertising markets

Digital advertising could be one of the digital markets impacted by the new pro-competition regime. The CMA Market Study, which presents evidence on digital advertising markets, helps to illustrate the types of expected costs and benefits of the regulation in a specific digital market.

**Total economic welfare vs consumer surplus:** As outlined above, some impacts in digital advertising markets are likely to be transfers from SMS firms (e.g. reduced profits) to consumers (e.g. lower prices). Given the direction of transfers, as per the objectives of the regime, we view the resulting increased consumer surplus as beneficial overall. It can also be argued that the current allocation in the market has given rise to a deadweight welfare loss. If the DMU's actions increase output and thus lead to a reduction in this deadweight loss, relative to the counterfactual, this would constitute a net gain in total welfare.

**Changes in advertising inventory - multidirectional impacts:** Like many other digital markets, digital advertising markets are multi-sided and complex, and the proposed interventions could have impacts on multiple sides of the markets.

Fewer ads for end users - Currently, incumbent firms are able to push a large volume of advertisements ('ads') to their end users given a lack of attractive alternatives. As a result of increased competition and threat of market entry, stemming from the DMU's activities, firms may feel under increased competitive pressure and decide to reduce ad load to attract or retain customers (a form of non-price competition). Decreased ad exposure would constitute an improved outcome for end users in these markets.<sup>97</sup>

Potential for increased advertising prices - On the other hand, a reduction in the supply of advertising inventory may lead to an increase in the purchasing price of the remaining advertising space. This cost would be borne by advertisers (i.e. businesses on the opposite side of the market to end users) in the first instance, and subsequently by end consumers through increased prices of consumer goods throughout the economy. As outlined in the 'Case for change' section above, the CMA cites empirical evidence that up to 100% of cost increases can be passed through to end consumers.<sup>98</sup>

Potential for decreased advertising prices - This price increase on the business-side of the market may be offset/outweighed if digital advertising providers respond to greater contestability by competing on price (i.e. offering lower prices to attract or retain advertisers). Just as cost increases are often passed through to end consumers, it can be assumed that in competitive markets, a reduction in costs to advertisers may be passed on to end consumers through a reduction in the prices of consumer goods.

Net impact - We cannot be sure which of these multidirectional impacts would prevail, as firms' behaviour is uncertain. However, we would expect the DMU's actions to encourage multi-homing and switching. For example, a PCI that would give competitors greater access to data held by SMS firms would enable competitors to offer a more similar quality of service (e.g. tailoring of advertising) that is more attractive to end users and therefore to advertisers. So, even if each firm were to reduce its ad load, with greater alternative services on which to advertise, we expect that the potential negative impact on the total supply of high-quality advertising inventory available to advertisers would not be large enough to result in a price increase across the market. Therefore, we expect the positive impacts arising from greater competitive pressure, such as reduced ad load (higher quality) and lower advertising prices, would likely prevail.

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<sup>97</sup> This assumes end consumers consider ad load when making consumption decisions, would switch to alternative services on the basis of ad load, and therefore that firms are likely to compete on this aspect. This is a reasonable assumption, since end consumers have both stated their preference for fewer ads, as '42% of online adults dislike all online advertising' (Ofcom Adults' Media Use & Attitudes Report, 2020), and revealed it by paying for ad-free experiences on platforms like Spotify and YouTube.

<sup>98</sup> See footnote 53 on cost pass through.

**Increased advertising revenue to the press sector (positive externality):** As mentioned above, the CMA market study suggests that digital intermediaries currently capture at least 35% of the value of advertising bought from newspapers and other content. The erosion of the incumbents' market power may alter the balance of bargaining power between parties. This may lead to the renegotiation of advertising revenue share, or may mean alternative intermediaries place greater competitive pressure on incumbents' prices. This would result in publishers receiving a greater share of advertising revenue for ads served to their users.

**Question 7:** Do you agree with our understanding of these potential multidirectional indirect impacts on digital advertising markets, and that the net direction of these impacts would likely lead to an improvement in consumer outcomes?

## Innovation impacts (indirect)

141. In general an increase in competition in and for (contestability) markets would be expected to increase innovation. As outlined in the 'Case for change' section above, there is some anecdotal evidence that innovation in many digital markets has been stifled due to a lack of competition, a lack of successful new market entry, and the anticompetitive conduct of incumbents. It is the CMA's expectation that increased innovation would be the greatest benefit of a new regulatory regime for these markets.
142. In general, an increase in the amount of innovation in digital markets relative to the counterfactual can be expected to increase consumer choice and the quality of products/services in the long-run, and subsequently lead to higher consumer welfare.<sup>99</sup> Given the interdependence of many other industries on digital platforms (e.g. retailers on digital marketplaces, advertisers from various sectors on digital advertising markets, app developers on app stores), the benefits of increased innovation might also spill over into adjacent markets.
143. However, as presented in the final report of The University of East Anglia Centre for Competition Policy's (UEA CCP) research, on behalf of BEIS, into competition and innovation in digital markets,<sup>100</sup> the relationship between competition and innovation in digital markets is not always as straightforward as has been empirically found in more traditional markets. Empirical evidence is relatively limited, and the impacts of pro-competitive regulation on innovation may depend on complex, market-specific factors.
144. Hence, while we expect the overall outcome of greater competition would be to boost innovation, there may be some countervailing risks to innovation as a result of the DMU's actions, which we outline in this dedicated subsection.
145. The institutional design of the DMU, and the pro-competition regime it will implement, would aim to guard against any negative impacts on innovation, and to evaluate the expected net impact on innovation when deciding on specific interventions. However, the multiple complex incentives at play, and limited evidence of the impacts these - mostly novel - pro-competition remedies would have on innovation in digital markets, mean unintended or unforeseen consequences are a potential risk.

## **Innovation Costs**

146. **Potential for reduced innovation by SMS firms (reduced profit incentive)** - Supernormal profits<sup>101</sup> can often be the reward for 'winning' a market, and can therefore be the motive for

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<sup>99</sup> This section predominantly refers to product innovations, resulting in new and higher quality products for consumers, rather than process innovations (innovations behind the scenes of a firm that increase productivity and thus may lead to lower prices). However, many of the impacts may also extend to process innovation.

<sup>100</sup> Deller, Doan, Mariuzzo, [Competition and innovation in digital markets](#). 2021. Report by University of East Anglia Centre for Competition Policy on behalf of BEIS. Henceforth 'UEA CCP Innovation research. 2021.'

<sup>101</sup> Profit of a firm over and above what provides its owners with a normal return to capital.

innovation.<sup>102</sup> Any regulatory activities that boost competition and so indirectly reduce the ability for SMS firms to earn supernormal profits in the next period, could risk reducing the incentive to innovate in the current period. For example, Google spent approximately 15% of its revenue on R&D in 2020. There is a risk that this may decrease if Google believes the reward for this R&D is lower as a result of increased competition (i.e. with a reduced profit incentive).<sup>103</sup>

147. **Potential for reduced innovation by new entrants ('damaged' incentives)** - The erosion of an SMS firm's supernormal profits, by virtue of an increase in competition, may also risk reducing innovation incentives for new entrants:

- While the probability of an entrant 'winning' the market may be higher in a more contestable market, the probability of the successful entrant itself then being deposed from that position is also higher, reducing the potential reward for innovative entry.<sup>104</sup> At a global level, foreign firms may be discouraged from expanding into UK markets as a result of the new regime. This may be significant as currently, the globalised nature of digital markets means that a significant number of firms, including many of the most powerful firms, are foreign.
- Incumbents in one market can often leverage their position to enter another. Sometimes, this type of market entry can provide a healthy disruptive force to other markets. If measures (e.g. PCIs) place constraints on this type of leveraging, or otherwise reduce the incentives for firms to disrupt other markets, this could negatively impact innovation.
- The prospect of being acquired by a dominant firm can encourage new entrants to invest in a given market. Firms may be discouraged to enter or grow if their perceived exit routes (e.g. being purchased by a large digital firm) is restricted by increased scrutiny and/or fear of CMA intervention. This may also limit access to sufficient funding to reach the scale needed to challenge the incumbents. In these situations, consumer choice, quality and consequently consumer welfare could be harmed.

148. **Potential for reduced innovation by SMS firms ('free rider' effect)** - Some measures might require SMS firms to provide competitors with access to resources they have developed or amassed through innovation. The SMS firm would be less able to exclusively appropriate the benefits of their own resource/innovation. As competitors would be able to benefit from it without investing ('free-ride'), the SMS firm may have a reduced incentive to further develop these resources in the future, or to develop new innovations at all.

149. For example, a PCI measure might mandate that an SMS firm open up Application Programming Interface (API) access to its service to allow other services to interoperate with it. If other services are able to interoperate with, and therefore benefit from, this feature without having to invest in developing it, the SMS firm may be less inclined to improve that feature.

150. We would not expect these potential countervailing effects on innovation outlined above to outweigh the benefits outlined below. The procedural safeguards built into the regime are expected to ensure the DMU weighs up all potential costs and benefits, including innovation effects, and intervene only where the overall benefits outweigh the costs.

## Innovation Benefits

151. **Increased innovation (competitive pressure on SMS firms)** - Literature suggests that incumbent firms in digital markets innovate less than they would under more competitive conditions. An erosion of their market power should result in greater competition within the market. This may be seen through increased innovation by SMS firms in order to retain their market share. For example, the UEA CCP's research showed that Google appeared to innovate more following Bing's introduction in 2009.<sup>105</sup>

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<sup>102</sup> UEA [CCP Innovation research](#). 2021.

<sup>103</sup> Ibid.

<sup>104</sup> Ibid.

<sup>105</sup> UEA [CCP Innovation research](#). 2021.

152. Increased scrutiny of mergers involving SMS firms could also lead to increased innovation by the SMS firms if it alters their business models and they invest more on 'in-house' innovation rather than undertaking 'reverse killer acquisitions'.<sup>106</sup> Without the ability to reduce competition and remove future rivals, we would expect the large digital firms to increase their R&D activities in order to ensure they further develop products and services to attract and retain customers and not fall behind. It is important to note though that there may be opportunity costs from R&D resource reallocation if the resources are diverted from other productive developments.

153. **Increased innovation (new entrants)** - Evidence suggests that the anti-competitive behaviour of incumbents stifles the potential for innovation by new entrants.<sup>107</sup> The presence of large digital firms in market segments has also been found to harm start-up formation and venture capital funding, creating investment 'kill zones'.<sup>108 109</sup> Additional evidence suggests that some M&A could be undertaken with the rationale of eliminating future innovative competitors, who may then be shut down.<sup>110</sup> Interventions that lower barriers to entry should allow for more successful entry and expansion by innovative competitors. The UEA CCP research cites evidence that the same quantity of R&D expenditure spread over many firms may deliver greater innovation outputs than if it was concentrated in a single large firm, holding all other factors constant.<sup>111</sup>

Specific interventions to directly tackle exclusionary behaviour may also increase successful entry and expansion, and consequently the level of innovation. For example, as outlined in the 'Case for change' section above, following the US Department of Justice filing an antitrust lawsuit against Google in relation to revenue sharing agreements it used to acquire default positions on Apple devices, Apple has announced intentions to develop its own innovation in the general search market.<sup>112</sup> Active merger control can also help to prevent excessive market power being gained by a small number of firms which could make the markets more attractive to investors of other smaller firms active in that market.

154. **'Better' innovation (disruptive or breakthrough not complementary or incremental)** - There is some evidence that the presence and actions of large powerful firms in concentrated markets can impact not only the level, but also the direction, of innovation. Innovation can be distorted as new entrants are encouraged to invest in incremental and/or complementary innovations, rather than competing head-to-head with powerful firms by introducing disruptive/breakthrough innovations.<sup>113 114</sup>

Historically, disruptive, breakthrough innovations have delivered the most noticeable improvements in end consumers' lives, and have sometimes transformed or created new markets. For example, breakthrough innovations in digital markets often disrupt existing traditional markets, such as the taxi and hotel markets,<sup>115</sup> while price comparison websites have returned benefits to consumers across markets.

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<sup>106</sup> 'Reverse killer acquisitions' describe acquisitions, with the intention of adopting the target firm's innovations. These are considered detrimental to competition as the acquirer 'kills' its own organic innovation in favour of absorbing a developed technology, depriving consumers of potential future competition between two innovative services.

<sup>107</sup> CMA Market Study into digital advertising markets.

<sup>108</sup> UEA [CCP Innovation research](#). 2021.

<sup>109</sup> Kamepalli, S. K., Rajan, R., & Zingales, L. (2020). Kill Zone. *NBER working paper 27146*.

<sup>110</sup> For example, Facebook has acquired and then shut down four other social networks, including Lightbox, a London-based photo sharing start-up. Tim Wu, Stuart A. Thompson. The New York Times (2019). [The roots of Big Tech run disturbingly deep](#).

<sup>111</sup> Cohen, W. Fifty Years of Empirical Studies of Innovative Activity and Performance. 2010. Via [UEA CCP Innovation research](#). 2021.

<sup>112</sup> Financial Times, [Apple develops alternative to Google Search](#). October 2020.

<sup>113</sup> UEA [CCP Innovation research](#). 2021.

<sup>114</sup> Incremental innovations differ from breakthrough innovations in their magnitude, with breakthrough innovations being more significant in size and so more impactful than a single incremental innovation.

Disruptive innovations differ from complementary (or 'sustaining') innovations in their impact on the value of surrounding products. A complementary innovation may sustain or increase the value of products already in the market, where a disruptive innovation may go so far as to render them obsolete.

<sup>115</sup> The Furman Review notes: 'companies such as Uber and Zipcar in transportation, Airbnb in hotel and

Therefore, an improvement in competition within digital markets may lead to an increase in disruptive/breakthrough innovations and, it could be argued, subsequently increase consumer welfare relative to a counterfactual in which the main source of innovation is incremental/complementary.

### Net impact on innovation

155. Overall, we expect the net impact on innovation to be positive. Whilst the impact on incentives is not clear cut, the overall improvement in contestability should lead both to increased new 'disruptive' innovative entry, and to increased pressure on incumbents to innovate. We do not expect any countervailing costs presented in this subsection (e.g. increase in appropriability damaging incentives) to outweigh these positive effects. Furthermore, it is expected that through the implementation of the pro-competition regime the potential countervailing impacts on innovation would be accounted for when considering interventions on a case-by-case basis, and so would mitigate this risk or avoid certain interventions altogether.

**Question 8:** Do you agree with the potential impacts to innovation outlined in this subsection? Are you able to provide evidence of any potential impacts to innovation that may arise from the DMU's activities?

**Question 9:** Do you agree the net impact on innovation of pro-competitive regulation in digital markets will likely be positive?

**Question 10:** Do you agree the net impact on innovation of the SMS merger regime will likely be positive?

**Question 11:** Do you disagree with any of the costs or benefits outlined throughout this 'Monetised and non-monetised costs and benefits' section? Can you provide evidence and calculations of costs and/or benefits we have not considered?

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## Options appraisal

156. The impacts described in the section above are expected to result from the implementation of a pro-competition regulatory regime. The impacts achieved, and the scale of these impacts, will vary by policy option. In this section we aim to evaluate the relative impacts we would expect under each policy option.

157. The preferred policy option is 'Option 3: A DMU with powers to implement a code of conduct and PCIs on SMS firms only'. This option is expected to deliver the greatest positive impact on competition and competitive outcomes, whilst remaining proportionate and targeted, as it gives the DMU sufficient powers and flexibility to react appropriately to competition concerns it has identified through its expert monitoring and knowledge. By providing the greatest likelihood of achieving the overarching objective of intervention (and of meeting the indicators of success for the regime outlined in Annex B), including by delivering the greatest range and magnitude of expected benefits relative to costs, this option represents the best value for money option. Hence, it is the preferred option.

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hospitality, and Deliveroo and UberEats in takeaway food delivery, are just a few examples of firms that have each used digital technology to innovate within areas of existing service provision.'

[Unlocking Digital competition, Report of the Digital Competition Expert Panel](#) ('The Furman Review'), March 2019.

158. The detailed appraisal of policy options against indicators of success for policy objectives can be found in Annex C.
159. The tables below attempt to link the impacts described in the preceding sections to the regulatory activities/components included in the policy options. While it is expected many of the impacts would stem from a general increase in competition and contestability as a result of the regime as a whole, it may be possible to isolate certain impacts as more directly resulting from certain activities, or components, of the regime. It should be noted that this is an approximate, high-level exercise, as it can be difficult to ascribe specific impacts to specific activities given the dependence on market and firm specifics.
160. Where an impact is a result of multiple components, it is possible that a different magnitude of cost or benefit arises from one component than the other. To reflect this, the below tables include colour RAG ratings to demonstrate the relative extent to which code of conduct, PCIs, and the merger regime each may lead to respective impacts. Again, this colour rating is an approximate exercise intended to illustrate that certain activities are more likely to lead to a more significant specific impact.

**Table 6a: Origin of expected impacts**

	code of conduct	PCIs	Merger regime
<b>Direct costs</b>			
Direct costs of DMU operations	✓	✓	✓
Compliance and legal costs by SMS firms	✓	✓	✓
Familiarisation costs to digital market firms	✓	✓	✓
<b>Indirect costs</b>			
Reduced profits for SMS firms (transfer to consumers)	✓	✓	✓
Investment chilling	✓	✓	✓
<b>Wider justice costs</b>			
CAT and wider justice costs from sanctions and appeals	✓	✓	✓
<b>Indirect benefits from increased competitive pressure</b>			
Increased economic activity	✓	✓	✓
Increased choice	✓	✓	✓
Increased quality	✓	✓	✓
Reduced prices	✓	✓	✓
Reduced costs to business users associated with poor terms	✓	✓	✓
Improved control over data	✓	✓	✓
Increased investment	✓	✓	✓
<b>Direct benefits from specific regulatory measures</b>			
Increased choice (e.g. greater data control)	✓	✓	✓
Reduced costs to business users associated with poor terms	✓		
Reduced harm to end consumers	✓		
<b>Indirect benefits from specific regulatory measures</b>			
Increased economic activity from previously excluded firms	✓		

**Table 6b: Origin of expected innovation impacts**

	code of conduct	PCIs	Mergers
<b>Costs</b>			
Potential for reduced innovation by SMS firms - reduced profit incentive	✓	✓	



Potential for reduced innovation by new entrants - 'damaged' incentives	✓	✓	✓
Potential for reduced innovation by SMS firms - 'free-rider' effect		✓	
<b>Benefits</b>			
Increased innovation - competitive pressure on SMS firms	✓	✓	✓
Increased innovation - new entrants	✓	✓	✓
'Better' innovation - disruptive or breakthrough not complementary or incremental	✓	✓	✓

**Table 6c: Origin of expected advertising impacts (case study)**

	code of conduct	PCIs	Mergers
<b>Benefits</b>			
Changes in advertising inventory - multidirectional impacts	✓	✓	✓
Increased advertising revenue to press sector	✓	✓	

RAG key:

<div style="display: flex; flex-direction: column; gap: 5px;"> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: #d62728; margin-right: 5px;"></div> <p>Activity could incur a high magnitude of respective cost</p> </div> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: #f08080; margin-right: 5px;"></div> <p>Activity could incur a reasonably high magnitude of respective cost</p> </div> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: #fbb4ae; margin-right: 5px;"></div> <p>Activity could incur a <b>relatively</b> low magnitude of respective cost</p> </div> </div>	<div style="display: flex; flex-direction: column; gap: 5px;"> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: #2ca02c; margin-right: 5px;"></div> <p>Activity could deliver a high magnitude of expected benefit</p> </div> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: #c7e9c0; margin-right: 5px;"></div> <p>Activity could deliver a reasonably high magnitude of expected benefit</p> </div> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: #e0f2f1; margin-right: 5px;"></div> <p>Activity could deliver a <b>relatively</b> low magnitude of expected benefit</p> </div> </div>
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*(Note: RAG does not reflect the likelihood of an expected impact occurring, but rather gives an indication of the relative role each activity (code of conduct, PCIs, or the Mergers regime) would likely play in the magnitude of the impact if it were to occur.*

### Option 0: Do Nothing (No new action)

161. This option includes the continuation of the regulation currently in place: the enforcement of existing competition law, similar use of existing CMA regulatory tools (including market studies and market investigations), and the recent changes to platform to business regulation.<sup>116</sup> In addition, it includes the non-statutory DMU, recently set up within the CMA.

162. This option is not appropriate. As we have outlined throughout this document, there is an issue with substantial and entrenched market power within and across digital markets, which results in persistent consumer harms and sub-optimal outcomes. Intervention is needed to correct these issues and ensure that conditions do not worsen.

### Option 1: Alternatives to regulation

Two example alternatives to regulation are considered:

- Self-regulation: Government could leave it to firms in digital markets to collaborate on self-regulation, for instance to develop rules or a code of conduct to help reduce consumer harm.

<sup>116</sup> The Online Intermediation Services for Business Users (Enforcement) Regulations, 2020

- Information and education: The government could engage in campaigns to improve consumer awareness of the value and uses of their personal data. This could help end consumers to make more informed decisions when selecting which firms to engage with, and on which terms, and to choose services with a lower 'data cost' more often.

Costs	<p>These approaches may require some cost-incurring activity from firms within digital markets. Costs to firms would likely be related to the time required to coordinate and make any changes they deem necessary.</p> <p>The scale of these costs is very much dependent on the exact non-regulatory approach and the subsequent scale of the changes to firms' operations. Regardless, any of the example non-regulatory approaches outlined would still likely make this the cheapest option, relative to the counterfactual.</p>
Benefits	<p>The scale of benefits brought about are expected to be limited. The large market power enjoyed by large firms means that any attempt to rebalance market power absent an enforcement mechanism is unlikely to return much of an impact, especially relative to regulatory options.</p> <p>Alternatives to regulation are not appropriate in this specific instance, as they do not align with the identified objectives as closely as other options.</p>

## Option 2: A DMU with power to implement a code of conduct on SMS firms only

Costs	<p>Direct costs of the pro-competition regime:</p> <ul style="list-style-type: none"> <li>• This option would include all of the costs associated with the initial implementation of the DMU, market monitoring, SMS designation, and designing, monitoring, and enforcing the code of conduct. This would include salary costs and the cost of recruiting staff.</li> <li>• This option would be the cheapest of the regulatory options, given the lowest FTE requirement.<sup>117</sup></li> <li>• For this policy option, we estimate a range of costs between £4m and £20m per annum. This is based on informed assumptions around the FTE required to deliver market monitoring, SMS designations, and codes of conduct.<sup>118</sup></li> <li>• These cost estimates should be considered as indicative only. They are not related to previous spending decisions, and are not intended to anticipate or inform future government decisions on funding.</li> </ul> <p>Compliance and familiarisation costs:</p> <ul style="list-style-type: none"> <li>• Our indicative estimate for compliance costs is £625k per SMS firm per year.</li> <li>• Our indicative estimate for familiarisation costs is £425k across all SMS firms in the first year of the regime.</li> </ul>
Benefits	<p>The code of conduct would reduce the occurrence and severity of consumer harms in digital markets. Therefore, benefits would be related to the remedying of harms being experienced by end consumers and businesses.</p> <p>The inclusion of just the code of conduct within the pro-competition toolkit would predominantly deliver the benefits detailed under the 'Direct and indirect benefits from specific regulatory measures' heading of the 'Monetised and non-monetised costs and benefits' section. There would also be some improvement in the overall competitive</p>

<sup>117</sup> FTE = Full Time Equivalent. An FTE requirement describes the number of 'full time' employees the body would require to carry out its specified activities.

<sup>118</sup> All figures in this section should be considered indicative only, and are conservative (i.e. wide) ranges based on costs incurred by the CMA for roughly comparable work.

	conditions in the market, and so some further benefits resulting from increased competitive pressure may also be seen, but these would not be significant. This assessment is outlined in more detail in Tables 6a-c above
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**Option 3: A DMU with powers to implement a code of conduct and PCIs on SMS firms only (Preferred option)**

<p>Costs</p>	<p>Direct costs of DMU operation:</p> <ul style="list-style-type: none"> <li>• In addition to the costs outlined in Option 2, this option would include the incremental impact of adding PCIs to the DMU's toolkit. The additional cost would mostly comprise the additional staff needed to work on PCIs.</li> <li>• For this policy option, we estimate a range of costs between £5m and £25m per annum. This is based on informed assumptions around the additional FTE required to implement PCIs.</li> <li>• These estimates should be considered as indicative only. These are not related to previous spending decisions, and are not intended to anticipate or inform future government decisions on funding.</li> </ul> <p>Compliance and familiarisation costs:</p> <ul style="list-style-type: none"> <li>• Our indicative estimate for compliance costs is £1.25m per SMS firm per year.</li> <li>• Our indicative estimate for familiarisation costs is £850k across all SMS firms in the first year of the regime.</li> <li>• The addition of PCIs to the DMU would increase compliance and familiarisation costs for firms as more time would be needed to fully understand the implications of the measures that may be imposed and how business activities would need to be changed in order to align with these, and to implement these changes.</li> <li>• The compliance costs associated with PCIs would likely be much greater than that associated solely with the code of conduct as measures would be more significant and aim to have longer term, transformational impacts on the structure of the market in which firms operate, and firms may be required to make large structural changes to their business models.</li> </ul>
<p>Benefits</p>	<p>The addition of PCIs would target the sources of market power within markets. This would have a long-term impact on the competitive conditions in the market, introducing competitive pressures that lead to improved consumer outcomes.</p> <p>It is estimated that Option 3 would have a <i>much</i> greater scale of benefits. The inclusion of the code <i>and PCIs</i> allows for all expected impacts to be achieved (as fully outlined in Tables 6a-c above), with the greatest long-term impact on the rebalancing of market power.</p> <p>As well as the inclusion of all the tools necessary to achieve the dual objective of addressing both the sources of market power and the economic harms that result from the exercise of this power, this option also keeps the regime proportionate and targeted by only focussing on firms whose combination of strategic position and market power has the greatest negative impacts on markets that are prone to tipping. As outlined above, these particular markets would not likely see any rebalancing of market power absent intervention to regulate these firms.</p>

**Case Study: Open Banking**

As can be seen in Tables 6a-c above, we expect PCIs to deliver the greatest scale of benefits. This expectation is based, in part, on the successful example of Open Banking as a demonstration of the potential scale of benefits PCI-style measures can achieve.

Open Banking is a UK scheme that allows the consented sharing of customer data from certain bank accounts with authorised third-party providers. These providers then use this data to provide innovative services for the consumer or business, such as automatic switching and account management. It unlocks competition by reducing a key barrier to entry for challenger firms: access to customers' data and transaction history held by incumbents.<sup>119</sup>

The Open Banking Implementation Entity estimates the potential annual benefit from Open Banking at £12bn for consumers, and £6bn for SMEs users.<sup>120</sup> Following the success of this UK scheme, it is now being copied globally. This demonstrates the scale of benefits that just one type of PCI-style intervention, such as the 'consumer led data mobility' example that the Digital Markets Taskforce suggested, could potentially achieve in digital markets.

*Source: Consumer Priorities for Open Banking, Open Banking Implementation Entity.<sup>121</sup>*

#### **Option 4: A pro-competition regime with powers to implement a code of conduct, PCIs and a Merger regime on SMS firms only**

Costs	<p>Direct costs of the pro-competition regime:</p> <ul style="list-style-type: none"> <li>● In addition to the costs outlined in Option 3, this option would include the incremental impact of adding a merger regime to the pro-competition regime's toolkit. The additional cost would mostly comprise the additional staff needed to work on overseeing the merger regime.</li> <li>● For this policy option, we estimate a range of costs between £7.5m and £38m per annum. This is based on informed assumptions around the additional FTE required to implement the mergers regime.</li> <li>● These estimates should be considered as indicative only. These are not related to previous, and are not intended to anticipate or inform future, government decisions on funding.</li> </ul> <p>Compliance and familiarisation costs:</p> <ul style="list-style-type: none"> <li>● Our indicative estimate for compliance costs is £1.38m per SMS firm per year.</li> <li>● Our indicative estimate for familiarisation costs is £930k across all SMS firms in the first year of the regime.</li> <li>● The addition of a mergers regime to the DMU would increase compliance and familiarisation costs for firms. More time would be needed to fully understand the implications of the measures.</li> <li>● The regime would require SMS firms to inform the CMA of any proposed merger activity and notify a subset of these transactions. Firms may also decide to take steps to prepare for any judgements made by the CMA and seek external legal advice.</li> </ul> <p>Where transactions would fall under the current merger regime, some or all of these costs would already be incurred. Under the new regime there may be certain efficiencies (e.g. a clearer jurisdictional test) that could result in a lower level of resource required. We would seek to estimate the additional cost to SMS firms due to a new regime, above the level of costs that they would have likely incurred under the current regime.</p> <p>The extent of the direct costs to business would also vary by the complexity of the cases themselves and the detail of the final policy design, specifically the reporting requirements, the clarity and nature of the UK nexus test and the transaction value notification threshold.</p> <ul style="list-style-type: none"> <li>● While the reporting requirements are envisaged to be light touch to capture the essential transaction details only, if the reporting remit is expanded, the business costs would also increase.</li> </ul>
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<sup>119</sup> [Power to the People: Independent report on competition policy](#) ('The Penrose Review'), p.31. February 2021.

<sup>120</sup> [Next steps for Smart Data](#), September 2020.

<sup>121</sup> Open Banking Implementation Entity, [Consumer Priorities for Open Banking](#)

- If the UK nexus test is not clear, businesses could incur additional costs to assess whether or not they would fall within the scope of the regime, or may notify mergers out of caution that do not need to be reviewed.
- The higher the transaction value threshold is set the fewer transactions would come under the scope of review. Increased costs from bringing more transactions into scope of review would need to be balanced against the increased ability to protect consumers from potential harm. Indicatively, if the transaction threshold was set at £100m or £200m we could expect that around 50% or 70% of transactions by large digital firms could be excluded from the expanded jurisdiction. (See Table 7 below).
- If mandatory merger reviews were taken forward, there would be additional costs for submitting mergers for review and to comply through the review period.

**Table 7 - Indicative analysis of the potential coverage of transaction value thresholds, based on transactions by Google, Apple, Facebook, Amazon and Microsoft between 2016 and 2020.**

Deal Values	Percentage of transactions within each value bucket		
	All	All, excluding non-disclosed	Cumulative total, excluding non disclosed
£0m-£50m	13%	22%	22%
£50m-£100m	14%	24%	46%
£100m-£150m	7%	13%	58%
£150m-£200m	6%	10%	69%
£200m-£250m	3%	5%	73%
£250m-£300m	1%	2%	75%
£300m-£350m	2%	3%	78%
£350m-£400m	0%	1%	79%
£400m-£450m	1%	2%	80%
£450m-£500m	1%	1%	82%
>£500m	11%	18%	100%
Not disclosed	42%	-	-

Source: BEIS analysis of Merger Market data. Based on 296 transactions identified between 2016 and 202, 123 of which did not have a disclosed value. This analysis is intended to provide an indicative assessment only of the potential scope of the transaction value thresholds. This analysis should not be regarded as complete. This is due to the partial data analysed (42% of transactions had an undisclosed value) and the final coverage would depend on the particular firms that are designated with SMS.

**Benefits**

As well as the benefits outlined under policy 3, the addition of the mergers regime would go further to limit the ability of SMS firms to behave anti-competitively to the detriment of consumers through acquiring potential competitors.

Through the proposed reporting requirements of the SMS merger regime the CMA would

	<p>at an earlier stage become aware of the key information<sup>122</sup> about the transactions made by SMS firms. Many of the deals are only publicised following completion, at this stage integration is likely to have already occurred. If these transactions are later found to be anticompetitive, harm to consumers could have already occurred and could result in complexities and additional costs to unwind. This may likely result in consumer benefits through more effective mitigation of harmful integration and reduce the associated costs of the merger investigation for both businesses and the CMA.</p> <p>Furthermore, under the current merger system, significant resources and time are used in establishing whether the CMA has jurisdiction to investigate certain cases, particularly those where the target business does not meet the UK turnover test. This burden falls on both the CMA and the merging firms, as well as third parties in some cases. A clear-cut jurisdictional test, for SMS transactions, based on a transaction value threshold (combined with a requirement for a UK nexus) would provide legal certainty for both the CMA and the merging firms. This could result in a reduction in the resources needed to assess each merger due to the clearer jurisdictional boundaries. These resources can instead be used to assess the substance of the case. The merging parties would also have increased certainty over the merger review process of their transactions and clarity as to when they would need to engage with the CMA.</p>
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This is not considered the 'preferred' option at this stage as a detailed policy position for the dedicated mergers regime is not yet as developed as other proposals. However, the government is supportive of its inclusion within the pro-competition regime. Hence, we do not wish to formally 'reject' this option at this stage.

**Option 5: A DMU with powers to implement a code of conduct and PCIs on all firms in digital markets**

<b>Costs</b>	<p>Direct costs of DMU operation:</p> <ul style="list-style-type: none"> <li>• This would include all of the costs outlined in Option 3.</li> <li>• Under this option, regulations would apply to a greater number of firms than just SMS firms. While it is not expected that the entire regulated population would come into scope, it is likely that the DMU would implement at least some measures on more than just 5 firms. We expect this widening of scope would vastly increase costs, with a greater number of staff needed to oversee codes of conduct, PCIs, and monitoring of more firms, making this the most expensive option by some way.</li> </ul> <p>Compliance and familiarisation costs:</p> <ul style="list-style-type: none"> <li>• Our indicative estimate for compliance costs is £1.25m per firm per year.</li> <li>• Our indicative estimate for familiarisation costs is £1.27m across all firms in the first year of the regime.</li> <li>• Given the significant widening of the scope of the DMU, the total cost to business in terms of compliance and familiarisation, would be scaled up significantly.</li> </ul>
<b>Benefits</b>	<p>As with option 3, the inclusion of both the code of conduct and PCIs would mean that all expected benefits of a pro-competition regime can be achieved.</p> <p>With this extended scope, the scale of benefits <i>could</i> be expected to be larger, by capturing additional firms in digital markets. However, it is expected that the issues experienced within digital markets are mainly related to the most powerful firms, whose substantial and entrenched market power has the greatest impact due to their strategic position. Therefore,</p>

<sup>122</sup> Such as the target's name, the purchase price, whether the transaction is notifiable under the mandatory thresholds and the proposed date of completion.

the marginal benefit derived from capturing additional firms beyond this is likely diminishing.

Furthermore, the additional regulatory burden a wider scope would impose on non-SMS firms may actually limit their ability to compete and so to take advantage of improved competitive conditions resulting from regulation - this might therefore reduce the scale of potential benefits resulting from the DMU's interventions.

**Question 12:** Do you agree with the appraisal of costs and benefits of options considered in this section? Can you provide evidence (e.g. calculations) to support your views?

## Demonstration of the scale of potential benefits

163. The Competition and Markets Authority's (CMA) Market Study into Digital Advertising estimated that there was consumer detriment of around £2.4bn in 2018 as a result of excess profits (profits well above what is required to reward investors with a fair return).<sup>123</sup> If even a small percentage of this detriment is remedied, there would be a significant benefit to consumers.
164. When you further take into account that this figure represents the excess profits of just two firms in one digital market in one year, and that a reduction in the cost of advertising is just one of many expected benefits of the proposed pro-competition measures in this one market, it is easy to see that the potential scale of benefits could be highly significant.
165. Given even a high-end consideration of the likely annual costs of operating the DMU, this value of detriment would be approximately 100 times larger than the overall cost of the regime. Hence, the high potential value for money is clear. For example, using the upper bound of the illustrative range for the direct operational cost under the preferred option (Option 3), and the indicative estimates for compliance and familiarisation costs to businesses (total around £32m), the DMU would have to remedy just 1.3% of this detriment figure to break even.<sup>124</sup>
166. The CMA also estimates that its activities have returned a Benefit Cost Ratio (BCR) of 14.6 from financial years 2017/18 to 2019/20, when taking into account only direct benefits.<sup>125</sup> As the DMU will be located within the CMA, it is reasonable to assume that it will aim to achieve similar value for money. It may take some time to start returning significant benefits, but the BCR of the DMU should be expected to be in line with the rest of the CMA, over the course of the appraisal period.<sup>126</sup>

**Question 13:** Do you agree with the assumptions used to provide an indication of the potential scale of benefits the DMU and new pro-competition regime could deliver?

<sup>123</sup> The CMA compared estimates for the return on capital employed (ROCE) – actual profitability – with weighted average cost of capital (WACC) for Facebook and Google. The analysis using the most cautious set of assumptions suggested that, in the UK, Google earned £1.7 billion more profit in 2018 than the benchmark level of profits. For Facebook, the comparable figure for 2018 was £650 million.

CMA, [Online platforms and digital advertising market study](#), July 2019.

<sup>124</sup> Although a transfer from SMS firms to end consumers via business users would be NPV neutral, as discussed above we consider this to be a net benefit for consumer welfare (as per the objectives of the regime)

<sup>125</sup> [CMA impact assessment 2019/20](#)

<sup>126</sup> Estimates of the scale of indirect benefits arising across a sample of four CMA Competition Act 1998 cases find indirect benefits to further exceed direct benefits, with indirect benefit to direct benefit ratios ranging from 3 to 21. [CMA Evaluation of CA98 cases - A DotEcon report](#). (May 2018).

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## Direct costs and benefits to business

167. There are a number of expected direct costs and benefits to business from this proposal. Most benefits are expected to be indirect, however there are some benefits resulting from direct changes to firms' operations through the code of conduct and PCIs.
168. There are no quantified direct costs or benefits to business estimated at this stage of the analysis. Any figures in the preceding section are illustrative only. We aim to develop and refine our assumptions, and subsequent quantified estimates, through the consultation process.
169. Decisions on the funding model for the DMU are still to be taken, and are being consulted on. Possible models include Exchequer funding, or full/partial levy funding, in line with government guidance on Managing Public Money. We will model impacts of such funding models in the final impact assessment if taken forwards.<sup>127</sup>
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## Risks and assumptions

170. There are a number of risks associated with the proposals in this document that mean interventions and their subsequent impacts may not materialise as we expect. The table below outlines some of these potential risks, the likelihood of them occurring, and the impact on the efficacy or sustainability of proposals if they were to occur.

**Question 14:** Do you agree with the risks presented in the below risk register table, and the ratings assigned to their potential impact, likelihood, and therefore overall severity?

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<sup>127</sup> Exchequer funding: the DMU's work would be directly funded through the CMA's departmental budget. At present the non-statutory DMU, established in April 2021, is funded in this way;  
Full or partial levy funding: covering the DMU's running costs through fees, charges, or a levy so that the DMU is cost neutral to the public sector. This could fund the full range of the DMU's activities or could be supplemented by Exchequer funding. Further work would be done to determine who should pay this levy.



**Table 8 - Risk register**

Risk	Description	Impact	Likelihood	Severity
Market power is significant	Market power is so significant that the DMU's tools prove ineffective in improving competitive conditions in digital markets.	High - If the instruments used by the DMU are not effective in eroding market power and improving competition, it will not be able to meet its objectives.	Medium - The DMU would have significant knowledge of and expertise in digital markets. Under the preferred option, it would have an extensive toolkit to enable proportionate and targeted interventions to address even the most severe issues identified. However, there is still potential that certain tools will not have the desired effect in some markets.	High
DMU will not use powers effectively	There is a risk that the newly established DMU will not appropriately and effectively implement the tools at their disposal.	High - If the DMU does not use the powers granted to them appropriately then improvements to the competitive conditions in digital markets would be reduced.	Low - The government has worked with the CMA to develop the proposed pro-competition regime for the DMU. Therefore, there is agreement on the need for these measures to be implemented	Medium
Incorrect scope (mis-designation of SMS)	Related to the above, the DMU may not designate SMS appropriately, such that they capture too many or too few firms. This could mean targeting firms who are not contributing considerably to negative competitive outcomes/harm in their respective digital markets, or failing to target firms responsible for a significant amount of harm.	Medium - Extending the scope of interventions beyond the most powerful firms responsible for the majority of harms/ negative outcomes, risks unduly increasing the burden on businesses. The additional costs associated with a broader scope would likely outweigh the marginal benefits. A scope that is too narrow risks not targeting all of the firms whose market power must be tackled to rebalance competition and address harms, such that the DMU fails to meet its objectives.	Low - The DMU would have significant knowledge of and expertise in digital markets. The SMS designation process would ensure assessments could be made in the round, rather than relying on 'bright line' rules/metrics, thus reducing the risk of firms inadvertently falling into or out of scope. Criteria such as 'strategic position', in addition to considerations of substantial and entrenched market power, will ensure only the most significant firms with the greatest impact on respective markets are targeted.	Low
Compliance and Familiarisation	There is a risk that compliance and familiarisation will be a greater burden to SMS firms than estimated within this analysis.	Low - The relatively low indicative estimates within this document are benchmarked against estimates for comparable measures.	Medium - The estimates in this IA are indicative only and do not form part of a value for money assessment. The true costs may differ from these estimates. These costs can be informed further by responses to the consultation, and reflected in the Final IA.	Low

SMS firm compliance	There is a risk that SMS firms may choose to not comply with new regulations, and either accept any potential resulting penalties/sanctions, or they evade enforcement action because of the difficulties of enforcing a UK judgment overseas, in an attempt to maintain their position of power.	Medium - If SMS firms do not comply with DMU measures, the expected impact on digital markets would be stalled. However, in the long term (dependent to some extent on international co-operation to enable the enforcement of UK judgments overseas, or on the use of alternative enforcement mechanisms such as senior manager liability) it is expected that courts could enforce compliance, and continuous fines could erode market power over time	Low - SMS firms may see the potential fines for non-compliance as a risk/cost of doing business and continue operating unchanged in order to protect their market power, or may rely on the difficulties in enforcing UK judgments overseas to avoid penalties. However, the potential for significant penalties, and the consideration of further measures, alongside the desire for these firms to retain their reputation as 'responsible, good actors', should be sufficient to incentivise compliance even from firms with substantial market power.	Medium
International regulatory divergence (see 'potential trade implications section' below for further detail)	Convergence across the regulatory landscape would help to enforce fair principles and promote competition in global digital markets. However, if this convergence does not occur, there may be negative impacts associated with the UK being the first mover (short-term), or the only mover (long-term) in this space.	High - Many large digital firms invest significantly in R&D, <sup>128</sup> and are responsible for employing a large number of people in the UK. If international regulatory divergence led them to reduce their investment in the UK (e.g. relocate existing operations, or reconsider expanding their service into the UK), this could have a negative impact on digital markets and the UK economy more generally. This may occur either due to the increased burden associated with regulatory fragmentation, or as firms believe they can in some way avoid regulation by diverting resources from one jurisdiction to another to avoid the burden of regulation.	Low - A number of countries across the globe have stated their intention to implement a pro-competition regulatory regime for digital markets, including the EU and Australia. While the US has not announced plans for a similar regime, recent reports, and the increased frequency of antitrust cases against the largest digital firms suggest a similar sentiment. Therefore, there is unlikely to be significant international regulatory divergence in the long-term. Furthermore, regulation of the SMS firm's service would apply regardless of its physical operations in the country (providing it continues to make its service available in the UK), suggesting a low likelihood of SMS firms diverting resources in response to greater regulation in the UK than other jurisdictions.	Medium
Withdrawal of services/ functionality in the UK (see 'potential trade	SMS firms may respond to new and/or increased regulation by offering different services or reduced functionality to UK consumers. See for example, the dispute between Facebook and the Australian ACCC	High - If functionality was reduced by some of the most popular digital services, the result would be a degraded experience for the millions of UK consumers who can typically use many of these services on a	Low - We believe the likelihood of this occurring is relatively low, given the open, transparent, and participative approach the DMU will take to regulation, including consultation with affected parties. In the aforementioned Australia-Facebook example, engagement between senior Australian	Low

<sup>128</sup> PwC [2018 Global Innovation 1000](#) data on companies with the highest spending on research and development in 2018. Via The Furman Review, p. 20.

implications section' below for further detail)	regarding payments to news publishers, where Facebook temporarily blocked Australian users from sharing or viewing news content on its platform.	daily basis. <sup>129</sup> Thus whilst trying to improve a service, or the choice of services, for UK consumers, the regulator might inadvertently actually deprive them of it altogether.	officials and Facebook executives led to the situation being resolved and news content being restored for Australian Facebook users. <sup>130</sup>	
Reduced value of platforms to consumers	As mentioned above, a number of digital markets can be prone to 'network effects', meaning that the value of a platform to users on both sides of the market is increased as the number of users increases. If an increase in competition leads to greater switching away from certain platforms, this may result in a reduction in the number of users of those platforms. The result could be a reduction of utility for the end and business users left on the now relatively worsened platform (i.e. users who did not switch).	Low - From an overall economic perspective, consumers will switch to a new platform if they feel that they can derive a greater level of utility from doing so. This should <i>somewhat</i> offset any potential negative impacts on the utility of consumers 'left behind' on the original platform. In addition, PCIs such as interoperability should allow for platforms to work well together and therefore reduce the impact of network effects currently experienced under the counterfactual.	Low - If an increase in competition results in consumers switching away from incumbents, the presence of network effects could mean that the value remaining consumers derive from these platforms would be diminished. This could be mitigated by further interventions that erode the impact of network effects more generally. In addition, it is likely that many users will multi-home rather than switch consumption entirely away from (i.e stop using) the original platform.	Low
Potential reduced SMS firm efficiency	If the DMU decides to implement separation measures (e.g. operational or data separation) on an SMS firm through PCIs, there is a risk that this may negatively impact the efficiency of these firms. Large firms are often able to benefit from low average costs as a result of low marginal costs and large volumes of output within (economies of scale) and across (economies of scope)	Low - As well as potentially leading to productive inefficiency, if such measures increased costs and the firm passed these on to end or business users through higher prices, this could also lead to worse outcomes for consumers. However, the overall impact of this would be low since, providing it is afforded the power to, the DMU would only be able to implement such measures if it can show that the expected benefits will outweigh any costs (e.g. from	Low - This potential impact assumes the DMU will be able to enact separation measures as part of its PCI toolkit, and may choose to actually implement these measures. As they constitute significant interventions in the market, these measures would likely be an uncommon 'last resort' in the event competition could not be sufficiently improved through less severe measures.	Low

<sup>129</sup> For example, social media and messaging sites reach 98% of the UK adult digital population. In 2019, on average, UK visitors aged 18+ spent 49 minutes per person per day on social media sites. They also spend 12 minutes per day on news sites, and 14 minutes on e-commerce sites.

Comscore MMX Multi-Platform, Sep 2019 (Nov 2019 for social media). Via Ofcom, [Online Nation report](#) (2020).

<sup>130</sup> BBC News, [Facebook reverses ban on news pages in Australia](#). February 2021.

	markets. Any measure that looks to separate or silo activities of a firm might reduce the ability of firms to benefit from these scale efficiencies.	reduced efficiency).		
Additional costs of 'multi-homing'	In response to the proposed measures, consumers may decide to 'multi-home', meaning they will consume more than one service within a market (e.g. using both Facebook and Twitter). This may cause consumers to experience an increased total cost (e.g. higher 'data cost' as they are now sharing their data with more than one party).	Low - A significant number of services are free at the point of consumption, meaning there would be no financial implications. Furthermore, any additional 'data cost' of multi-homing should be somewhat offset by the additional benefit consumers would receive from multi-homing.	Medium - Multi-homing is a welcome outcome of the proposed measures as it has been well-established that more viable alternative services for consumers would represent a desired increase in competition within digital markets.	Low
Regulatory Failure	DMU interventions may result in a worse allocation of resources than in the counterfactual.	High - The aim of the DMU is to rebalance market power and remedy consumer harms. If the DMU intervenes in markets and gets it wrong, harms could be exacerbated, and consumer outcomes made worse than before.	Low - The DMU would have significant knowledge of digital markets, and safeguards in place to ensure that interventions are proportionate, effective, and minimise the risk of unintended consequences. Certain interventions (e.g. complex and significant PCIs) would carry a higher risk of unintended consequences.	Medium
<i>Example 1 Regulatory failure:  Unintended impacts in adjacent markets</i>	<i>Interventions on SMS firms in one market may have anti-competitive impacts in other markets.</i>	<i>Medium - digital markets can be strongly interrelated with dependent, more traditional markets. If the DMU fails to recognise potential unintended consequences associated with this, such as hindering an SMS firm providing healthy competition in an otherwise concentrated adjacent market, the negative impacts on markets outside of the DMU's remit could be significant.</i>	<i>Low - The DMU would have significant knowledge of digital markets, and safeguards in place to protect against the risk of unintended consequences. It is also expected that a consideration would be given to SMS firms' roles in adjacent, related markets.</i>	<i>Low</i>
<i>Example 2 Regulatory failure:</i>	<i>Certain interventions aimed at boosting competition in digital markets, may risk having undesired impacts on innovation (e.g. by</i>	<i>Medium - Any unintended negative impact on innovation resulting from a specific intervention would be expected to be counteracted, to some extent, by the general increase in competition resulting from the</i>	<i>Medium - As presented in the UEA CCP report, evidence on the relationship between competition and innovation in digital markets is relatively weak, and it can be difficult to properly assess the potential innovation impacts of competition policy</i>	<i>Medium</i>

<i>Unintended dampening of innovation</i>	<i>negatively impacting the incentives to innovate).</i>	<i>intervention and the pro-innovation effects this would naturally bring.</i>	<i>until after the fact. As such, the regulator will have to make decisions based on weak evidence and under uncertainty, hence raising the risk of unintended negative consequences.</i>	
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## Impact on small and micro businesses (SaMBA)

171. Given the targeted scope of the regulatory regime in the preferred option, all the direct costs to business arising from this policy option would be borne by SMS firms. The criteria for designating a firm with SMS would, by design, exclusively capture only the largest, most powerful firms with a strategic position in the market. Therefore, there is no risk of small and micro businesses coming into scope of direct regulatory measures in this option.
172. While it may still be in the interest of non-SMS firms to be familiar with the regulatory regime (which would require employees to take time to read about regulatory changes and reflect on how this may affect the firm), there is no requirement for this, as they would be clearly out of scope of potential regulations under the preferred option.
173. Any foreseen impacts on small and micro-businesses are indirect if the preferred option is taken forward, by virtue of them operating in digital markets in which SMS firms also operate, or otherwise interacting with (e.g. doing business with) SMS firms. These indirect impacts are expected to be mostly benefits. For example, they would likely benefit from: reduced harm resulting from exclusionary or exploitative practices by SMS firms, reduced costs (e.g. of advertising or selling on digital platforms), improved data privacy, increased choice, and increased quality (these benefits are explored further in the 'Monetised and non-monetised costs and benefits' section above).
174. None of the policy objectives would be sacrificed by applying a full exemption to small and micro businesses, and no proportion of the overall cost to business is expected to fall on them.

**Question 15:** Do you agree that small and micro businesses would incur no direct costs as a result of the DMU's new pro-competitive regulation of SMS firms? Are you able to provide specific evidence of any indirect costs that may fall on small and micro businesses, which we have not considered?

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## Public Sector Equality Duty Assessment

175. The Department is required to comply with the public-sector equality duty (PSED) set out in the Equality Act 2010 ("the Act"). The PSED requires the Minister to have due regard to the need to advance equality of opportunity, hinder discrimination and foster good relations between those with and without certain protected characteristics. This due regard is taken to eliminate unlawful discrimination and to tackle prejudice and promote understanding. The characteristics that are protected by the Act are: age, disability, gender reassignment, marriage or civil partnership (in employment only), pregnancy and maternity, race, religion or belief, sex and sexual orientation.<sup>131</sup>
176. The powers given to the DMU under the preferred option to intervene in digital markets would impact businesses directly, rather than consumers. Large businesses designated with SMS are within the direct scope of the regulation, and there should be no indirect consequences for those with specific protected characteristics through this. However, consumers would benefit indirectly from the outcomes of this regulation. In turn, those who use digital markets more will benefit the most from a reduction in harm and improved consumer outcomes. For example, data from the Office for National Statistics (ONS) on digital exclusion in the UK shows that males, 16-24 year-olds, non-disabled people, and those of Chinese ethnicity are the highest users of digital services.<sup>132</sup> Therefore it could be argued that these groups may see the greatest benefits from DMU interventions that improve outcomes in these markets. However, aside from this ONS data, there is a lack of available evidence to reliably support this assessment at this stage. We intend to gather further evidence through consultation to produce a more developed PSED in the final IA.

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<sup>131</sup> HM Government, [Discrimination: your rights](#).

<sup>132</sup> ONS, [Exploring the UK's digital divide](#), 2019.

177. The actions of the DMU have the opportunity to interact with the three key aims of the PSED<sup>133</sup>. Although consumers with specific protected characteristics are not directly in scope of the DMU's activities, improved competition in markets as a result of pro-competitive interventions may open the market up to previously excluded groups. For example, internet non-use is higher for those aged 75+, as well as those with a disability.<sup>134</sup> Previously excluded groups such as these may indirectly benefit from the DMU's regulation.

178. The matters considered in this Impact Assessment do not raise any issues relevant to the public sector equality duty under section 149(1) Equality Act 2010 because the policy does not discriminate or unjustly favour any person or group of people based on their protected characteristics.

**Question 16:** Do you agree with the assumptions that the policies considered in this IA do not raise any issues relevant to the public sector equality duty? Are you able to provide any evidence to support or oppose this conclusion?

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## Wider impacts

179. A movement towards more competitive digital markets may result in benefits to wider society and the economy, in addition to digital market participants.

### *Positive externalities (spillovers)*

180. Given the interdependence of many traditional markets with digital markets, improvements in competitive conditions in digital markets can be expected to have spillover benefits into adjacent markets. For example, in its market study, the CMA proposed that greater competition in digital advertising markets would be expected to improve the quality and accuracy of journalism, and see a decline in the prevalence of so-called 'fake news'. Other markets might similarly benefit from higher quality content or new innovations spilling over from digital markets, bringing benefits to consumers in these markets and the economy more widely.

### *Case Study: Positive externalities from sustainment of journalism*

The increase in revenue to news publishers would likely improve the sustainability of high-quality journalism, from which a number of positive social and economic externalities emerge:

- UK research recently found that for every percentage point growth in a local daily newspaper's circulation, electoral turnout in its area goes up by 0.37 percentage points.<sup>135</sup>
- Journalism plays a key 'watchdog' function in deterring and detecting misconduct at all levels of public office - a comprehensive US review found that public-interest news generated "hundreds of dollars in benefits to society" for each dollar spent on producing the journalism, through resultant policy changes and the elimination of waste and corruption.<sup>136</sup>
- High-quality, trusted journalism is important in countering the prevalence of low-quality news and misinformation (so called 'fake news') which poses risks to the integrity of democracy.<sup>137</sup>

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<sup>133</sup> The 3 key aims are: to eliminate unlawful discrimination, harassment and victimisation and other conduct prohibited by the Act, to advance equality of opportunity between people who share a protected characteristic and those who do not, and to foster good relations between people who share a protected characteristic and those who do not.

<sup>134</sup> ONS, [Exploring the UK's digital divide](#), 2019.

<sup>135</sup> Plum Consulting, [Research into recent dynamics of the press sector in the UK and globally](#), October 2020.

<sup>136</sup> Hamilton, James (2016) *Democracy's Detectives: The Economics of Investigative Journalism*, Cambridge, MA: Harvard University Press.

<sup>137</sup> [The Cairncross Review: a sustainable future for journalism](#). February 2019.

### *Positive impacts on economic growth*

181. There is credible empirical evidence supporting a positive correlation between an increase in competition and a long-run increase in economic growth. The CMA cites studies that demonstrate with data from 154 countries between 1960 and 2005 that competition law has a positive effect on the level of GDP per capita and economic growth after ten years. The empirical evidence also shows that increasing funding on competition policy by one standard deviation would be expected to increase economic growth by 0.84%.<sup>138</sup>
182. It is widely accepted that competition policy interventions generate productivity improvements, and thus contribute to long-term economic growth. The CMA State of Competition Report 2020 sets out that competition drives productivity growth in three main ways: by acting as a disciplining device, placing pressure on the managers of firms to become more efficient; via reallocation, by ensuring more productive firms increase their market share; and by driving firms to innovate, coming up with new products and processes which can lead to step-changes in efficiency.<sup>139</sup>

### *Positive impacts on wages*

183. The International Monetary Fund (IMF) presents evidence that firms with substantial and entrenched market power, also have labour market power. This means, although they may pay higher wages than other firms, they pay less than others with respect to workers' marginal productivity - which tends to be higher in larger, more productive firms.<sup>140</sup> This is an inefficient outcome, as, even where these wages are still ostensibly very high and above those of competitors, employees are being paid less than their labour is worth.
184. Assuming this finding currently holds in digital markets, it follows that DMU actions that erode this market power in digital product markets, and subsequently reduce labour market power, could improve this relative to the counterfactual.

**Question 17:** Do you agree with the potential wider, non-market impacts presented in this section? Are you able to provide evidence of any additional wider impacts that may result from the DMU's activities?

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## Potential trade implications

185. The impacts in this section are not specific to any one policy option, but instead focus on the trade and investment impacts arising from a new pro-competition regime that successfully improves competitive conditions in digital markets and provides a certain and transparent regulatory environment. We also consider the risks associated with international regulatory fragmentation. The potential trade impacts in this section have been agreed with analysts at the Department for International Trade.
186. Regardless of policy option, the DMU will be required to comply with any international obligations which have been agreed to in the UK's FTA programme. The DMU will not breach non-discrimination clauses which the UK is bound to under the WTO.

### *Better protected and more competitive digital markets*

187. A new pro-competition regime would create a stronger regulatory environment in which both competitors in digital markets, and business users of them (e.g. online retailers or advertisers), are

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<sup>138</sup> Clougherty (2010) via CMA, [Productivity and competition: a summary of the evidence](#), p21. (2015)

<sup>139</sup> CMA, [State of UK competition report 2020](#). November 2020.

<sup>140</sup> IMF, [Rising Corporate Market Power: Emerging Policy Issues](#). March 2021.



better protected from harm relative to the counterfactual. These businesses should face lower costs associated with exploitative or exclusionary behaviours.

188. If successful in achieving its objectives, a new pro-competition regime should also reduce market concentration, foster more dynamic competition, and improve the ability for new entrants to successfully contest these lucrative digital markets.
189. In turn, we would expect a more competitive and protected business environment to encourage more foreign companies to establish operations in the UK, and to do business/trade in UK digital markets. The result should be an increase in foreign direct investment and trade, all else remaining equal.
190. There is a risk that any increased trade or investment from new sources may actually replace existing flows from the SMS firms in these markets, or otherwise be offset by disinvestment from these SMS firms in response to increased regulation of their activities, such that the net impact on trade and investment is not as clear cut.
191. However, it should be noted that regulations would apply to SMS firms regardless of their physical operations in the UK, providing there is an effect on UK consumers. Hence the risk may be less about disinvestment by foreign-owned SMS firms, and more about the SMS firms offering different services or reduced functionality to UK consumers in response to regulation. See for example, the dispute between Facebook and the Australian ACCC regarding payments to news publishers, where Facebook temporarily blocked Australian users from sharing or viewing news content on its platform.<sup>141</sup> We believe the likelihood of this occurring is relatively low, given the open, transparent, and participative approach the DMU will take to regulation, including consultation with affected parties.

#### *A certain and transparent regulatory environment*

192. A transparent and participative approach to regulation is expected to be at the core of the DMU's actions. This should contribute to a certain regulatory environment in which all market participants are clear on what is expected of them and can have their views heard. Relative to the counterfactual, and particularly in the short-term where a similar degree of regulatory certainty may not exist in other jurisdictions, this could make the UK a more attractive destination for foreign firms (both SMS and non-SMS) to trade and invest in.

#### *Regulatory convergence vs divergence*

193. As introduced in the Background section of this IA, there is significant international momentum towards digital markets reform. As such, many countries are seeking to develop their own policy and regulatory approaches to digital competition, including antitrust initiatives in the US and the Digital Markets Act in the EU.<sup>142</sup>
194. While these countries are establishing novel policy and regulatory approaches pertaining to digital firms, if the UK choose the Do Nothing option and takes 'no new action' (i.e. implements no *new* regulatory changes but continues with existing pro-competition policy/tools, as under Policy Option 0: counterfactual) or otherwise implements regulatory changes that significantly diverge from new approaches in other jurisdictions, there is a risk that this could lead to international regulatory fragmentation.<sup>143</sup> This could be problematic given the global nature of digital markets and the multinational firms that operate within them.
195. Regulatory fragmentation could lead to greater trade friction, as firms operating in multiple jurisdictions would face the higher burden of having to comply with differing regulatory standards and

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<sup>141</sup> Sky News, [Why has Facebook blocked news in Australia and what does it mean for the rest of the world?](#), 2021.

<sup>142</sup> Other national efforts to tackle digital competition include: the establishment of the Headquarters for Digital Market Competition in Japan; recent German competition legislation; and a new digital unit being set up in the French competition authority.

<sup>143</sup> Regulatory fragmentation refers to disparities in the implementation of regulation, and regulatory reform initiatives, by individual jurisdictions, which typically raise the regulatory burden (cost) faced by firms.

systems. This could also in turn exacerbate the issue of weak competition (high concentration) in digital markets, since regulatory fragmentation, and the higher regulatory burdens it brings, typically favours large incumbents over smaller companies and potential entrants. This is because larger companies are better equipped and resourced to manage the additional regulatory burden.

196. Overall, if this fragmentation were to arise, it could make the UK a less attractive place for foreign (e.g. EU or US-based) companies (both potential rivals of SMS firms, and potential business users of them) to establish operations, offer their digital services, or do business, leading to decreased foreign direct investment in, and trade with, the UK.
197. In the converse of the above scenario, introducing a new pro-competitive regime that closely aligns with proposed developments internationally (e.g. in the US and EU) could yield greater regulatory convergence (though the extent of this may be dependent on international engagement and the appropriate coordination mechanisms being in place).<sup>144</sup> Greater regulatory convergence would minimise the costs to business associated with fragmentation, and subsequent potential negative impacts on trade and investment, outlined above.
198. The UK is arguably further ahead in establishing a new pro-competitive regime for digital markets than the EU through their Digital Markets Act and the US through their potential antitrust reforms.
- In the short term this could lead to higher trade friction for digital firms operating in the UK and other jurisdictions due to greater regulatory fragmentation. However, this could also result in increased investment in the UK tech sector due to greater regulatory certainty in the UK than in other jurisdictions.
  - In the longer term, as global policy reforms take shape, and through international engagement and coordination efforts, there may be greater convergence across the international regulatory landscape. If this does occur, trade frictions would reduce as companies are more easily able to comply with similar regulations across different jurisdictions.<sup>145</sup>

**Question 18:** Do you agree with the potential impacts on trade and foreign direct investment outlined in this section? Can you provide evidence on whether/how the impact on trade and investment might differ by policy option (e.g. the inclusion or exclusion of PCIs or SMS merger rules)?

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## Monitoring and Evaluation

199. The Digital Markets Unit would be responsible for monitoring and enforcing compliance with the proposed measures. The DMU will be required to report on compliance, as well as overall effectiveness of the DMU with respect to its policy objectives.
200. With regards to evaluating the impacts of the proposed measures, the government will propose a post-implementation review for approximately 2 to 3 years after legislation comes into force. Post-

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<sup>144</sup> We believe international regulatory convergence in the long-term is a reasonable assumption. This is not only as there is expected to be a degree of international engagement and coordination (e.g. already ongoing G7 work), as regulators understand the competition issues in global digital markets extend to jurisdictions around the world, but also given the similarity in conclusions of reports and proposals internationally. For example:

- The US House Judiciary Subcommittee on Antitrust's Investigation of Competition in Digital Markets report proposed a series of measures (similar to examples of PCI measures suggested by the Digital Markets Taskforce in the UK), including interoperability and open access to revive antitrust enforcement and restore competition.
- The EU's proposal for the Digital Markets Act includes a list of obligations, akin to PCI-style remedies and code of conduct principles, for firms designated as 'gatekeepers' to abide by. This includes obligations for interoperability, data openness and the prevention of exploitative practices.
- The Draft Act on Digitalisation of German Competition by the Ministry of Economics and Energy has enhanced the Bundeskartellamt's powers to impose interim measures and introduce a code of conduct.

<sup>145</sup> See footnote 144 on regulatory convergence.

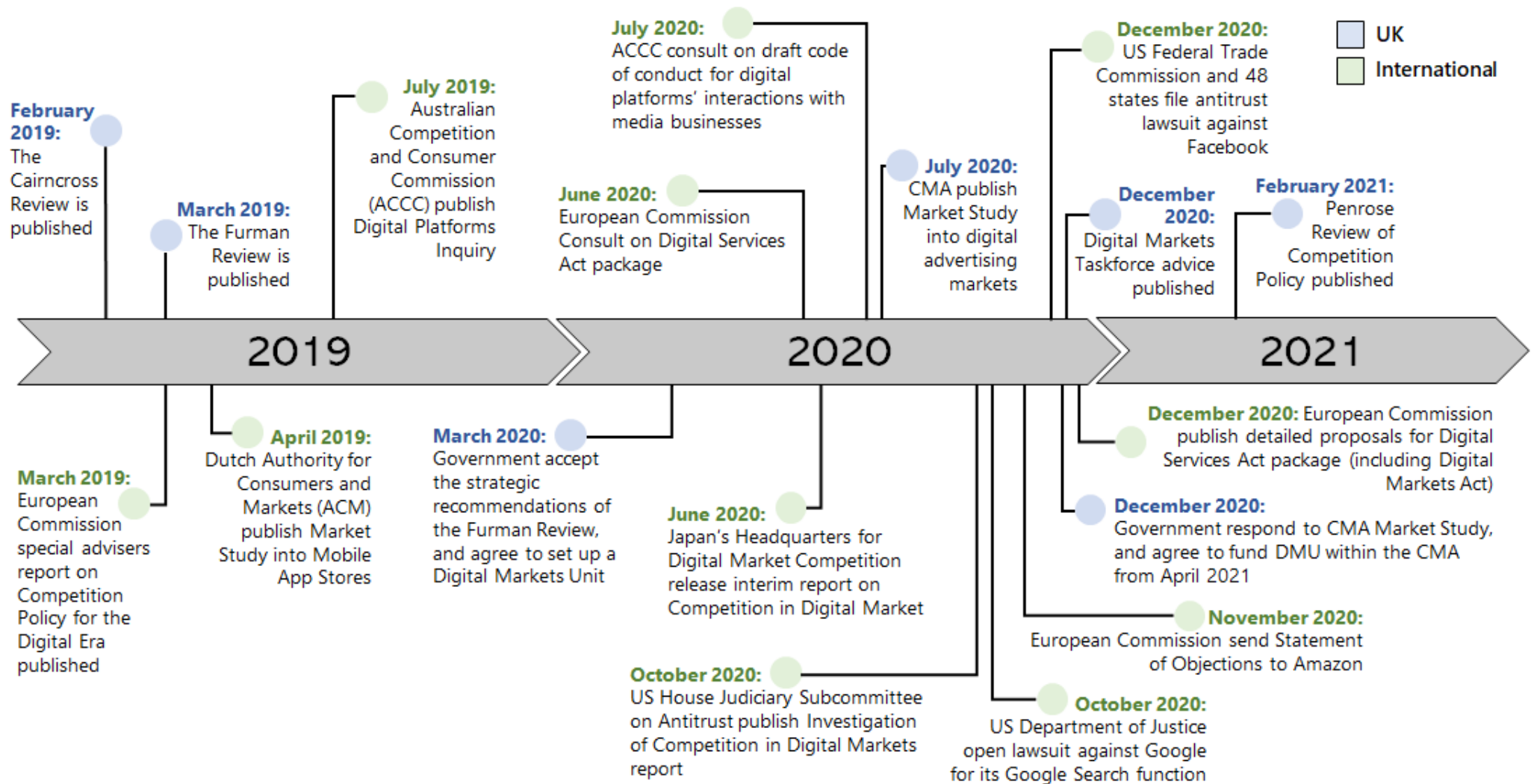
implementation review will provide an opportunity to examine the emerging effects of the DMU and associated measures and any unintended consequences arising from its actions, as well as the DMU's place in the wider digital regulatory landscape. This review will include a full impact evaluation of the DMU's activities, alongside appraising DMU performance against success factors. Monitoring activity, as part of the report requirements set out above, will be used to develop counterfactual evidence in order to undertake a robust impact evaluation. Evaluation activities will also include quantitative and qualitative research into business and household impacts arising from the DMU's activity, including stakeholder engagement.

201. In addition to the monitoring of the DMU, the CMA regularly completes an Impact Assessment on the consumer benefits achieved through their activity. As a part of the CMA, the DMU should be within the scope of this assessment, and its performance should be assessed and reported on.
202. The DMU should form part of the CMA's annual reporting to parliament.
203. More detailed proposals for monitoring and evaluation of the DMU, and pro-competition regime it will oversee, will be included in the final-stage Impact Assessment. This will likely include a strategy for appraising its success against the policy objectives and appropriate thresholds/metrics for the indicators of success summarised in Annex B. This may also include additional proposals for monitoring and evaluation than is typical in a post-implementation review, such as an additional ongoing role for the regulator and/or government.

**Question 19:** Can you suggest appropriate metrics against which to evaluate the success of the DMU and pro-competition regime, particularly in relation to the indicators of success in Annex B?

**Question 20:** Is there any baseline evidence either the non-statutory DMU or the government should look to gather at this stage to aid with monitoring and evaluation in the future?

## Annex A: Timeline of recent international momentum towards digital markets reform



## Annex B: Table of identified policy objectives

Outcome / Impact	Indicators of success
Greater understanding of competition and consumer issues in digital markets; and of activities by firms with SMS	Regime is able to perform expert monitoring, and deliver up-to-date trend reporting and market intelligence on digital markets.
More timely identification of competition issues and harmful behaviour	Competition issues and harmful behaviours are identified prior to consumers experiencing significant prolonged harms.
More timely interventions in digital markets where competition issues exist	Interventions in digital markets occur swiftly after harms are identified, and before negative market outcomes are irreversible.
Implement effective remedies to improve market outcomes	Specific and targeted interventions lead to marked and measurable improvements in market outcomes without unintended consequences.
Greater agility to react to evolving markets, including changes in market dynamics, business model innovation and technological advances	The effectiveness of interventions is reviewed and interventions are subject to revision in light of changes to market conditions.
An effective organisation that provides good value for money	The DMU's activities have a greater positive impact on businesses and end consumers than the cost associated with operation (net positive welfare impact).
An organisation that is coherent with the wider regulatory landscape both domestically and internationally	The regime minimises regulatory burden on businesses in the long term, where possible.
Increased growth in digital and adjacent markets	Increased number of users, providers and overall GVA growth in digital markets and markets reliant on digital platforms.
Greater dynamic competition in digital markets, including increased entry	Increased number of new entrants in digital markets, and greater rivalry for market share (e.g. higher 'churn' in market positions).
Increased innovation in digital markets	For example: Increases in R&D expenditure by incumbent firms, increased rate of change in product offerings in digital markets, greater number of successful and disruptive new entrants.
Lower prices for end and business users of digital markets, and for consumers in the economy more widely via 'pass through'.	Decreases in price and non-price costs for digital market users, which are also passed through as lower consumer prices in industries reliant on digital markets.
Greater choice of digital products and services	Increase in number and variety of product offerings available to consumers.
Improved quality of digital products and services	Improved quality of services/features in digital markets leading to increases in consumer satisfaction.

## Annex C: Assessing policy options against objectives

Outcome / Impact	Option 1	Option 2	Option 3	Option 4	Option 5
Greater understanding of competition and consumer issues in digital markets and SMS digital activities	Firms will have a good or better knowledge of the markets they operate in and their issues.	Market monitoring undertaken by the specialist DMU is expected to promote understanding of issues within and across digital markets.			
More timely identification of competition issues and harmful behaviour	Firms would be aware of the arising issues and behaviours within their own market, but might not deem certain behaviours harmful or anticompetitive.	Market monitoring undertaken by the expert DMU, with dedicated resources, is expected to allow more timely identification of issues within and across digital markets.			
More timely interventions in digital markets where competition issues exist	Measures that require government actions (e.g. information provision) would likely take time to get approval and implement.	The DMU would be able to swiftly intervene in markets when they identify issues.			
Implement effective remedies to improve market outcomes	Non-regulatory options would not likely change the market structure, and/or lead firms to change behaviours, sufficiently to achieve policy objectives (i.e. increased competition and improved consumer outcomes).	The code of conduct would drive certain behaviour changes to remedy consumer harms, but would not significantly impact the structure of, or long-term dynamic competition in, the market.	The addition of PCIs would target the sources of market power, resulting in more transformational impacts on the structure of the market and long-term competition.	The addition of a merger regime would further reduce anti-competitive behaviour by SMS firms, and bring about more competitive outcomes.	Regulating all firms would increase the burden on smaller firms and may limit their ability to take advantage of any improvements to competitive conditions.
Greater agility to react to evolving markets, including changes in	The government would not be able to review firm-led measures (self-regulation)	The DMU will be able to react quickly to changes and update	The DMU would be able to intervene in markets when they observe issues using the most appropriate and effective tool, or combination of tools (code and/or PCIs). The design of the PCI process will give		

market dynamics, business model innovation and technological advances	And information provision would take time to review and amend.	the code of conduct.	the DMU flexibility to review and amend remedies.		
An effective organisation that provides good value for money	Whilst the cost of non-regulatory approaches would be relatively low, they may not lead to significant benefits (e.g. improved competition/ less consumer harms).	The code of conduct would target consumer harms that occur as a result of firm behaviour.	The addition of PCIs will target the sources of market power, resulting in long term impacts.	The addition of a merger regime could be fairly costly relative to the other components considered, but would pro-actively reduce anti-competitive behaviour and bring about more competitive outcomes.	An extended scope would significantly increase the cost of the DMU, whilst only marginally increasing or perhaps even diminishing the potential efficacy of its interventions.
An organisation that is coherent with the wider regulatory landscape both domestically and internationally	Countries across the globe are announcing regulatory responses to competition issues associated with digital markets. If the UK adopted a non-regulatory approach there would be some divergence / fragmentation.	The pro-competition regime is in line with proposals from other countries.	The inclusion of PCIs is in line with other proposals, including the EU's Digital Markets Act	Wider merger powers are being called for and implemented internationally, including in the US, the European Commission and by additional national European competition authorities.	The regime is in line with proposals from other countries. However, these are mainly focussed on powerful firms only (e.g. 'gatekeepers' in the EU DMA).

Increased growth in digital and adjacent markets	Changes under a non-regulatory option are uncertain and may not lead to greater competition or growth.	The code of conduct would target harms resulting from firm behaviour, including exclusionary practices. This may attract more consumers and businesses to digital markets.	The addition of PCIs will target the sources of market power. This should reduce barriers to entry and expansion and thus increase economic activity.	The addition of a merger regime will further the ability for innovative entrants to expand within markets.	Regulating all firms would increase the burden on smaller firms and may limit their ability to take advantage of any improvements to competitive conditions.
Greater dynamic competition in digital markets, including increased entry		The code of conduct would not target long term competition issues.	The addition of PCIs would enable erosion of barriers to entry.	The addition of a merger regime may reduce the number of firms entering markets using an 'entry for buyout' strategy. However, 'killer' and 'reverse killer' acquisitions are less likely to occur.	
Increased innovation in digital markets	It is unlikely that many changes would be made under a non-regulatory option, and therefore innovation would likely remain relatively unchanged.	The code of conduct would not deliver long term structural changes to the market. Therefore, it is unlikely to introduce significant competitive pressure on incumbents or enable significant new innovative entry.	The addition of PCIs will improve long term, dynamic competition. Increasing the incentive for incumbents to innovate to retain market share, and enabling greater new innovative entry.	The addition of a merger regime will increase the incentive for more innovative 'disruptive' entrants. The incentive to create innovations 'complementary' to SMS firms is reduced as firms are less able to utilise an 'entry for buyout' strategy	
Lower prices for household and business users of digital markets, and for consumers in the	Some firms may not have the incentive to reduce their own supernormal profits so changes could be limited.	The code of conduct would not target long term competition issues. Therefore it is	The addition of PCIs will target long term competition. This may result in	The addition of a merger regime will further reduce anti-competitive	



economy more widely via 'pass through'.		unlikely to put significant downward pressure on the prices charged by firms.	downward pressure on prices as firms compete to retain market share.	behaviour, and increase competition. This may result in downward pressure on prices as firms compete to retain market share.	
Greater choice of digital products and services	Changes under a non-regulatory option are uncertain, improvements in choice could be limited relative to the counterfactual.	The code of conduct would target consumer harms that occur as a result of firm behaviour, such as the active restriction of consumer choice (e.g. defaults).	The addition of PCIs will target long term competition. This should encourage greater market entry and increase the range of services on offer.	The addition of a merger regime will increase the number of firms within markets, and therefore the range of services on offer	
Improved quality of digital products and services	Changes under a non-regulatory option are uncertain, improvements in quality could be limited relative to the counterfactual.	The code of conduct would target consumer harms that occur as a result of firm behaviour, such as the active degradation of service quality (e.g. API restrictions).	The addition of PCIs will target long term competition. This may result in pressure on the quality of services in order for firms to retain their market share.	The addition of a merger regime will further reduce anti-competitive behaviour, and increase competition. This may result in pressure on the quality of services in order for firms to retain their market share.	

## Annex D: Summary of questions

**Question 1:** Do you agree with the assumptions used to give an indication of compliance costs, including potential legal costs? Are you able to provide evidence on the expected costs associated with complying with the new pro-competition regime?

**Question 2:** Are you able to provide evidence on potential compliance costs that may be specifically associated with PCI measures?

**Question 3:** Are you able to provide evidence and information on the potential compliance costs that may arise as a result of the SMS merger measures?

**Question 4:** Do you agree with the assumptions used to give an indication of familiarisation costs, including potential legal costs? Are you able to provide evidence on these costs (e.g. information on staff required for the familiarisation process), and how they may differ by policy option?

**Question 5:** Are you able to provide evidence of any additional direct or indirect costs that may arise as a result of the pro-competition regime that we have not captured in this subsection?

**Question 6:** Are you able to provide evidence of any additional direct or indirect benefits that may arise as a result of the proposed interventions that we have not captured in this subsection?

**Question 7:** Do you agree with our understanding of these potential multidirectional indirect impacts on digital advertising markets, and that the net direction of these impacts would likely lead to an improvement in consumer outcomes?

**Question 8:** Do you agree with the potential impacts to innovation outlined in this subsection? Are you able to provide evidence of any potential impacts to innovation that may arise from the DMU's activities?

**Question 9:** Do you agree the net impact on innovation of pro-competitive regulation in digital markets will likely be positive?

**Question 10:** Do you agree the net impact on innovation of the SMS merger regime will likely be positive?

**Question 11:** Do you disagree with any of the costs or benefits outlined throughout this 'Monetised and non-monetised costs and benefits' section? Can you provide evidence and calculations of costs and/or benefits we have not considered?

**Question 12:** Do you agree with the appraisal of costs and benefits of options considered in this section? Can you provide evidence (e.g. calculations) to support your views?

**Question 13:** Do you agree with the assumptions used to provide an indication of the potential scale of benefits the DMU and new pro-competition regime could deliver?

**Question 14:** Do you agree with the risks presented in the below risk register table, and the ratings assigned to their potential impact, likelihood, and therefore overall severity?

**Question 15:** Do you agree that small and micro businesses would incur no direct costs as a result of the DMU's new pro-competitive regulation of SMS firms? Are you able to provide specific evidence of any indirect costs that may fall on small and micro businesses, which we have not considered?

**Question 16:** Do you agree with the assumptions that the policies considered in this IA do not raise any issues relevant to the public sector equality duty? Are you able to provide any evidence to support or oppose this conclusion?

**Question 17:** Do you agree with the potential wider, non-market impacts presented in this section? Are you able to provide evidence of any additional wider impacts that may result from the DMU's activities?

**Question 18:** Do you agree with the potential impacts on trade and foreign direct investment outlined in this section? Can you provide evidence on whether/how the impact on trade and investment might differ by policy option (e.g. the inclusion or exclusion of PCIs or SMS merger rules)?

**Question 19:** Can you suggest appropriate metrics against which to evaluate the success of the DMU and pro-competition regime, particularly in relation to the indicators of success in Annex B?

**Question 20:** Is there any baseline evidence either the non-statutory DMU or the government should look to gather at this stage to aid with monitoring and evaluation in the future?