Roaring Twenties or Digital Depression?: Unintended Consequences of Antitrust Activism on the U.S. Small Business Economy

Policy Analysis

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Welcome To the New Roaring Twenties

The COVID-19 pandemic accelerated digital transformation for businesses both large and small. What would have taken years took mere months. This was especially true of the millions of small and medium-sized businesses (SMBs) that make up America's "Main Street economy." According to one study that explicitly looked at U.S. SMBs, the broad majority of them adopted new digital tools during the pandemic, and those that used many more tools ("Advanced" SMBs) saw significantly better revenue outcomes than those that didn't, and they also retained customers better, found new customers easier, and hired more people.

Digitally advanced businesses now emerging from the pandemic are well-positioned to continue innovating, deploying new products and services, and growing the economy. Digital platforms, services, and apps ("digital tools") have, in effect, become the default operating system for the U.S. economy. And similar to how the Roaring Twenties of the 1920s was a dynamic period that saw broad economic prosperity, technological marvels (household appliances, telephones, radio, cars, traffic lights), and societal and cultural change (music, dance, film, architecture), the U.S. is now poised for another "Roaring Twenties" of the 2020s rooted in seamless communication and collaboration, marketing and advertising, e-commerce, and data analytics. Further, so-called "emerging" or "exponential" technologies such as artificial intelligence (AI), machine learning (ML), additive manufacturing, and biotechnology will complement earlier innovations and power products and services still on the drawing board.

The future is already here - and it is bright.

Heightened Regulation of U.S. Tech Giants

Most digital tools are envisioned, developed, and made available by private industry - typically a healthy mix of new startups backed by investors, large technology companies (informally, those with roughly a $200M to $2B private valuation/public market capitalization), and by tech giants such as Google, Apple, Facebook, Amazon, and Microsoft ("GAFAM"). Each of the members of the latter group has a dominant market position and makes leading products used by millions of businesses and people around the world across many categories. Part of the value of using digital tools offered by GAFAM, especially to SMBs with limited time and staff to devote to technological issues, is that services are integrated in a way that simplifies logins and accounts, facilitates data sharing, and other benefits - think Gmail with Google Docs (to get convenient alerts on document edits in your email), or Google Translate with Google Ads (to easily write ads in various languages), to name but two of many examples.

While technology is arguably the leading sector of both American and global innovation, there are clear signals from governments that regulatory risk related to antitrust and M&A has been elevated from where it was just a short time ago, with regulators and legislators at an inflection point with regard to GAFAM and their slightly smaller brethren. In Europe, the newly proposed Digital Markets Act (DMA) would regulate large tech "gatekeeper" companies (commonly thought to be GAFAM) based on size rather than behavior or actual harm, in a paradigm shift. The DMA has come under criticism from many fronts (see, for example, this analysis from the Information Technology & Innovation Foundation (ITIF)), with even the White House's National Security Council reportedly warning the EU about singling out U.S. tech companies in a protectionist manner.

Meanwhile, Lina Khan, legal scholar and author of the influential article Amazon's Antitrust Paradox, was recently appointed to be the chair of the U.S. Federal Trade Commission, which along with the Department of Justice oversees mergers and acquisitions (M&A) and antitrust violations. Simultaneously on Capitol Hill, the House Judiciary Committee rolled out a suite of proposed legislation explicitly designed to curtail the power of GAFAM. While the new legislative proposals are overly broad and sometimes contradictory, and a serious departure from the traditional focus on consumer harm and market manipulation, they would have massive consequences for company breakups, technology integrations, data sharing, mergers and acquisitions, what comes preloaded on a new smartphone, and more if enacted.

The aforementioned legislators and regulators utilize language that positions GAFAM as the new Standard Oil, crushing competition and innovation at every level and completely dominating their industry to the detriment of all others. Meanwhile, away from the Washington DC policy bubble:

- Global venture capital (VC) funding of tech startups hit an all time high last quarter (Q1 2021) at $125 billion, a 50% increase quarter-over-quarter, according to CrunchBase. VC funding also remained strong throughout the pandemic, with about $60-90 billion invested per quarter.

- According to research firm CB Insights, there are currently 712 "unicorn" tech startups (private companies with valuations of $1 billion or higher) with a cumulative valuation of $2.337 trillion. Over 300 of them became unicorns in 2020 and 2021; about two-thirds of these new unicorns are U.S.-based companies.

- Larger tech companies including Zoom, BigCommerce, Monday.com, SquareSpace, ZipRecruiter, DoorDash, ZoomInfo, and Snowflake all had initial public offerings (IPOs) during the last two years - and many of their offerings compete at some level with offerings from GAFAM.

These statistics hardly paint a picture of competition and innovation being snubbed out Rockefeller-style. As noted tech commentator Benedict Evans recently wrote in an article about the proposed antitrust legislation, “People in tech agree on very little, but everyone would agree we're in the hottest market for tech startup creation in history - any relevant data would tell you that tech startup creation has actually risen by three to four times in the last decade.”

Unintended Consequences of Tech Antitrust Regulation on SMBs

Here we consider the downstream consequences of increased antitrust regulation of GAFAM companies on the digitally-driven Main Street economy. Such “second order” economic effects occur because SMBs are not only major customers, partners, and users of products and services offered by the tech giants, but having just been through the pandemic, even more reliant on their services. A survey of SMBs earlier this year found that:

- 98% of small businesses say digital tools are helpful in running their business.
- 81% of SMBs changed their business to incorporate new digital tools and strategies due to COVID-19.
- Approximately 11 million U.S. small businesses (37%) would have closed all or part of their business without access to digital tools.
- 93% of small businesses report that they intend to maintain or increase their use of digital tools after the pandemic.
- 63% of SMBs prefer to get training related to using digital tools in their business from private companies who make the tools.

With this as a backdrop, we analyzed likely scenarios by which proposed U.S. legislation as-is would have a negative impact on America’s SMBs. In general, the effects could be widespread and serious. Here are four ways this could happen.

Hamstringing small business recovery from the pandemic

With the most onerous societal restrictions related to the pandemic only just recently being lifted during May and June 2021 in most areas of the country, this new legislation couldn't be coming at a worse time for small businesses. Consider a future with new "digital restrictions" in which GAFAM and perhaps additional very large technology companies are smaller, less integrated across business units, and have diminished reach. Even assuming product quality is the same, SMEs with limited budgets and limited or no technology staff will experience a number of pain points that will slow their growth and innovation. They:

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

Dismantling the private sector rules for scalable, connected digital infrastructure

Beyond the tactical aspects of SMB operations listed above that could be disrupted if GAFAM offerings are disconnected from each other, some aspects of the newly proposed legislation would, in effect, rewrite some of the rules, regulations and standards of the large tech platforms and digital tools and begin to create ambiguous or even absurd situations. A subset of these would wreak havoc on small business strategies across the board, including how SMBs brand themselves or their products and services, their approach to marketing, their sales strategies, the mechanisms by which they fulfill orders, and more. Some effects would be seen almost immediately, while other effects would slowly manifest themselves over time. Here are just two examples of this, with credit to analysis by the Chamber of Progress:

- Google could not display shopping results in its main search results, because to do so would advantage those listings over competing listings. In other words, it would hurt small businesses whose stores/products are displayed in Google Shopping. This would create unnecessary impediments to customers discovering SMB-made products through Google Search.

- Alexa device users could not order from Amazon’s store, because while Amazon shopping is currently integrated into Alexa devices, advantaging one’s own product would be banned under the proposed legislation. This would create unnecessary impediments to customers attempting to buy SMB-made products on Amazon’s marketplace, such as blocking a consumer setting up a recurring delivery of their favorite SMB-made product.

Roadblocks to many tech acquisitions to prevent the occasional “killer acquisition”

The notion of a so-called killer acquisition is one that is done specifically to kill an innovation and in turn, reduce competition for the acquirer. While corporate motives can be hard to discern, these legitimately happen sometimes, and the practice is certainly not limited to the technology industry (see for instance this analysis of killer acquisitions by pharmaceutical companies). However, Minority Report-style policing of M&A deals that anticipates a few bad apples is sure to have negative side effects on them in general. Unlike crime, however, most tech acquisitions are benign and even quite beneficial in nature. Among the benefits:

- Acquisitions as a lifeline: A stagnated or nearly failed company unable to sell its products or access additional capital can try to have their innovations live on within a larger company; this kind of M&A is, frankly, a lifeline to many risk-taking innovative companies.

- “Acquihire” as a side benefit: Even if the smaller company’s innovations are killed off - typically because of straightforward business reasons like return on investment or product-market fit and not for anticompetitive reasons - the acquired company founders and employees frequently have already obtained employment at the larger technology companies (sometimes called “acquihiring”), which has its own obvious benefits.

- Reinvestment back into small business entrepreneurship: Investors in the small acquired companies can break even or come out ahead, which obviously earns them capital that is then often applied to future investments in younger innovative small companies. Founders and employees who have equity in the company frequently parlay such windfalls into new entrepreneurial ventures as well.

- Acquisitions as a badge of prestige: Being acquired by a well-regarded company - or frankly any company - is considered a prestigious “exit” within the culture of the technology industry. And for companies not wishing to go bankrupt, stay private forever, or IPO, it’s the only reasonably good option.

Since every company is now a tech company, who should Congress target next?

It's become a cliche for leaders of large companies in traditional industries to publicly claim that they are now a "tech company," but in many respects it is true that every industry and company will be increasingly digitally-driven. But that just raises the question: Will gigantic companies from financial, retail, and other industries fall under these new regulations? With terms in the proposed legislation like "critical trading partner," "online platform," and "net annual sales" being vaguely defined, even experts are confused about exactly which companies these new regulations would apply to.

The current parameters in the draft legislation are 50 million U.S. users and a $600 billion market cap, which currently only applies to GAFAM. That said, these parameters could be lowered prior to the bills passing, or the users and market caps of very large companies which currently fall below these parameters could exceed them in the near future. This raises the important question of whether and how non-GAFAM companies would be affected by this legislation if it passes into law in close to current form and how this would lead to unintended consequences. For example, since "size" is the major consideration related to the market power of the companies targeted in the legislation, consider the following (to select just three prominent companies that would conceivably fall into this category):

- Finance: Are J.P. Morgan Chase and Visa, each with market capitalization in the area of $500 billion dollars, megalomaniacal online platforms monopolizing the flow of money between merchants and customers?

- Retail: Is Walmart, with a market cap around $400 billion and an estimated 80,000 marketplace sellers a dangerous quasi-monopolistic marketplace taking advantage of America's small businesses? Do Walmart's owned brands like Hyper Tough tools deceptively obtain an unfair advantage against competitors within their marketplace?

Each of these companies, and quite a few others, have dominant market positions, have a "worrisome" size close to that laid out in this new legislation, and could be viewed as wielding gigantic market power via their online platforms and software.

Small businesses rely on J.P. Morgan Chase bank accounts, Visa transactions, Walmart's physical shelves and online marketplace, and many other companies like this for their daily operations. If the proposed antitrust legislation eventually applies to (currently) smaller but still very large tech companies (say, PayPal and Shopify), or large companies in other industries that facilitate commerce in some way (say, J.P. Morgan Chase, Visa, and Walmart), this would have even further-reaching implications for America's SMBs than outlined above.

Avoiding a U.S. Digital Depression

The current inflection point in proposed antitrust regulation and elite anti-tech opinion is a red flag that the U.S. is in danger of purposely stagnating our own technological advancement, industrial innovation, and national competitiveness. It should go without saying - but perhaps it bears repeating at this juncture - that this is one of our greatest national assets and sources of soft power on the world stage.

The newly proposed legislation from the House Antitrust Subcommittee will not only impede innovative large businesses from making acquisitions that enable them to better compete with rival firms, improving choice and access to goods and services for all Americans in the process, but will also stymie the next generation of innovative small businesses from taking on the risk that will propel some of them into being larger, globally influential companies - which is a major source of U.S. economic growth and national competitiveness. Ironically, this all comes at the same time the Senate passed a $250 billion bill to invest in science and technology to counteract the rise of China's technology industry (which is increasingly a source of its soft power on the world stage).

Done right, a digitally-empowered U.S. economy, from the largest corporations to the smallest micro-businesses and sole proprietorships, can help solve some of our most pressing economic and social challenges. Emerging from the economic crisis caused by the COVID-19 pandemic, digital tools can dramatically shape and deliver support for SMBs to reinvest and sustain their pandemic digital transformation rather than let it erode. What was a "Digital Safety Net" during the pandemic crisis will become a Digital Dividend - in other words, the economic value provided by the application of digital tools to business operations.

These digital tools lower overall the cost of entrepreneurship and greatly facilitate reaching customers and selling to them, but there are education, cost, and return on investment gaps to close in order to maximize this economic opportunity in an equitable manner. The government can help here by investing in new policy, digital infrastructure, and more so that during the 2020s the U.S. can complete its digital transformation permanently, at scale. The government can also pay attention to and create new programs for solving problems identified during the pandemic and solving more structural problems such as disparities amongst entrepreneurs who had a harder time accessing capital or making the most use of digital tools during the pandemic, like business owners who are people of color, so they don't fall behind in the process.

In conclusion, we agree with legislators that technology companies sometimes do violate antitrust regulations. But current laws, enforced by the FTC, the Department of Justice (DOJ), and the nation's courts, are capable of dealing with such infractions when they occur. (Take for example the recent Epic Games vs. Apple case, which went through a formal trial and is awaiting verdict by a judge) We also agree that there is a legitimate debate to be had over whether and how antitrust enforcement should be strengthened to take into account the speed, scale, and innovation of the modern economy. However, there is no valid reason for singling out large technology companies with what are effectively “special rules,” nor a valid reason to completely reinterpret the current laws, which enjoy the support of the broad majority of antitrust experts.

Small business leaders agree with this sentiment too. A poll we recently conducted of SMB decision makers in 15 U.S. states revealed that 81% see digital tools as important for running their businesses [#9], 89% predict that post-COVID-19 they will use digital tools at least as much if not more than pre-pandemic [#13], and 68% agree that government shouldn’t waste taxpayer dollars attacking companies that help small businesses [#21]. The potential for unintended consequences, particularly for America’s Main Street economy, is too great to ignore.

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