

Q&A

Hanne Melin, Samuel Laurinkari, and Taina Tukiainen

Q. *How Can Online Platforms Contribute to Smarter and More Prosperous Regions in Europe?*

A. Commerce has always depended on connections. The difference today is how the online platform model is enabling connections that are cheaper, more evenly spread, and more accessible. Indeed, the online platform model has revolutionized commerce by reducing the cost of serving consumers over a large geographical area. This has effectively opened up commerce to any entrepreneur anywhere, and it is driving the emergence of new economic hotspots throughout Europe.

Traditional forms of commerce over distance carry costs related to transportation and logistics chains, regulatory and administrative red tape, different legal systems, communication and marketing, uneven access to information, difficulties in matching supply and demand, trust, and enforcement. Economists have for years confirmed that these costs increase as distance increases. So, the further away market participants are from each other, the less likely they are to engage in commerce with each other (Allen, 2013; Chaney, 2011; Disdier & Head, 2008; Lendle et al., 2012)

Due to the costs that come with distance, small enterprises have traditionally been confined to commerce within limited areas, such as the size of a city or the distance that a consumer would be willing to travel to the enterprise's place of business. Another way to think of it is that most traditional commerce models came with the cost of establishing certain facilities and firms were able to capture commerce only within a range of their facilities.

Being limited to small markets in this way is an impediment to building a viable and sustainable business as there might simply not be enough demand available, or a local economy might suffer from economic shocks or tail winds that depress demand. This is exactly what happened during the recent financial crisis. Between 2008 and 2013, domestic demand dropped by about 4% across the European Union (EU), while foreign demand grew by approximately 7% (Muller et al., 2014; European Commission, 2015a).

Today, in 2016, the more remote and less prosperous regions across the EU are hosting communities of active

online small businesses selling across national borders (eBay, 2015). They leverage the online commerce platform model for direct access to European and global markets, and that enables them to contribute to the local economy and society. Extending commercial activity to a market the size of the EU's Single Market brings in to play a potential customer base of 500 million people (European Commission, 2015b). This creates an opportunity for "[a] lot more businesses ... starting up and existing companies ... flourishing by finding new market niches thanks to the 'long tail' effect" (European Commission, 2011). This opportunity signals a potential for the EU to reduce imbalances between regions through digital market-driven growth, making all regions "smarter" in the process.

Overcoming the Cost of Distance

One of the fundamental revolutions brought about by the Internet and digital technologies comes about through online commerce, where the cost of transacting over distance has fallen dramatically. The chief reason is how much easier it is online to overcome uneven access to information and difficulties in matching supply and demand. A 2013 report by the European Commission's Joint Research Centre (Gomez-Herrera et al., 2013) concludes that distance matters far less online, explained primarily by the decline in communication costs.

Research by a team of economists at Sidley Austin confirms that distance indeed has a much less negative impact on firms transacting across borders in the online marketplace (Lendle et al., 2012). For example, based on a global dataset of transactions through eBay – the employer of the current article's first and second authors – Sidley Austin concluded that distance matters 83% less for international transactions compared to traditional transactions (eBay, 2013).

Even within the EU, geographical distance has a negative effect on cross-border activity. However, the detrimental effect of geographic distance on trade within the EU is more than four times lower when commerce is conducted leveraging the online commerce platform model, as compared to traditional cross-border trade.

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This effect can also be seen in the 61% growth rate of EU cross-border commerce over the eBay Marketplace for the period 2010 to 2014, compared to the modest growth of 15% for traditional commerce (eBay, 2015).

But overcoming distance to the extent where small businesses and entrepreneurs start engaging in international commerce takes more than simply adding the Internet to retail.

Although recent years have seen an increase in the use of the Internet as a sales channel among retailers in the EU, there has been no clear upward trend in the level of cross-border activities (European Commission, 2013). The European Commission reports that, in 2014, only 12% of firms in retail sold online across borders within the EU (European Commission, 2015c). This situation is strikingly different to what is happening on the eBay Marketplace where 93% of firms, predominately micro-firms with less than 10 employees, engage in cross-border sales (eBay, 2015).

The difference can be explained by how the online commerce platform model acts as an “e-commerce booster” (European Commission, 2015d). It provides access to both the Internet’s global reach as well as to relevant technology tools that further mitigate commerce costs, such as fulfillment services, website design, sales insights and research tools, search optimization, and paid search marketing. In contrast, retailers selling online using their own website, which represents 80% of online retailers (TNS, 2015), must themselves make the investments required to attract consumers from abroad.

Regional Variation

The European Commission has since 2000 recognized the important role online commerce could play for economic, social, and territorial cohesion: “new technologies ... provide an opportunity, by overcoming geographical obstacles, for bringing the outermost regions closer to the heart of Europe and combating various forms of exclusion” (Erkki Liikanen in Press Release IP/00/1477: European Commission, 2000). The Commission has called out the so-called Information Society as a real opportunity for regional development as it could help “even the remotest regions to network with the rest of the Union and beyond” (Michel Barnier in Press Release IP/03/396: European Commission, 2003).

Nevertheless, in 2008, the Commission let it be known that, in terms of economic activity, there “continues to

be heavily congested urban areas and other areas with untapped potential” across the EU (European Commission, 2008). So, whereas in 2000, there was confidence that “through the internet and e-commerce we can achieve the ‘death of distance’” (European Commission, 2000); eight years later, the pattern of economic activity was still “more concentrated across the EU than population” (European Commission, 2008).

This disappointing conclusion aligns with the literature and research where strong correlation is again and again confirmed between regional entrepreneurship or competitiveness and population density, GDP per capita, and proximity to metropolitan and capital areas, as the following examples show:

- Entrepreneurial activity is traditionally greater in densely populated regions. Research into regional entrepreneurship has concluded that the number of entrepreneurs is often linked to population growth and density (European Commission, 2013b). Bosma and Schutjens (2011) found that “urban regions, indicated by high population density, are characterised by many nascent entrepreneurs per inhabitant”.
- Regional entrepreneurship and competitiveness are traditionally connected to economic growth. Research presented by the Regional Entrepreneurship and Development Index (REDI) displays a close connection between entrepreneurship and economic development as measured by GDP per capita (European Commission, 2013b). The same research also found a strong correlation between GDP per capita and regional competitiveness – as measured by the Regional Competitiveness Index. Furthermore, the literature has argued that regions with persistently high economic growth are characterized by positive attitudes towards entrepreneurship (Bosma & Schutjens, 2011).
- Metropolitan and capital regions traditionally hold higher degrees of entrepreneurship and competitiveness. For instance, the regions of Berlin, Ile-de-France, and London top the national REDI ranking on entrepreneurship in Germany, France, and the United Kingdom. Similarly, these metropolitan and capital regions also have some of the highest levels of competitiveness (Bosma & Schutjens, 2011; European Commission, 2013b). The literature on regional entrepreneurship describes cities as “the centres of diversity, creativity and new ideas” and argues that urban areas attract people with a more positive attitude to entrepreneurship (Bosma & Schutjens, 2011).

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New Economic Hotspots Emerge

eBay Public Policy Lab and Sidley Austin have analyzed the impact that the online commerce platform has on the EU regions, finding that the traditional ties between entrepreneurial success and population density, GDP per capita, and proximity to metropolitan areas are getting weaker (eBay, 2015). While the ties have proved strong for decades – they have even been described as “persistent” (Bosma & Schutjens, 2011) – a closer look at the digital economy reveals an ongoing shift at the regional level with new “economic hotspots” emerging outside of the conventional ones.

The analysis covered the level of online small business activity in 2014 across EU regions, as defined by Level 2 of the Nomenclature of Territorial Units for Statistics (NUTS 2; tinyurl.com/8cutsh9). By combining two indicators – i) the number of eBay small businesses (for the purpose of this research limited to those with at least \$10,000 USD in annual sales on eBay) per 100,000 inhabitants and ii) sales by eBay small businesses per 100,000 inhabitants – a so-called “digital density” of each European region at the NUTS 2 level was calculated (eBay, 2015).

The digital density assessment shows that metropolitan regions or regions holding a higher GDP or a larger population, or both, are not necessarily the ones with the greater community of active online small businesses when analyzed on a per capita basis: many of the more remote and less privileged regions are also participating in the digital economy at very meaningful, even surprising rates. The findings suggest that, when costs associated with commerce over distance are slashed as they are on the online commerce platform, economic opportunity expands to not only more enterprises but also more places. Herein lies a great potential of delivering on the EU’s ambition of “equal opportunities for citizens and enterprises, wherever they are located” (European Union, 2011).

A Shift from Regional Variation to Regional Integration

This digital density assessment is not the first attempt to understand how the digital economy touches the regions of the EU. But, to our knowledge, it is the first to detect a shift away from small business success being dependent on setting up operations in a metropolitan region with a large population and high overall economic activity. eBay Public Policy Lab has produced an interactive map of digital density compared against na-

tional GDP and population, with analyses for each EU country (see screenshots in Figure 1 and full interactive map at ebaymainstreet.com/digital-density-europe/country.htm). This map highlights that, in many places across the EU, the online commerce platform model is weakening the long-lived linkage between entrepreneurial success and population density, GDP per capita, and proximity to metropolitan areas. When distance is reduced as an impediment to building and sustaining operations in remote locations, small businesses have a greater chance to emerge outside of the previous “must-be-in” cities and areas: enterprises are no longer confined to consumers in their very proximity but can cover an immense range at little extra cost. Close to 100% of the eBay small businesses in the regions represented in eBay’s map sell across borders and most of them sell both within the EU as well as to countries outside of the EU. In traditional commerce, this is something only fairly large enterprises located in economic hubs or with wide-spanning networks of facilities could dream of doing. Now, small business owners can remain in their hometowns irrespective of where these are situated and they can contribute to the local economy and society thanks to their ability to access European and global markets.

These research findings suggest a potential for economic progress that is more inclusive. The prospect of economic growth is becoming geographically more balanced in the digital economy than in the traditional economy, where thriving central hubs have been found to dominate.

Conclusion

As the online commerce platform model reduces the costs of commerce over distance, it helps create economic activity and entrepreneurship in less populated, less prosperous, and more remote regions. This is a force for enabling a great diversity of businesses across the EU and supporting the rise of smart regions irrespective of location and their preconditions.

The entrepreneurs showcased in the map are all emerging leaders in “a new commerce geographic”. They show that there is an alternative to market consolidation and uniformity; they prove that self-employment is not only a viable option to traditional employment but a way of making ends meet with a deep sense of fulfillment and accomplishment; and they suggest to us that efforts making the EU’s regions and cities smart will support more inclusive growth.

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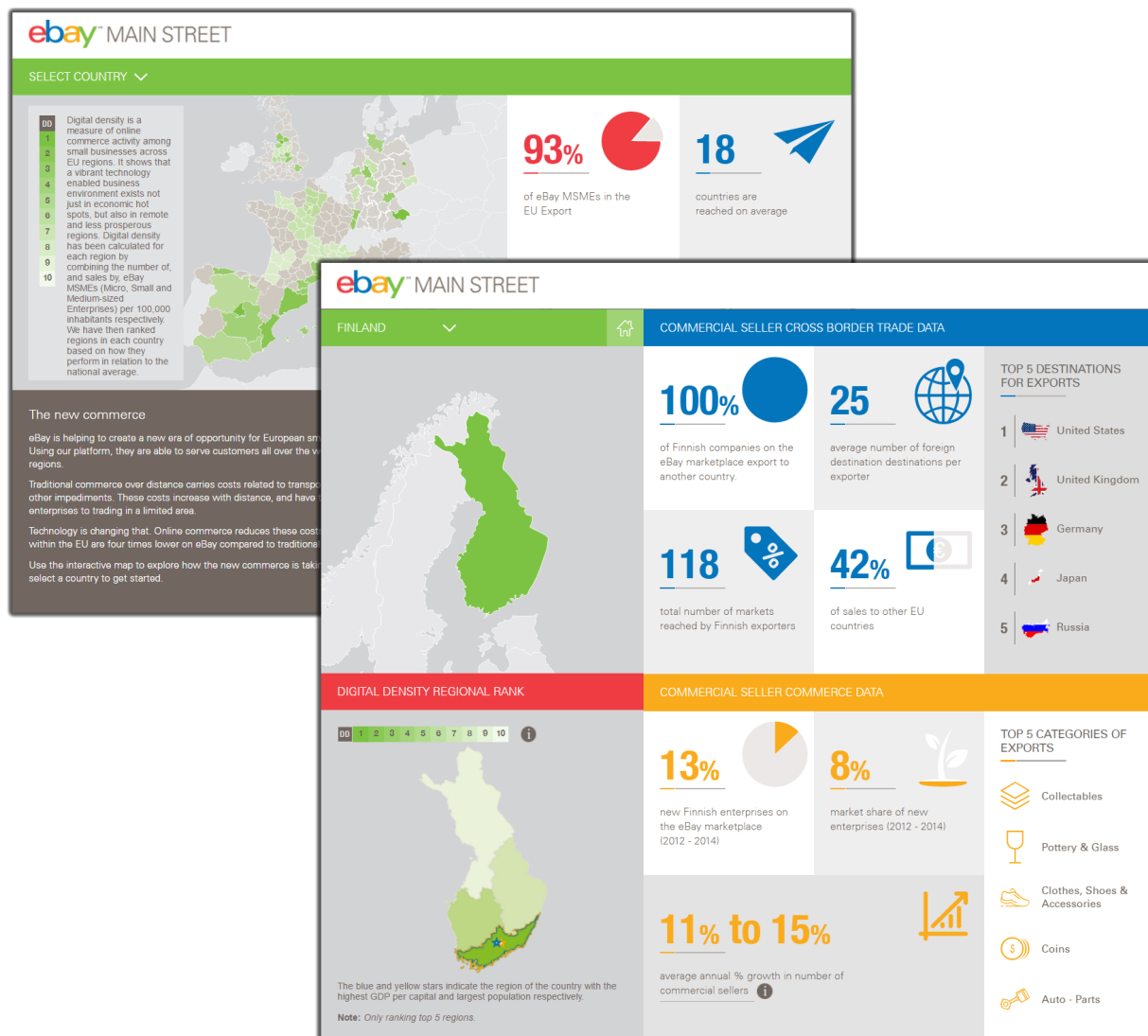


Figure 1. Screenshots of the eBay Public Policy Lab's "Digital Density" interactive map, including an example of a country-specific analysis (Finland). Full interactive map available at: ebaymainstreet.com/digital-density-europe/country.htm

This is good news in view of the recent downturn. Already in 2010, the European Commission warned that a continuing decline of small businesses due to competitive pressure from large merchants raises territorial and social cohesion concerns. And recently, the Commission reported that “[t]he legacy of the crisis is still particularly acute, in particular on labour markets with unemployment remaining very high at EU level” (European Commission, 2015c). Moreover, there remain great variations in terms of achieving the targets set by the EU 2020 Strategy, in particular, the employment target, between regions as well as between, on the hand, cities and, on the other hand, towns, suburbs, and rural areas (European Commission, 2015e).

Supporting online, small, yet international, businesses is thus central in ensuring inclusive growth and job creation; and promoting the online commerce platform model to that end should form a central part of efforts making regions smarter within the EU.

An example of how this could look is the pilot project initiated by the private sector development authority in Mönchengladbach, Germany, in 2015. The authority contacted eBay for help with bringing local businesses online, and eBay assisted with establishing online presence for the businesses and advising them on marketing their products to local as well as foreign customers. The pilot phase ran for nine months, and during that

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period the 79 participating businesses sold a total of 87,000 items online, generating more than €3.2 million in additional sales (eBay, 2016).

The project's primary objective was to bring the town's merchants online. But, the project also led to the majority of participating businesses starting to engage in exports. During the pilot phase, a total of 84 different countries were served out of Mönchengladbach, suggesting that a program for close liaison between a city, town, or region; its businesses; and an online commerce platform can make a successful foundation for enterprise expansion.

Such a structure introduces the workings of an online commerce platform to a group of merchants, thereby creating social ties between the participants; it connects them with similar businesses that are already engaged in platform-based internationalization; and it effectively provides a network for sharing of knowledge about entrepreneurial opportunities and practicalities. This is a three-legged structure for supporting the making of smart regions across the EU.

About the Authors

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