European Commission

CLOSENESS OF COMPETITION AND THE ROLE OF BIDDING DATA

Global Competition Law Centre, 79th Lunch Talk

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Disclaimer: the views expressed are those of the presenter and cannot be regarded as stating an official position of the European Commission.

Introduction

- Bidding data:
  - Competition for the market
  - Even if a firm is not the winner of the auction, it can still be an important competitive constraint during the tender procedure
- Economic framework:
  - Open auctions vs sealed bid auctions
- Empirical analyses used in practice

SOME ECONOMIC PRINCIPLES

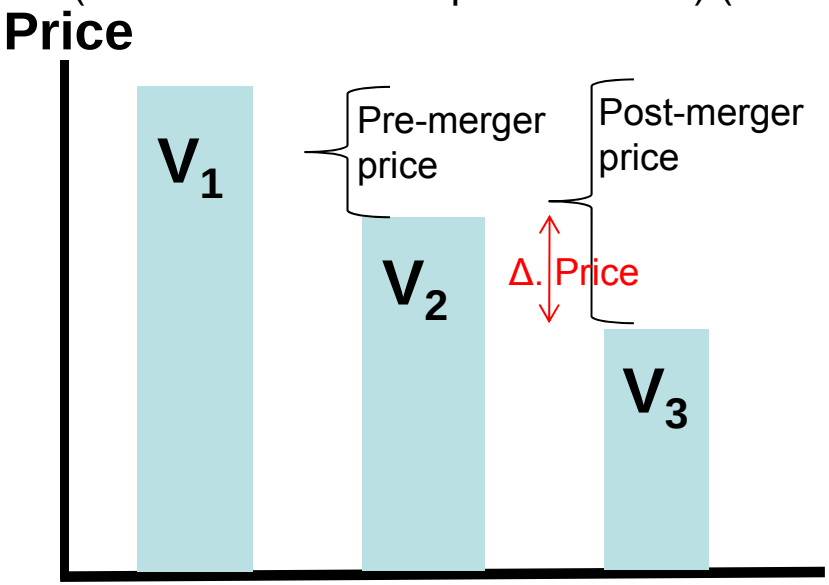
Some basics

- **Klemperer survey (2005)**
  - The existence of a "bidding market" does ***not*** mean that competition concerns from a merger should be less severe
- **Targeted customers and market definition**
  - If pricing is highly individualised, in principle each tender may represent a well-defined market
  - In practice, it makes sense to focus the analysis on the subset of customers/tenders with broadly similar competitive conditions

The argument of "*2 bidders for a competitive outcome*"

- Argument:
  - only those tenders where the merging parties are the winner and runner-up would be affected by the merger
  - Price effects limited for those tenders if there is a strong number 3

Illustration of an open auction
(also called second-price auction) (no cost)



Strict conditions:

- Bidders have or receive **very good ("perfect") information** on characteristics of competing offers, including their cost and their value to customer

Implication:

- All bidders other than the winner **offer their product at cost** (<u>making zero expected margin</u>)

Bidding with imperfect information (sealed bid auction, first-price auction)

- Features of FPA: private offers to customers, uncertainty on competing offers (cost, quality)
- The optimal bid is based on familiar price-volume trade-off (as in standard differentiated products)

E(Profit (bid))	**=**	**Profit margin if bid successful**	**X**	**Probability of bid being successful**

- Pre-merger:
  - A higher bid by **Firm 1** increases the probability of the bid of **Firm 2** being successful
  - The closer is Firm 2 to Firm 1, the higher is the increase in the probability of Firm 2 to win **(probability diversion) =>** This constrains the bidding behaviour of Firm 1
- Post-merger (**Firm 1** and **Firm 2** merge): this competitive constraint is lost
  - All bids where the merging parties would have met are potentially affected by the loss of competitive pressure
- **Diversions** of sales from **Firm 1** to **Firm 2** needs to be interpreted as "***probability diversions***"
- Assessment of closeness (e.g. diversions) and of margins informs the evaluation of unilateral effects (as in standard differentiated products)

EMPIRICAL ANALYSES

Empirical tools for unilateral effects in bidding markets (see for example Annex in GE/Alstom, 150+ pages)

Analysis	Questions that can be addressed
Participation	o Is (firm) participation indicative of product fit and of closeness? o How often do the parties meet? o How concentrated are tenders where the parties meet?
Win / loss	o How often do the Parties lose to each other?
Switching analysis	o How often one merging party won a customer from the other merging party (not done in GE/Alstom)
Runner-up	o How often are the Parties runner-up to each other?
Probit	o Does participation by one party affect the probability of the other winning (controlling for other factors)?
Margins	o What is the level of gross margins? o Are margins affected by participation by the other party (controlling for other factors)? o Is the evolution of margin at different stages of the bidding process affected by the presence of the other merging firm?

Participation analysis

- Tender participation is costly, selective, and indicative of product fit
- Evidence on participation is informative on closeness across bidders
- How often are the merging parties participating against each other in tenders?
- Siemens/Dresser-Rand (see press release): the activities of Dresser-Rand and Siemens are largely complementary as:
  - Focus on different oil and gas applications
  - They are only rarely bidding against each other in tenders procedures
- See also GE/Instrumentarium: the merging parties often participated in the same tenders (FR, DE, SP)

Loss analysis

- When one firm participate in tenders, how often does it lose to the other merging party?
- See for example Baxter/Gambro (2013)
  - Market for haemodialysis
  - Most tenders lost by Gambro were won by Fresenius, and Baxter won only very few tenders lost by Gambro

Probit analysis

- Does participation by one party affect the probability of the other winning (controlling for other factors that may also affect the probability of winning)?
- Data requirements:
  - Participants, cost to provide the product to the customers as a control for scope/quality, other tender characteristics
- See GE/Alstom (2015)

Margin analysis

- Does participation by one party affect the (expected) margin of the other merging party (controlling for other factors that may also affect the expected margins)?
- Data requirements:
  - Participants, cost to provide the service to the customers as a control for scope/quality, other tender characteristics
- See GE/Alstom (2015)
- See also GE/Instrumentarium (2003)
  - Regression analysis run for France
  - Average discount offered when Instrumentarium is participating= [35-45]%
  - Average discount when Instrumentarium is not participating: [25-35]%
  - Regression analysis: [5-10]% effect on discount when Intrumentarium is present

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