Dynamic markets and dynamic enforcement: a focus on merger control

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Agenda

I • What is the objective of merger control in dynamic markets?

II • How do we ensure that merger control captures the right mergers?

III • Do we have the right tools to assess mergers in dynamic markets?

IV • In practice, what has been done to assess mergers in dynamic markets?
What is the objective of merger control in dynamic markets?

The objective of merger control is to ensure that the transaction does not harm competition on price/quality of current and new products in the market. In dynamic markets, this involves preserving the potential for innovation, regardless of who is going to bring the next innovation in the market.

In digital markets, the following features need to be taken into account:

- leapfrogging innovation
- network effects that are often strong but short-lived (e.g., My Space)
- lines between substitution and complementarity are blurred
- two-sided markets
- new business models (sharing economy)
How do we ensure that merger control captures the right mergers?

• There is currently a live debate on whether the current EU merger control guidelines are able to identify relevant transactions for review

• In dynamic and digital markets, we might see some mergers involving innovative companies which currently have little or no turnover
  • these companies could fail to be captured by current EU guidelines
  • e.g. Facebook/WhatsApp fell below the EU threshold

The acquisition of a company with low turnover can not be captured under current notification requirements of EU and German law, even in cases where the acquired company holds commercially valuable data, or has a considerable market potential for other reasons. Therefore, the Monopolies Commission recommends complementing the existing merger control thresholds based on turnover by additional notification requirements based on the transaction volume. […] In the digital economy, the purchase price often reflects the economic potential of an acquisition target better than the turnover generated previously.

*Competition policy: The challenge of digital markets, paras S54, Monopolies Commission*
The role of merger control in dynamic markets

Commentators have raised a number of doubts on this proposal:

- valuations based on share value might be subject to market volatility
  - In Facebook/WhatsApp, the price rose by $3 billion between offer and completion as a result of the rise in value of Facebook’s shares
  - potential for a threshold effect

- relative value are different in different industries, a one-fits-all threshold might not be available

DG Competition

The Commission has recently closed a consultation on its guidelines for merger control, including a proposal for a deal-value threshold to capture these transactions

Germany NCA

Germany is also independently discussing the introduction of a €350m deal–value threshold (draft law)
Do we have the right tools to assess mergers in dynamic markets?

- In general, merger assessment involves comparing two hypothetical scenarios
  
  **Counterfactual**
  
  the market situation that would arise in the absence of the merger
  
  **Forecasting of merger effect**
  
  the market outcome that is likely to result from the merger

- In most merger cases, the conditions of competitions prevailing before the merger are considered as the right counterfactual
  
  - the current EU guidelines acknowledge the need to take into account of *future changes that can be reasonably predicted* (entry/exit/failing firm)

- In dynamic and digital markets the counterfactual will also need to consider a forecasting element

How do we find the right counterfactual?
Do we have the right tools to assess mergers in dynamic markets?

- Most of the tools available to understand market outcomes arising from the merger are static and focus on expected price changes
  - analysis of closeness of competition
    - diversion ratios, customer surveys
  - forecasting of the effect of the merger
    - uses past information on prices, customer preferences and costs (UPP, GUPPI, merger simulations, etc.)

Price effects

Quality effects

Product repositioning

Innovation / New products

Increasing difficulty in assessing the merger effect
The assessment of mergers in digital markets
Dynamic efficiencies

- Dynamic efficiencies, unlike static efficiencies, are synergies that enable firms to improve their performance on a potentially continual basis
  - diffusion of know-how, more efficient use of IP, increased R&D, and increased investment
- Mergers may help in developing new products or reducing costs by combining assets and expertise that are not easily transferred between separate companies

- non-linear relationship between competition and innovation

How do we assess where we are on the curve?

How do we incorporate these considerations into merger assessment?
In practice, what has been done to assess mergers in dynamic markets?

- The effect of consolidation on investment and innovation has been at the forefront of the merger control debate in the recent years. It has been looked at from two very different perspectives
  - as a potential theory of harm
  - as a (dynamic) efficiency benefit

<table>
<thead>
<tr>
<th>Theory of harm</th>
<th>Dynamic efficiencies</th>
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| Some transactions can undermine the incentives and ability of the merging parties to innovate.  
For example, overlapping R&D research in the pharmaceutical sector | Mergers could bring dynamic efficiencies in the form of innovation; this type of efficiency is likely to have larger welfare effect in the long run.  
For example, claims in the mobile industry that mergers would lead to higher investment and innovation |
The assessment of mergers in dynamic markets
Theories of harm (i)

• In a number of merger decisions, competition authorities have explored the possibility that the proposed transaction would reduce the incentives of the merging parties or their rivals to innovate

**GSK / Novartis**

Novartis would have had an incentive to discontinue the clinical programmes for the overlapping drugs, to avoid duplication of costs and effort.

Divestment of overlapping drugs

**GE / Alstom**

Alstom was the most innovative player, GE would have the incentive to discontinue some of the projects and close innovation pools.

Divestment of pipeline and R&D facilities (including staff)

• The Commission has also considered a series of vertical mergers where the innovative power of the parties raised vertical input foreclosure concerns
  • *Intel/McAfee*
The assessment of mergers in digital markets
Theories of harm (ii)

- In digital markets, competition authorities have reviewed a number of cases that have been mostly been cleared unconditionally

<table>
<thead>
<tr>
<th>Merger</th>
<th>Outcome</th>
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<tbody>
<tr>
<td>Google / Youtube (2006)</td>
<td>Cleared unconditionally by the FTC</td>
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<tr>
<td>Facebook / Instagram (2012)</td>
<td>Cleared unconditionally by the OFT</td>
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<tr>
<td>Facebook / Whatsapp (2014)</td>
<td>Cleared unconditionally by DG Comp</td>
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<td>Microsoft / Skype (2011)</td>
<td>Cleared unconditionally by DG Comp</td>
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<td>Microsoft / Yahoo (2012)</td>
<td>Cleared unconditionally by DG Comp</td>
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<tr>
<td>Microsoft / Linkedin (2016)</td>
<td>Cleared with remedies by DG Comp</td>
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Have these predictions been correct?
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