

Merger control

Introduction

- First merger regulation in the the EU : 1989
- Revised in 2004 (EC merger regulation 139/2004)
- Under the 1999 regulation, merger test = «creation or reinforcement of a dominant position » (dominance test).
- In the 2004 regulation, close to the « substantial lessening of competition », (SLC test, used in the US)
- Economic debate : dominant position test creates 2 types of risks:
 - Reject a merger (because it leads to a dominant position) that has positive competitive (or no anticompetitive) effects (type 1 error).
 - Accept a merger (because it doesn't lead to a dominant position) which has nevertheless negative competitive effects (type 2 error).
- Debate even more accurate after the General Electric (GE)-Honeywell case
 - Accepted in the US on the ground of the SLC test.
 - Rejected in Europe according to the dominance test.
- New regulation : analogous to the US test.

Analysis of the effects of a merger

- Prospective analysis.
- Two types of possible effects,
 - Unilateral effects : increase of the market power of the merging firms and decrease of consumers' and global surplus.
 - Coordinated effects : i.e. pro-collusive effects, due to the reduction in the number of firms (called « joint dominance » in the EU regulation)
- Merger motivated (according to the parties) in general by efficiency gains, synergies etc,
 - that have to be assessed;
 - that may lead to a reduction in costs that compensates the losses.
- These two types of effects are considered differently in the SLC/dominance test
 - dominance test : efficiency gains can be examined in a second step as « efficiency defense » that may offset the negative effect of dominance
 - SLC test : the comparison of the ex ante/ex post equilibria measures directly the combined effect of increased concentration and efficiency gains

In practice

- Mergers are submitted to a 2-step analysis
 - 1) After the notification, a first assessment of the effects of the merger (« phase I »), possibly with a negotiation on remedies. Time constrained.
 - 2) If it appears that after the end of the legal period of time, the merger cannot be approved, the « phase II » takes place with a deeper examination of the effects of the merger, remedies etc.

Unilateral effects

- Without efficiencies, a merger increases market power:
 - Supermarkets in a city, differentiated by location, range of products, etc
 - One of them increases its prices : buyers reduce their demand, switch to another supermarket...
 - This competitive mechanism reduces the incentives to increase prices.
 - Merger of 2 or more : it can be now profitable to increase prices : consumer have to travel greater distances to find another store, prefer to stay at the same one...
 - The merger increases market power and prices.
 - Presumably negative effects on welfare.

Effects of a merger

- Depend on the nature of competition
 - Price competition :
 - the merged entity (M) increases its price, the outsiders (O) also.
 - O benefit from the merger, O may even gain more than M from the merger.
 - Quantity competition :
 - M lowers its output (increases the price)
 - O increases its output (lowers the price)
- Overall effect of mergers always negative, but quite different on insiders and outsiders.

Effects of a merger

- Increase of market power due to the merger depends on a number of factors.
 - Concentration : the larger the number of firms, the less likely the merger is to be detrimental to consumers.
 - Gives a rationale to the study of the HHI, at least as a screening device for the study of mergers.
 - $HHI = \text{sum of the squares of the market shares}$, varies from 0 (perfect competition) to 10 000 (monopoly)
 - But effects of the merger depend on the variation of the situation (ΔHHI).

HHI and competitive harm

- $HHI = \sum s_i^2$ with $s_i = q_i/Q \cdot 100$ (%) and $Q = \sum q_i$
- Perfect competition : $s_i = 0$ and $HHI = 0$
- Monopoly : $s_i = 100$ and $HHI = 10\,000$
- Competitive harm : ability to increase the price above the marginal cost
- Can be measured by the Lerner Index
- $(p-c)/p = k/\varepsilon$
- In a merger analysis, assessment of unilateral effects should focus on the Lerner Index rather than on the HHI.

Links between HHI and competitive harm

- At equilibrium in a Cournot Model :

$$\text{Lerner Index} = (p_i - c_i) / p_i = s_i / \varepsilon$$

- In a symmetric ($c_i = c$) Cournot model, at equilibrium, $s_i = 1/n$

$$\text{Lerner Index} = (p - c) / p = \text{HHI} / \varepsilon$$

- In a general Cournot model :

$$\text{Average Lerner Index} = \sum s_i (p_i - c_i) / p_i = \text{HHI} / \varepsilon$$

- Therefore HHI gives information on the competitive harm in a quantity competition model.
- Useful to investigate the effects of the merger on the HHI, despite the fact that it does not capture fully the strategic interactions due to the merger.

HHI and assessment of mergers

- US guidelines recommend to screen mergers according to the following test, relying on the ex post HHI (the ex post market shares are obtained by adding the pre merger market shares):
- If $HHI < 1000$, the merger should be approved.
- If $1000 < HHI < 1800$, it should be approved if $\Delta HHI < 100$ (the market concentration was already high before the merger).
- If $HHI > 1800$, it should be approved if $\Delta HHI < 50$.
- If $HHI > 1800$ and $\Delta HHI > 50$, the merger should be further investigated.

Effects of a merger

- Market shares and capacities :
 - some models show that a merger that increases the size of the largest firm always decreases welfare.
 - That is, merger between number 1 and another firm should be prohibited.
 - Ability to increase prices depend on available capacities of the rivals.
- Entry
- Demand variables : ex. high switching costs
- Buyer power
- Failing firm argument

Efficiency gains

- Might offset the increase in market power :
 - Lower the costs;
 - New equilibrium may entail lower prices.
- 2 ways to increase profits : to increase prices (lower output)/ to decrease prices (sell more, increase output) : the larger the efficiency gains, the more likely it is that the second one is more profitable.
- If there are efficiency gains and M decreases its prices, then competitors suffer from the merger : a pro competitive merger will decrease the outsiders profits.
- Eckbo (1983) suggests to study the impact of a merger announcement on the stock market prices of the outsiders.
- Idea : if these prices increase, it may reveal that competitors will benefit from the merger, which means that post merger competition will be soft (and the merger has anti competitive effects).
- Difficult :
 - the stock market should anticipate correctly the effects of the merger;
 - Exogenous shocks
 - Influence of the expectations about antitrust authority's decision.

Sources of efficiency gains

- Economies of scale/scope. (that could not be achieved without the merger)
- Synergies in R&D
- Rationalisation of distribution and marketing
- Substitution of less able managers by more successful ones.
- May affect fixed or variable costs
 - If EG affect fixed costs, no pass on to consumers, only higher profits (cf US merger guidelines)

Merger specific gains

- Competition authorities should only accept efficiency gains that are merger specific :
 - The non merger specific gains can be obtained without the merger and cause less competitive problems.
 - Farrell and Shapiro (2001) : the efficiency gains merger specific are those resulting from the combination of firm specific assets, non tradable assets (« knowledge », methods, ...), often intangible assets : synergies.

Merger specific gains (2)

- Synergies : obtained through « intimate integration of the parties' unique, hard to trade assets »
- No synergy gains : reallocation of the output among the facilities, less likely to outweigh the negative effect of increased market power.
- The stronger the market power, the larger should be efficiency gains required.

Assymmetric information problem

- Each of the parties (M, outsiders, competition authorities) have different private information.
- Claims from rival firms that the merger will be anti competitive : should be received with skepticism (may reveal efficiency gains). Maybe a first indication that the merger will increase welfare.
- Buyers and final consumers complain when the merger is likely to increase prices.
- The opposite for the rivals.

Coordinated effects

- A merger may generate more favourable conditions for collusion in the industry.
- EU : « joint dominance » before 2004.
- Mechanism : twofold
 - 1) A merger reduces the number of firms.
 - 2) A merger might give rise to a more symmetric distribution of assets.
- In these cases a collusive equilibrium is more likely to appear.

Coordinated effects

- Industry already affected by factors which favour a collusive outcome : mergers more dangerous.
 - Entry barriers
 - Structural links (cross ownership)
 - Information exchanges
 - Multimarket contacts
 - Regularity and frequency of interactions
 - Absence of countervailing power
 - Particular clauses (best price, RPM...)
- Analysis of joint dominance has to take into account these factors

Coordinated effects

- Efficiency gains and pro collusive effects : improvement of efficiency of one of the competitors through a merger may disrupt collusion (create a stronger incentive to deviate)
- Efficiency gains might also create more symmetric positions and facilitate collusion (ex. the 2d and the 3rd firm merge to make a new entity close to the 1st one).

Remedies

- Comp. Auth. might approve a merger if remedies are adopted by the merging firms.
- Quite frequent : 40 out of 345 in 2000 at the EU level, even more in the recent years.
- 2 types of remedies :
 - Behavioral : constraints on the commercial policy, on contractual arrangements...
 - Structural : divestiture of some assets

Divestitures

- Overlaps in geographical or product markets (ex : mergers between supermarket that create local monopolies)
- Divested assets : bought by a new firm or by an existing competitor.
- buyer : should be able to buy all the elements necessary to run the business, i.e., tangibles, intangibles (IP rights), sales agreements.
- Due to economies of scope, scale, having an effective competitor might require to divest assets on markets which do not raise competition concerns.
- FTC study on remedies : likelihood of successful entry higher when an entire business is divested. More problematic in the case of selected assets (Parker and Balto)

Problems with divestiture (1)

- Structural remedies : often the best corrective measure, but :
 - Incentives for M to find a buyer which is not a viable competitor. The CA should ensure that the seller does not discourage efficient competitor : control the identity of the buyer?
 - Informational asymmetries between buyers and sellers
 - If some relationships are required between the buyer and the seller, the remedy may fail to restore competition.
 - FTC study : 13/14 cases where these relationships are at work, the buyer did not operate effectively or there were collusion.
 - Divestiture increases the risks of collusion if it increases symmetry between competitors or multi market contacts.

Problems with divestiture (2)

- Tradeoff between 2 problems : the competition authority should
 - guarantee by divestitures the existence of a viable competitor (avoid unilateral effects);
 - Avoid coordinated effects;
 - The remedies should be submitted to the same twofold test used in merger analysis.

Behavioral remedies

- Commitments aimed at guaranteeing that competitors can have the same access to key assets, inputs, technologies etc
- Vivendi-Canal + - Seagram : pay-TV;
 - Seagram has the control of content (Universal);
 - C+ = the largest pay-TV operator.
 - Problem : upstream content providers could limit access to premium contents (films) to other TV channels
 - Parties have proposed a commitment not to grant C+ « first window » rights covering more than 50% of Universal production.

Behavioral remedies (2)

- Quasi structural remedies : granting a license for a technology to a rival, shortening long term contracts.
- Ex Astra – Zeneca : both had the 2 first betablockers, the merger eliminates competition, remedy = grant a viable third party exclusive distribution rights for the main betablocker of Zeneca.

Problem with behavioral remedies

- Most remedies require some regulation, monitoring : costly.
- Sometimes, the efficient remedy deprives the merger from all its efficiency gains.
- Monitoring may be difficult : obligation to supply (but at which price), obligation to non discrimination...
- Requires the knowledge of a sectoral regulator more than that of a CA.
- In the case of access to a key resource : requires often a transitory period of collaboration between M and the outsiders.

Merger policy in the EU : some interesting cases

- Merger regulation, revised in 2004.
- Joint dominance (close to « coordinated effects ») : has been used before 2004 to deal with mergers that raised anti-competitive concerns without creating single-firm dominance.
- After the « Kali und Salz » case, the European court of Justice has set a higher standard of proof w.r.t. joint dominance.
- Gencor / Commission: the Court of First Instance (CFI) lowered the standard of proof (« the Commission can block mergers that create joint dominance »).
- Then came Aritours/First Choice : merger rejected by the Commission, on the argument of joint dominance.

Airtours-First Choice

- UK short-haul packaged holidays
- Product heterogeneity (destination, type of hotels, services) : makes collusion more difficult.
- High variability of market shares over time.
- Internet sales and reservation important.
- EC : argued that collusion would take the form of capacity reduction (reservations in hotels and seats in planes) rather than price increase, in the « Kreps and Scheinkman » spirit.
- Some features favourable to collusion, others not.
- Difficult to sustain joint dominance.

Airtours-First Choice (2)

- The court of first instance (CFI) cancelled the decision.
- The EC did not prove the the merger would have led to joint dominance.
- Main feature favorable to collusion :
 - The fact that capacities are booked in advance and then fixed for the remaining of the year : once these capacities are fixed, commitment not to deviate from a collusive price.
 - This guarantees the stability of tacit collusion.

Airtours-First Choice (3)

- But there are also features that reduce the probability of a collusive behavior :
 - Difficult to observe the deviation of a firm. Prices difficult to observe, differentiation of products....
- According to the CFI, the EC did not prove that the firms could build a detection mechanism that would allow a collusive behavior.

Google-Double click