The Benefits and Costs of Merger Control

Professor Bruce Lyons

ESRC Centre for Competition Policy

University of East Anglia

Norwich, UK

Outline of my presentation

- How is merger control justified?
- When and how should mergers be appraised?
- What are the problems with remedying any impediments to competition?

→ ***Do the benefits of merger control outweigh the costs?***

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Academic research has deepened our understanding of the benefits of competition

- Competition exists when firms fight fiercely for customers
  - By making a better price-quality offer than rivals
- Competition works well for consumers
  - Prices close to costs
  - Higher productivity (lower costs)
  - More innovation
  - Faster diffusion of new products
- Competition is not as simple as counting the number of firms or calculating market shares
  - Efficient firms grow market share
  - A small number of firms sometimes compete fiercely
  - A market with many firms may coordinate to reduce competition

Competition must be supported by strong competition policy

- Firms have a natural incentive to subvert the competitive process
  - Easier life!
- Competition can be suppressed by
  - Groups of firms who **agree prices** and share markets
  - A **dominant firm** which raises price, slows innovation and excludes rivals
  - Firms who **merge** and incidentally or by intention achieve market power
- Each of these ‘triggers’ for possible intervention is different*. Why? Ask 3 questions*

1. Did the situation arise from customer choice?
2. What could be lost by intervention?
3. How should competition policy be applied?

- **Dominant firm**
  - Usually comes about by providing an attractive product at a good price *for its customers*
  - Unless a privatized monopoly or very high entry barriers
  - *Would have to be much broader scope if no merger control*
    - *Too many firms at risk of intervention*
- Danger of harming customers by direct regulation
- Intervention justified if it excludes new rivals
    - Or exploits inherited or entrenched monopoly

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CENTRE FOR COMPETITION POLICY

- **Cartel**
  - Nothing to do with satisfying customers
- No chance of achieving efficiencies
  - *Do not want to include merger with cartel control!*
- Should be *per se* illegal
  - No saving graces
- Vertical agreements are different

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1. Did the situation arise from customer choice?
2. What could be lost by intervention?
3. How should competition policy be applied?

- **Merger**
  - *Not* the result of satisfying customers
  - May reduce competition

- Reasonable possibility of achieving some efficiencies or providing better product for customers

- Should allow firms freedom if merger does not impede competition
  - ***Need to appraise economic effects…***

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The economic effects approach to merger appraisal

- Cannot measure the process of fighting for customers

- But can estimate whether price is likely to rise or fall as a result of the merger
  - Much easier than judging whether a price is ‘too high’
  - With caution, take efficiency savings into account

- Want to encourage firms to propose mergers that achieve efficiencies *without* harming consumers

How? Evidence on likely economic effects

- Structural indicators provide important context
  - Market shares
  - Market concentration (e.g. HHI)
- But also need to understand how firms compete in specific markets
  - Price, capacity, quality, product range
  - Evidence on how demand responds to own & rival prices
  - Potential for reducing marginal costs
- Combine evidence to determine likely effects
- *Chile's 'Guide for the Analysis of Merger Transactions' is a very good start*

When? Should mergers be controlled *ex ante* or after completion?

- Most countries now require pre-notification of mergers
  - But not Chile or UK
  - Voluntary pre-notification remains an option

- Serious cost of unwinding a completed merger if found to impede competition
  - Considerable evidence on divestitures

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What remedies should be applied if a merger is found to impede competition?

- Structural
  - Prohibition of merger
  - Divestiture of certain products or production facilities
- Behavioural
  - Technology licensing
  - Access (especially for vertical mergers)
  - Behavioural undertakings
    - e.g. non-discrimination; no bundling
- *Note*: very different implementation costs of structural remedies for completed mergers
  - UK CC deliberately ignores these costs in its decisions

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Principles of a good remedy

First:

- Restoration of competition
    - More than just restoring market structure
- Fair and open process
    - also provides implicit guidance for future mergers

Second:

- Efficiencies & freedom
    - for merging parties
- Administration costs
    - design, implementation, monitoring

Empirical studies of divestiture

- FTC (1997)
  - Exclusive focus on survival after 1 year: only 75% success
- EC (2005); also Davies & Lyons (2007)
  - Had learned much from US experience
  - But many of the same issues remained
- UK (2006, 2012)
  - Behavioural remedies can work
    - Well funded OFT can monitor implementation

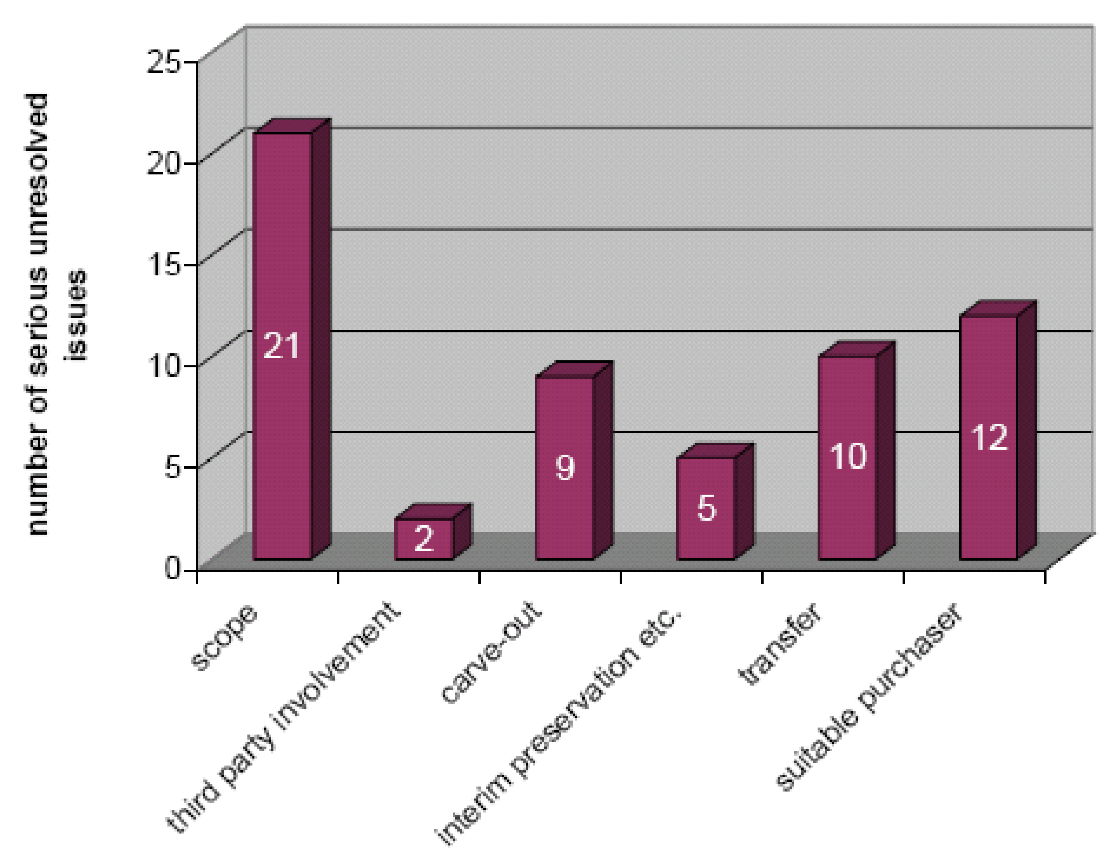
Divestiture risks

- Degradation of assets before transfer
  - E.g. loss of personnel or customers prior to transfer
- Composition of assets for viable independent business
  - Insufficient for efficient business
- Weak buyer
  - Without ability or incentive to compete effectively

Note*: same problems for prohibition of completed merger*

DG Comp study of merger remedies

Chart 2 – Number of serious unresolved issues



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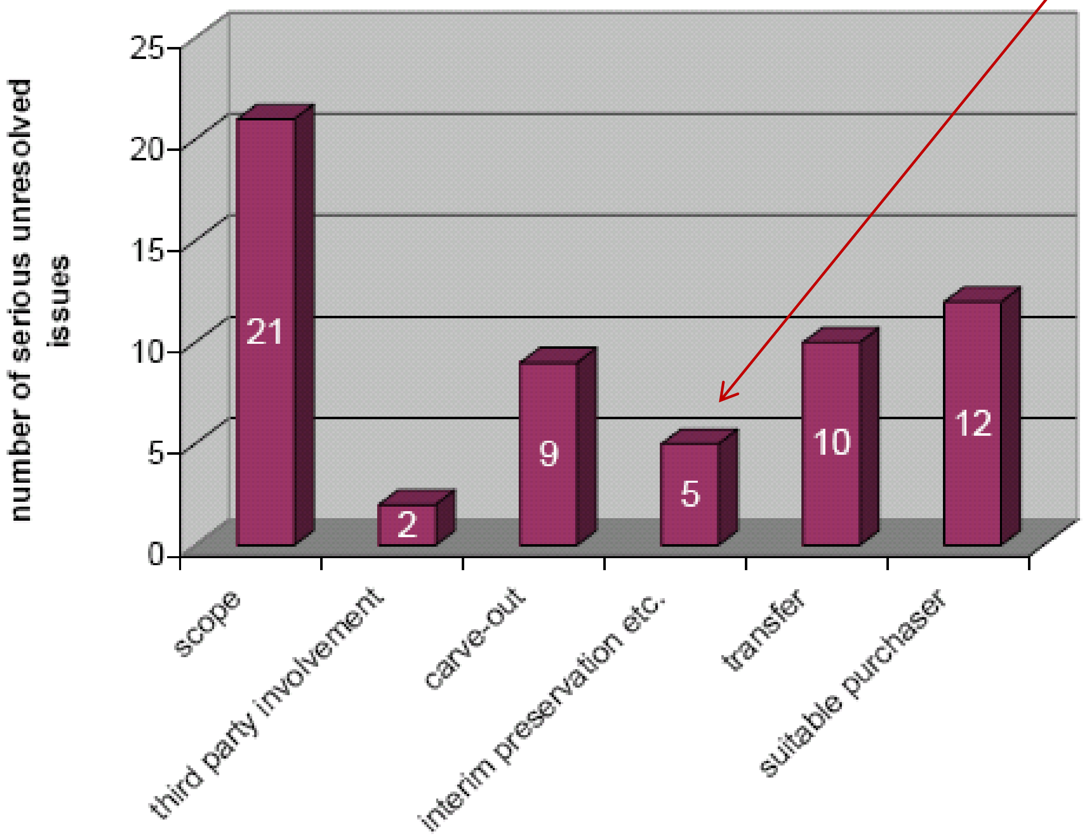

Independent trustees and ex ante control!

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The Benefits and Costs of Merger Control

Benefits

- Market structure that allows competition to flourish
  - Short run: prices
  - Long run: innovation
- Avoids confusion with cartel or growth by satisfying customers
- Firms benefit by reflecting on why they should merge
  - Half of all mergers are unprofitable
- Deterrence of anti-competitive merger proposals
  - If clear, consistent decisions
  - Encourage right type of merger

Costs

- Investigation costs
  - Firms
  - FNE & Tribunal
- Remedy implementation
  - Esp. for completed mergers
- Potential decision error
  - If prohibit or deter pro-competitive mergers
  - If ineffective remedies applied

Conclusions for effective merger control

- Competitive markets work **best for consumers** (& firms)
- Merger control is an **integral part** of the defence of competitive markets
- Not appropriate to treat mergers as either dominant firms or restrictive agreements
- Merger appraisal should focus on **economic effects**
- Mergers are efficiently **controlled before completion**

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- Not appropriate to treat mergers as either dominant firms or restrictive agreements
- Merger appraisal should focus on **economic effects**
- Mergers are efficiently **controlled before completion**

→ ***The benefits of effective merger control greatly outweigh the costs***