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The case for (stronger) merger enforcement

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Outline

- The case for (stronger) merger enforcement
  - Indirect evidence: increased concentration and profitability
  - Ex post evidence on mergers
  - What does theory tell us?
- Difficulties of merger control
- Theories of harm which are difficult to substantiate
- Remedies: increasingly complex and uncertain

The Economist, Nov. 16, 2017

"Business is less cut-throat than it used to be."

Increasing concentration and profitability

*Council of Economic Advisors, McKinsey, The Economist:**

1) Firms' profitability has increased; its distribution is more unequal
2) Sectoral concentration has increased

Possible reasons:

– Globalisation (successful firms earn more)
– Technological progress (IPR, network effects matter more)
– Fiscal policy (lower corporate taxes, tax competition)
– **Huge M&A activity in last decade: too weak competition enforcement?**

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Merger retrospectives

- Kwoka (2012): "meta-study" of US mergers. 76% anti-competitive; remedies were inadequate.
- FTC: 4 out of 5 hospital mergers price increases: even non-profit organisations raise prices.
- Ormosi et al. (2015): "meta-study" on mergers in the EU. Prices rise (less if remedies imposed)
- Even ex post assessment of some mergers (e.g. S-PVC, mobile) by the EC points to price rises…

(!) Not representative samples: "close calls"; sectors with public data; are all works properly done?

Still, a worrying picture of under-enforcement…

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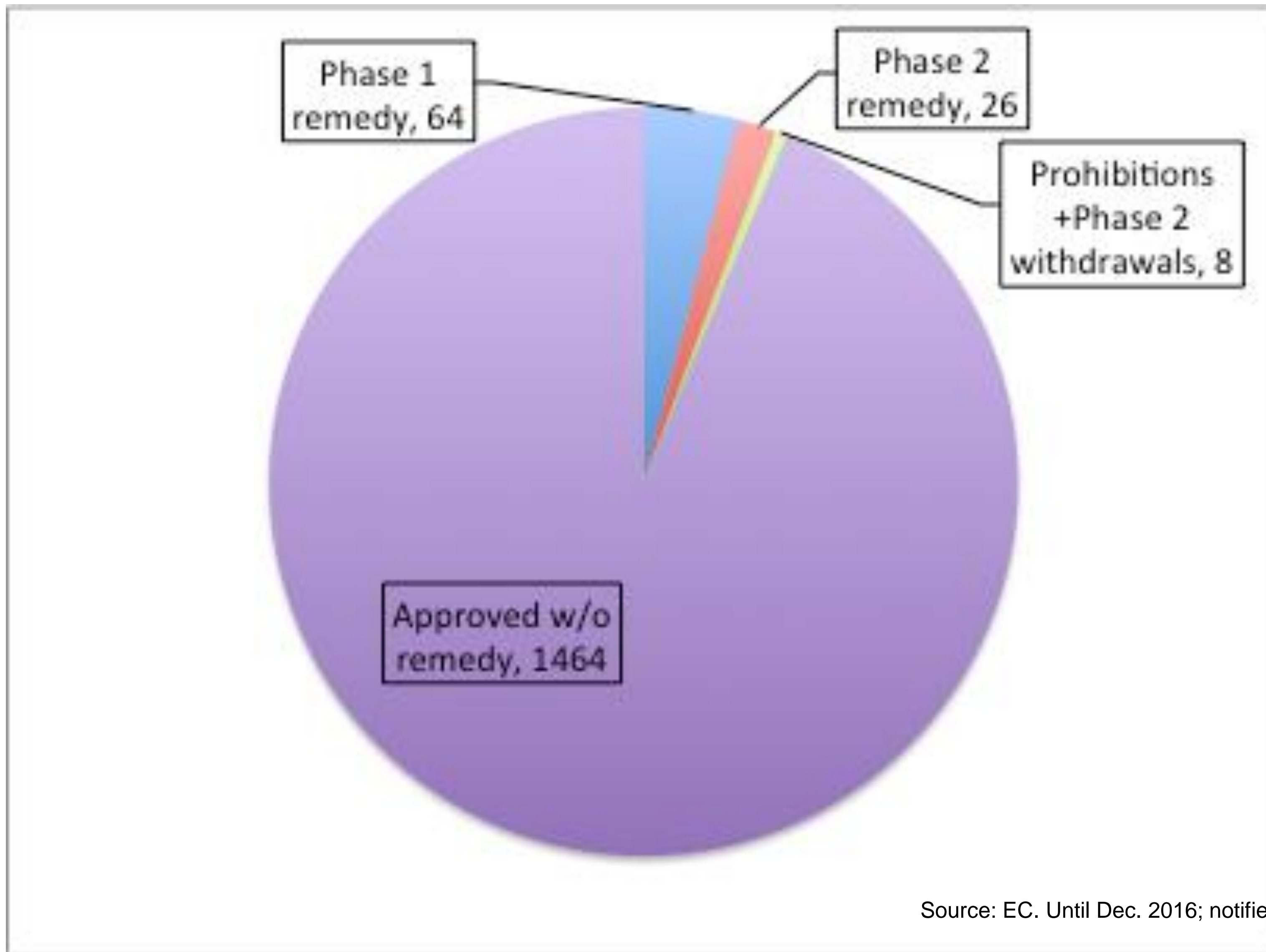
What do we know from theory?

- Vertical and conglomerate mergers are less likely to harm competition, but…
- *Horizontal mergers* have a detrimental effect on prices, except if efficiency gains are large enough (and the higher the merging parties' market power the larger the cost savings needed not to have anticompetitive effects)
  - But do we expect high efficiency gains for the mergers that competition agencies typically worry about?
  - Yet, it is Competition Agencies which have to show a merger "substantially lessens competition", and it is often expected that mergers be prohibited only rarely

EC's intervention rates, 2012-2016



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Merger control in the EU

It works reasonably well, but likely under-enforcement:

- EC and NCAs work under tight deadlines (rightly so) but are understaffed → not too many Phase II cases can be done at the same time; not enough time/people at crucial times (e.g. last-minute remedies): prioritisation matters
- Strong interests at stake → huge pressures on the CAs
- Prohibition perceived as truly exceptional, and last-resort…
  → increasingly complex remedies (see below)
- Since it is CAs which need to prove anticompetitive effects:
  - Theories of harm need to be substantiated and standard of proof may be very high (see below)
  - They depend on parties' data/information/internal documents - which may be 'strategic' about it

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Examples of mergers which may be anti-competitive but are difficult to challenge

- When merging parties' market shares barely overlap, there may still be reasons for concern:
  - *Potential competition*: if firms want to grow, likely they will enter each other market. But to prove the counter- factual, need for internal documents…And may economics help 'complement' documental evidence?
  - *Innovation markets*: sometimes by looking at the final market we get the wrong picture. E.g., pharma: Firms A,B do R&D in markets 1,2,3,4. Firm A successful in 1,2; B in 3,4. By allowing a merger between A and B, less competition in innovation (and in the future also in the product market)
  - *Technology*: a large firm swallows lots of minnows with good idea but little money/production/marketing capacity: synergies or getting rid of a possibly future rival?

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Merger remedies in the EU

- "Complex interventions" (25% of remedies, 2011-13): "creative" solutions, e.g. carve-outs within assets (or staff, contracts) of parties (e.g. multi product plants); access remedies.
- Need to assess not only scope (full overlap 60% of cases, 2011-13), but also viability/competitiveness of the purchaser; innovation and product portfolio matter; also, parties have incentive to select a weak buyer.
- Example: Capacity-based MVNO in mobile mergers: never tested in practice; size matters; future-proofness: difficult to address in an industry which changes so rapidly; contractual clauses may change completely the nature of the remedy.
- CAs redesign the industry with such remedies: But, are they good at it?

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Summary, and implications

Could anyone (apart from, possibly, shareholders) expect anything good from *horizontal* mergers in very concentrated industries?

Theory and empirical work suggest the answer is 'no' – unless the merger entails large efficiency gains (which should be proved).

Yet, CAs in most jurisdictions tend (safe exceptions) to allow them, and somehow there is the expectation that they should challenge mergers only rarely

Ever more complex remedies are not the solution

➔Strong merger enforcement is needed.

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Annex

Figures on firms' profitability and concentration

The global corporate profit pool has risen to a 30-year high

1980 | 2013

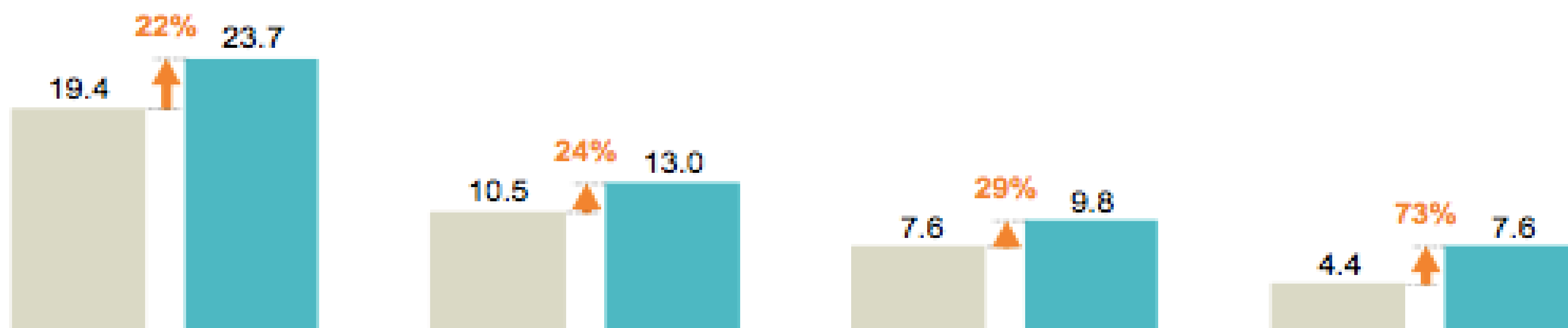
Gross pre-tax	**Net pre-tax**	**Net post-tax**	**Net income**
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	Earnings before interest and taxes (EBIT)	Net operating profit less adjusted taxes (NOPLAT)	

Total size of profit pool[1]

$ trillion, 2013 dollars

Corporate profit pool

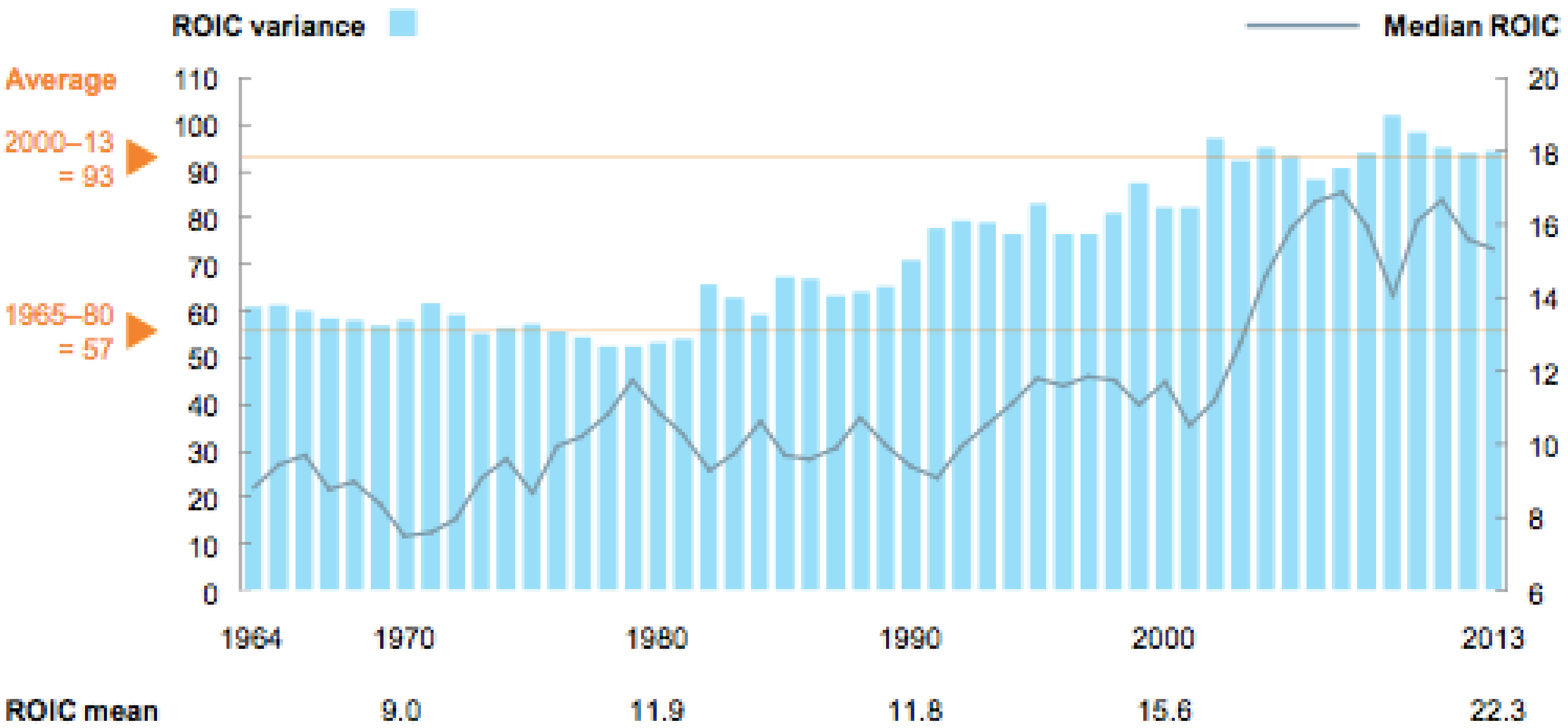
% of world GDP



1 Calculated using macroeconomic data combined with financial data for 28,250 companies (16,850 publicly listed firms and 11,400 privately held firms) with more than $200 million in annual revenue.

SOURCE: World Bank; OECD; Bureau van Dijk; European Commission AMECO database; US Bureau of Economic Analysis; IHS; Oxford Economics; McKinsey Corporate Performance Analysis Tool; McKinsey Global Institute analysis

Variance in return on invested capital (ROIC) for North American firms, 1964–2013[1]
%



1 Firms included in this analysis had more than $200 million in revenue in at least one year during this period as well as ROIC between zero and the 95th percentile. "Variance" is defined as the ratio of standard deviation to mean.

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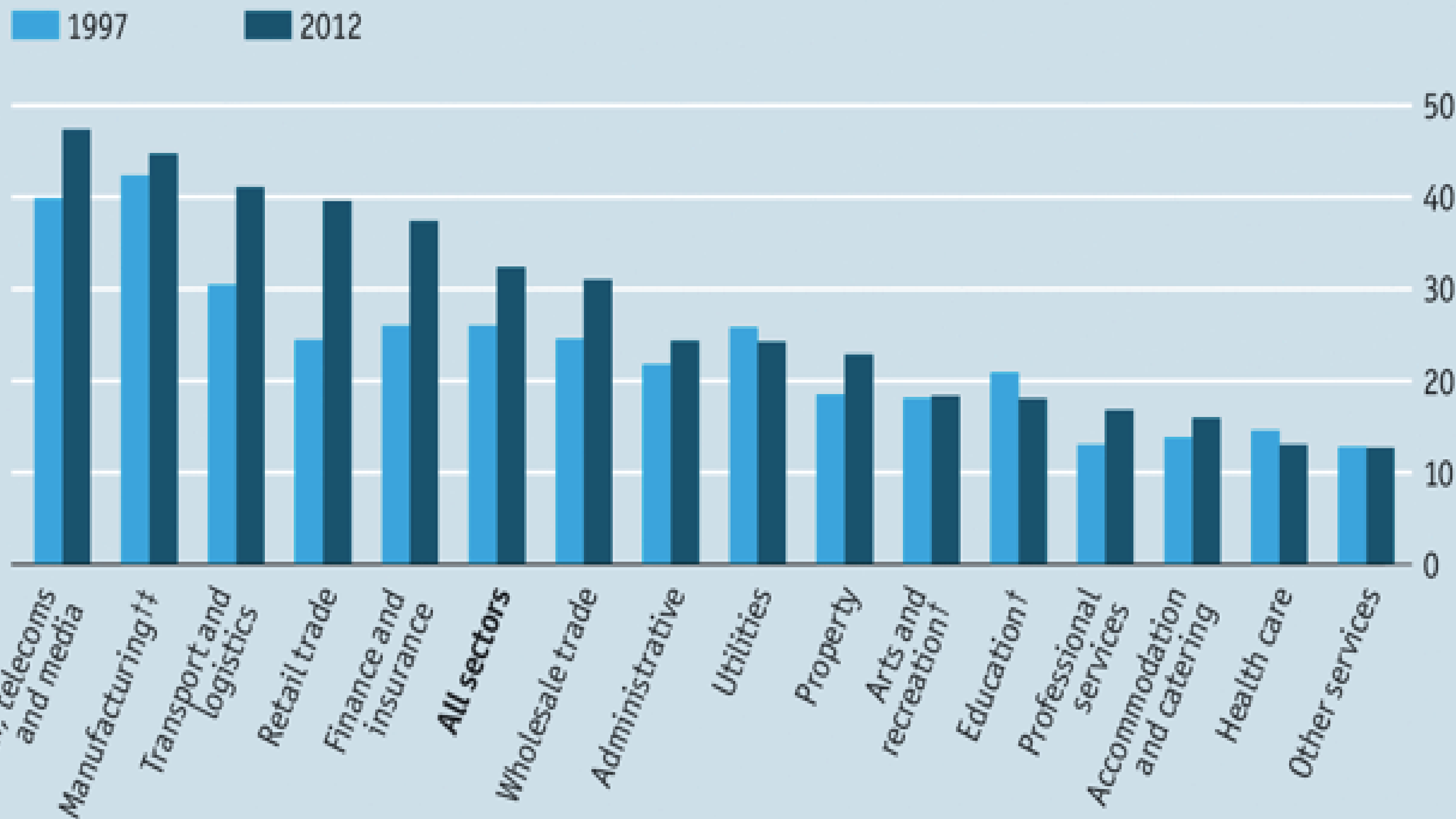
The top 10 percent of firms account for 80 percent of all profits

1 Sample set includes all publicly listed companies with $200 million or more in annual revenue in any year between 1990 and 2013.
NOTE: Numbers may not sum due to rounding.



More to fewer
2
Top four firms' average share of total revenue, %
United States, across 893 industries, grouped by sector*
1997
2012
50
40
30
20
10
0
IT, telecoms and media
Manufacturing†‡
Transport and logistics
Retail trade
Finance and insurance
All sectors
Wholesale trade
Administrative
Utilities
Property
Arts and recreation†
Education†
Professional services
Accommodation and catering
Health care
Other services
Sources: US Census Bureau; The Economist
*Weighted-average †2007 ‡By valued-added