Brno

12 November 2013

More Economic Approach in Merger Analysis

Norbert Maier

European Commission (DG COMP/Chief Economist Team)

Introduction

More economic approach:

1. Using more sophisticated economic arguments
   - Barriers to grow/expand – failure to act as a competitive constraint for the merged entity within the required time frame
   - Strategic use of spare capacities – spare capacity of competitors is not always a guarantee for exerting sufficient competitive pressure on the merged entity
2. Using more complicated economic/econometric techniques
   - not discussed here because it’s more technical

Barriers to grow/expand - Framework

Typical framework: merger to monopoly

Merging parties' argument: existing small players in the market will enjoy arising opportunities to expand

- merger specific because of strong competition between the merging parties prior to the merger does not allow for smaller parties to gain significant market share

Smaller players:

- the merger opens up new opportunities to win business and expand
- claim that they can expand without problems in all customer segments

Customers, especially the larger ones, do not look at smaller players as really being able to serve them

It can be shown that it is indeed difficult for smaller players to quickly develop to the level of being able to serve larger customers

Barriers to grow/expand – Practice
The Syniverse-Mach merger

Merger between the two largest players in the mobile roaming data clearing (DC) market (joint market share > 80%)

Customers: mobile network operators (MNOs: BT, Belgacom, etc.)

- Tier 1 MNOs: Vodafone, France Telecom, etc.
- Tier 2-3 MNOs: Telenor, Hutchinson 3G, Belgacom

QoS key – penalty schemes in the service level agreements (SLAs)

- larger penalties by Tier 1 MNOs

Parties claim that smaller players (SMs) will be able to expand quickly and pose a competitive constraint on the merged entity

SMs have experience of serving Tier 2-3 MNOs but not Tier 1 MNOs

SMs confident of being able to serve Tier 1 MNOs but Tier 1 MNOs did not think so

Barriers to grow/expand – Practice: The Syniverse-Mach merger

Data clearing an experience good

- reputation is a key issue – importance of track records

Tier 1 MNOs insist on the inclusion of strong penalty schemes

- to induce DC providers to allocate more resources to assure high QoS
- to let the DC provider choose not to quote for a contract if it thinks QoS can be a problem

Smaller customers with a limited income stream may not want to take the risk of signing service contracts with large penalties

- the triggered penalties would lead to financial difficulties for the service provider

Smaller players may decide to hire and train additional experts

- hiring and training at the required scale is time consuming and cannot be completed in the post-merger evaluation time frame (e.g. 2 years)

Strategic use of spare capacities - Framework

Competitive pressure increases with rival capacity in homogenous product industries with price competition

Merging parties' argument: reactions from rivals will ”defeat” any post-merger price increase

Para 33 HMG: SIEC is unlikely when ”… rival firms have enough capacity and find it profitable to expand output sufficiently”

- ability and incentive to expand – no automatic double ”Yes”

Merger consolidates parties' capacities

- reduces competitive pressure from rival capacity
- increases merged entity's market power (… unless rival capacity is HUGE, i.e. equaling total market demand)

Strategic use of spare capacities – Practice

The Outokumpu-Inoxum merger

Merger between the two largest players in the cold rolled stainless steel (CR) market (joint market share [50-60]%)

3rd and 4th players with smaller market shares ([10-20]%)

4 to 3 merger in homogenous goods market

Market investigation raising concerns

The industry suffers of overcapacity ([20-30]% of EEA demand)

Strategic use of spare capacities – Practice
The Outokumpu-Inoxum merger

Merger eliminates competition between Parties' capacities

- Reduction in rival capacity reduces competitive pressure
- Incentive for merged entity to raise price

Rivals may have the ability to expand output sufficiently, but they are unlikely to have the incentive to do so

- in equilibrium rivals will follow price increase – computer model to assess the Parties' arguments and order of magnitude of effect

Capacity shares and capacity increment are informative in homogenous goods markets!

- at least for large firms mergers that affect position of capacity leader

Conclusion

Economic analysis offers efficient tools for taking the extra step beyond well-sounding standard arguments

These standard arguments can be reinforced or rebutted with additional economic analysis