Agenda
Advancing economics in business

How do you solve a problem like a merger?

There are growing concerns about large corporations dominating markets and economies, and calls on competition authorities to take a tougher stance on mergers and acquisitions. Are these concerns any different from those about large trusts a century ago, and those about conglomerates in the 1960s and 1970s? Does merger control require radical reform? Dr Gunnar Niels, Oxera Partner, shares some views

Mergers and acquisitions routinely make the financial headlines. In the last few months alone, there has been news of Disney confirming a deal to buy 21st Century Fox for $60bn; Broadcom, a semiconductor company, making a $130bn offer for Qualcomm; AT&T's continued attempt to take over Time Warner for $84.5bn; and a potential tie-up between SSE and Npower, two of the UK's 'big six' retail energy providers.[1] Another widely publicised merger that was completed this year—following intense scrutiny by competition authorities—was Dow Chemical/DuPont, valued at $130bn.[2]

At the same time, there are growing concerns about the high levels of concentration observed in many markets worldwide. Joseph Stiglitz, a Nobel Laureate in Economics, expressed these concerns in a recent paper entitled 'America has a monopoly problem—and it's huge'.[3] Much of the focus is on tech giants Google, Facebook and Amazon, but other industries have seen increases in concentration as well, as confirmed by academic work.[4] Some competition authorities are asking whether they have been too 'light-touch' in merger reviews over the past 20 years, and whether a tougher stance is required going forward.[5] At the conspiracy-theory end of the spectrum, some even blame economists for enhancing corporate concentration.[6]

Are such concerns justified, or an over-reaction? One way of answering this question is to look at the past. Concerns about market concentration have come and gone in waves over the decades.

History lessons

In the early days of modern competition law—the US Sherman Antitrust Act was passed in 1890—there were widespread concerns about the growing economic power of 'trusts': large corporations that controlled substantial parts of their industries. The most famous intervention against such trusts was the break-up of Standard Oil into 34 companies, in 1911.[7] For decades, Standard Oil—co-founded and majority-owned by John D. Rockefeller—had dominated the refinement and shipment of oil in the USA, with a market share of 80–90%. It had achieved this position through a combination of superior efficiency, the acquisition of more than 120 rival companies (merger control did not exist at the time), and a variety of questionable business practices. Reference was also made to the 'enormous and unreasonable profits' earned by Standard Oil because of its monopoly power.

Concerns about market concentration surfaced again in the 1960s, during a wave of conglomerate mergers in the USA. In 1966, humorist Art Buchwald wrote the following in a newspaper column, which was reproduced that same year in a Supreme Court judgment concerning a brewery merger:

> It is 1978 and by this time every company west of the Mississippi will have merged into one giant corporation known as Samson Securities. Every company east of the Mississippi will have merged under an umbrella corporation known as the Delilah Co. It was inevitable that one day the chairman of the board of Samson and the president of Delilah would meet and discuss merging their two companies…
>
> The Antitrust Division of the Justice Department studied the merger for months. Finally the Attorney General made his ruling. 'While we find some drawbacks to

> only one company being left in the United States, we feel the advantages to the public far outweigh the disadvantages. Therefore, we're making an exception in this case and allowing Samson and Delilah to merge.'[8]

Consolidation has not turned out to be as inevitable as feared in past decades. Companies have discovered that growth through mergers has its limitations. Conglomerates have become less popular, and divestments of businesses are now almost as common as acquisitions. Competition authorities and policymakers have generally accepted that mergers and acquisitions are part and parcel of a market economy. Companies are forced to consolidate or reposition when an industry goes through fundamental changes on the supply side or the demand side—such as market liberalisation, technological developments, changes in consumer preferences, or a recession. Mergers are often aimed at improving efficiency through economies of scale and synergies. Ambitious companies (and their managers) see mergers and acquisitions as a means to achieve rapid expansion or to enter new markets more quickly than through organic growth. Some mergers are defensive, protecting a market position in the face of new entry. Some are designed outright to eliminate competition and create market power.

Whatever the rationale for the merger, deal-makers nowadays are well aware that they may require clearance from the competition authorities. Over the years many high-profile deals have been scuppered on competition law grounds. For example, AT&T abandoned its plans to buy T-Mobile USA for $39bn in 2011 when the Department of Justice challenged the deal.[9] AT&T's intended acquisition of Time Warner, mentioned above, is also currently facing competition law scrutiny.[10] The European Commission blocked a $9.5bn merger between Deutsche Börse and NYSE Euronext in 2012.[11] The need for regulatory clearance is often built into the deal preparations and negotiations, sometimes with explicit provisions for what happens if competition authorities object to the merger. The more far-sighted among deal-makers also consider at an early stage which divestments or other remedies may need to be offered to the authorities.

Does merger control need radical change?

A tried-and-tested system of merger control exists in most modern economies. Around 130 jurisdictions now have a competition regime—typically including rules on merger control—from Albania and Barbados to Yemen and Zimbabwe.[12] Competition authorities probe whether horizontal mergers eliminate competition between the merging parties, create market power for the merged entity, or dampen competition between the remaining suppliers in the market. They also test whether vertical mergers give a company control over bottlenecks in the supply chain. Should merger control be adjusted in light of the current concerns about market concentration? Let us consider some radical options.

Prohibit all mergers—would that not put an end to unwarranted market concentration? Companies that want to grow would have to do so organically, earning success on their own account. Such a policy would stimulate healthy competitive effort, and save enforcement costs. Yet outright prohibitions of mergers are relatively rare, for good economic reasons. Competition authorities recognise that mergers and acquisitions are an inherent part of how markets work and often have efficiency rationales. Without a possibility for mergers, there would be markets in which suppliers could not keep up with the pace of change—imagine an international legal services market in which Deringer, Bruckhaus and Freshfields, or Lovells and Hogan & Hartson, were still separate firms; or a film industry in which Disney could not acquire Lucasfilm, depriving millions of people from seeing *The Last Jedi* this month. Instead of a prohibition, what often happens is that mergers that risk reducing competition are cleared with remedies to address the competition concerns, often in the form of divestments.

Break up companies—if we are worried about companies being too large, why not break them up? Corporate break-ups have been relatively rare in competition law—beyond the Standard Oil case mentioned above, the few instances include the break-up of AT&T in the USA into a long-distance operator and seven regional operators (1982), and that of BAA in the UK separating Heathrow Airport from Gatwick and Stansted airports (2009).[13] There is more experience of vertical separation in regulated sectors in many countries, in particular telecoms, rail and energy, where competitive parts of the industry (e.g. electricity generation) have been separated from the monopolistic parts (e.g. electricity transmission).

There are now calls to break up the likes of Google and Facebook.[14] The difficult questions that such an intervention would raise are the same as for the more 'traditional' break-ups of network industries: how to split the company horizontally and/or vertically? How to regulate any remaining monopolistic bits? How to prevent negative effects on incentives to invest and innovate after the separation?

Prohibit acquisitions by big companies, even if competition is not (yet) threatened—a slightly milder variant of the above options is to prohibit any further acquisitions by big companies, even if these deals do not directly lessen competition in existing markets. Acquisitions such as those of Instagram (2012) and WhatsApp (2014) by Facebook, and YouTube (2006) and DoubleClick (2007) by Google, may not have raised concerns at the time because the merging parties were not in direct competition with each other. However, some would argue, perhaps with hindsight, that these deals have strengthened the positions of Facebook and Google in their various markets over time.[15]

Stick to your principles

Concerns about growing market concentration and the power of large corporations are often social and political, as well as economic. Radical reforms of the merger rules are always useful to consider, if only to satisfy oneself that the existing rules are still fit for purpose. This applies to the current tools and tests applied by competition authorities in merger cases when it comes to economic considerations—in particular, the effects of mergers on efficiency, competition and consumers.

There seems to be no compelling economic case for radical reform, such as prohibiting all mergers, or breaking up existing companies. Instead, the existing merger tests can be refined to tackle novel issues, such as mergers between digital platforms or innovative companies that do not (at first sight) compete directly with each other but would still affect competition negatively when merged. A recent example is the European Commission's ruling against the Dow/DuPont merger (2017) mentioned above, which it deemed to result in a lessening of competition, not so much in existing product markets as in the 'innovation space'.[16]

Competition authorities are proactively monitoring such market developments and are exploring refined approaches to merger analysis. They are also increasingly trying to learn from ex post evaluations of merger decisions. With the current merger rules in place, it seems unlikely that we will return to the Standard Oil days, or, for that matter, to the Samson and Delilah scenario.

Dr Gunnar Niels

[1] Garrahan, M., Fontanella-Kahn, J. and Bond, S. (2017), 'Disney and Fox near $60bn deal to reshape media industry', *Financial Times*, 13 December. *Financial Times* (2017), 'Broadcom's unsolicited £130bn Qualcomm bid sets stage for brutal fight', 7 November; Fontanella-Khan, J., Bond, S. and Garrahan, M. (2017), 'US regulators demand CNN sale to approve AT&T-Time Warner deal', *Financial Times*, 8 November; Thomas, N. (2017), 'Two of Britain's biggest energy groups in talks to combine', *Financial Times*, 7 November.

[2] *Fortune* (2017), 'Dow Chemical and DuPont have completed a $130 billion merger', 1 September. See also European Commission (2017), 'Mergers: Commission clears merger between Dow and DuPont, subject to conditions', press release, 27 March.

[3] Stiglitz, J.E. (2017), 'America Has a Monopoly Problem—and It's Huge', *The Nation*, 23 October, https://www.thenation.com/article/america-has-a-monopoly-problem-and-its-huge/.

[4] See, for example, Grullon, G., Larkin, Y. and Michaely, R. (2017), 'Are US industries becoming more concentrated?', working paper, https://www.economics.utoronto.ca/index.php/index/research/downloadSeminarPaper/70104.

[5] See, for example, the comments by the chief executive of the UK Competition and Markets Authority reported in O'Brien, H. (2017), 'Coscelli: Enforcers may have been too "light-touch" in merger review', *Global Competition Review*, 10 November.

[6] Eisinger, J. and Elliott, J. (2016), 'These professors make more than a thousand bucks an hour peddling mega-mergers', *ProPublica*, 16 November, https://www.propublica.org/article/these-professors-make-more-than-thousand-bucks-hour-peddling-mega-mergers.

[7] *Standard Oil Co of New Jersey v United States* 221 US 1 (1911).

[8] *United States v Pabst Brewing Co.*, 384 U.S. 546 (1966).

[9] *United States v AT&T Inc., T-Mobile USA Inc., and Deutsche Telekom AG*, Civil Action No. 11-01560, (ESH) (D.D.C. filed 30 September 2011).

[10] Department of Justice (2017), 'Justice Department challenges AT&T/DirecTV's acquisition of Time Warner', press release, 20 November.

[11] *Deutsche Börse/NYSE Euronext* (Case COMP/M.6166), Decision of 1 February 2012.

[12] The US Federal Trade Commission has a list on its website, https://www.ftc.gov/policy/international/competition-consumer-protection-authorities-worldwide.

[13] *United States v AT&T Co* 552 F Supp 131 (DDC 1982); UK Competition Commission (2009), 'BAA Airports market investigation', March.

[14] See, for example, European Parliament (2014), 'MEPs zero in on internet search companies and clouds', press release, 27 November; Taplin, J. (2017), *Move fast and break things: How Facebook, Google, and Amazon cornered culture and undermined democracy*, Little, Brown and Company; and 'Is it time to break up Google', *New York Times*, 22 April 2017.

[15] See, for example, Stratechery (2017), 'Why Facebook shouldn't be allowed to buy tbh', 23 October, https://stratechery.com/2017/why-facebook-shouldnt-be-allowed-to-buy-tbh/.

[16] European Commission (2017), 'Mergers: Commission clears merger between Dow and DuPont, subject to conditions', press release, 27 March. European Commission economists have written a number of academic papers arguing that mergers always have a negative effect on innovation. See Federico, G., Langus, G. and Valletti, T. (2017), 'A simple model of mergers and innovation' *Economics Letters*, **157**:C, pp. 136–140.