RAYMOND QUENEAU

On est toujours trop bon avec les femmes

Un roman irlandais de Sally Mara

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We are always too soft with mergers

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Milano, 28 February 2019

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Increasing concentration and profitability

- Firms' profitability has increased and its distribution is more unequal (and big business is getting bigger?)
- Sectoral concentration has increased
- Mark-ups have been rising considerably in the last decades
- Common ownership may have reduced the incentives for rival firms to compete aggressively

- *Council of Economic Advisors (2016), McKinsey, The Economist, McKinsey Global Institute Competition Report (2015)*
- *De Loecker and Eeckhout (WP, 2017), Traina (WP, 2017)*
- *Azar, Schmalz, & Tecu (J. Finance 2017)...*

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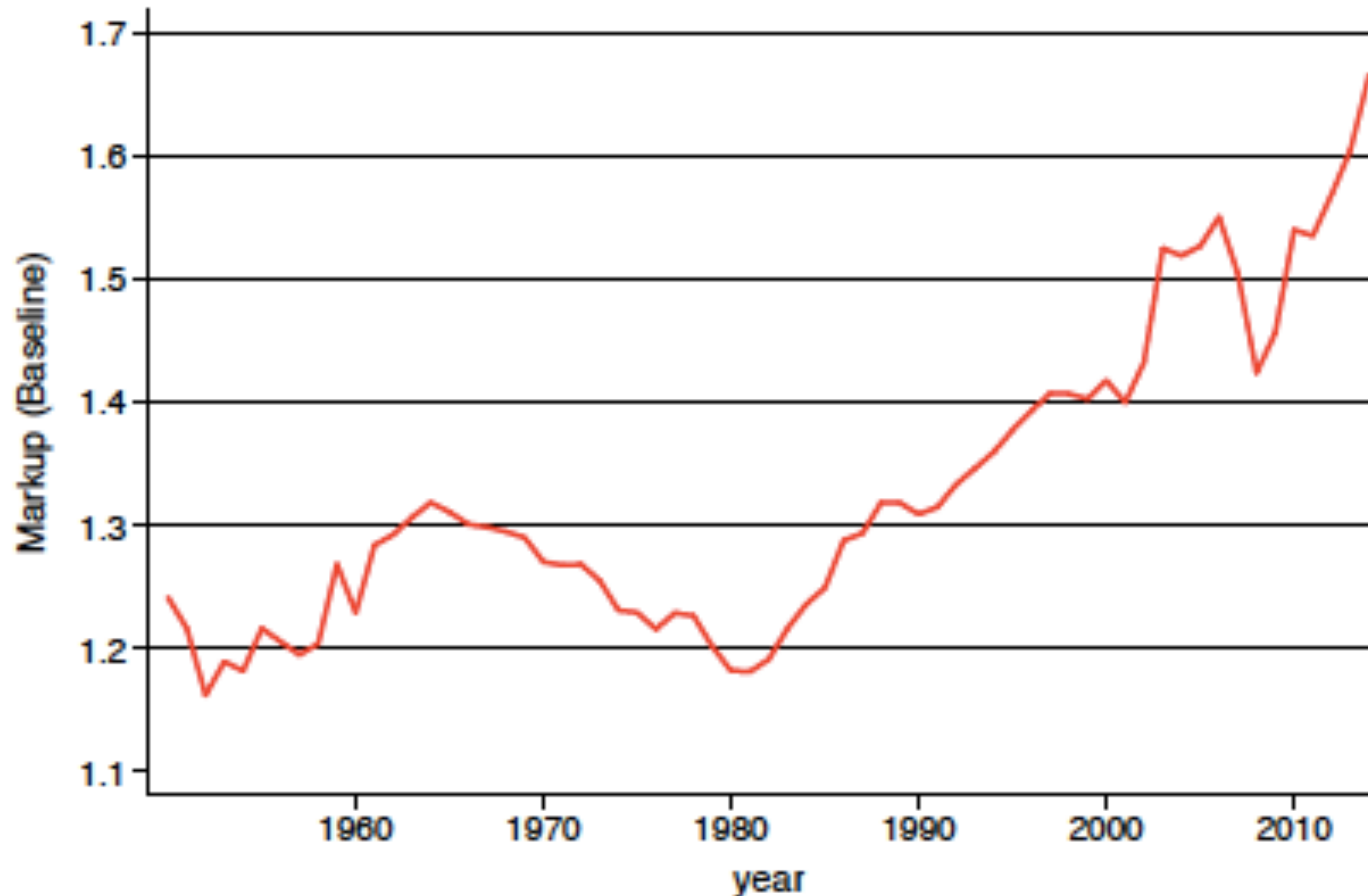
De Loecker & Eeckhout (2017): The rise of market power



Evolution of Weighted Average Markups, US, 1950 - 2014.

Compustat (publicly traded firms, firm-level balance sheet data), US

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DeLoecker&Eeckhout 2018: Global mark-ups

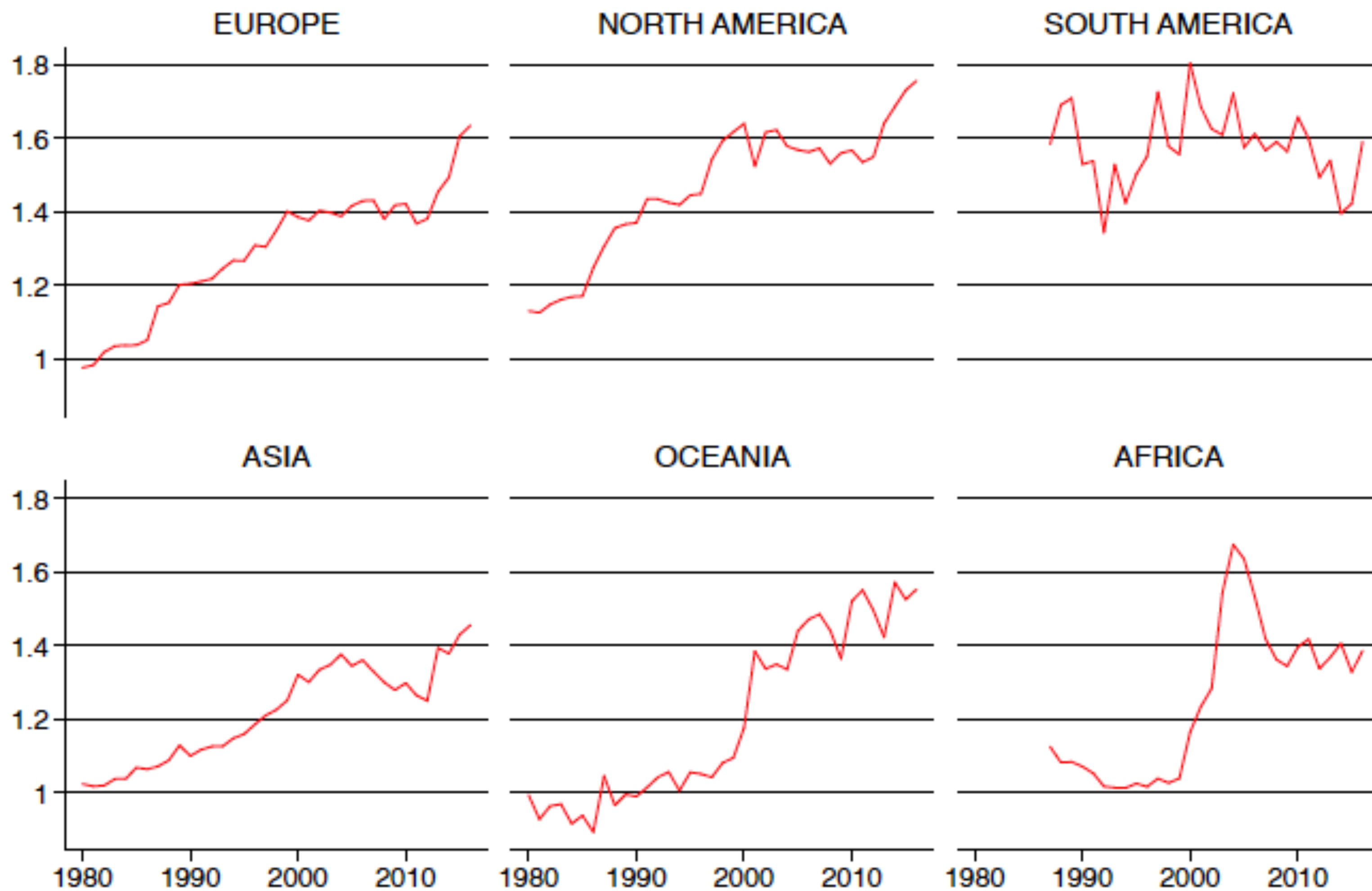

Figure 3: GLOBAL REGIONS

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Why should we care?

- Profitability is not bad per se: the expectation of profits (i.e., *appropriability*) is one of the factors which pushes firms to invest and innovate
- But competition (i.e. *contestability*) is likely the single most important factor in productivity growth, and..
- …higher concentration and increased profitability may signal that firms are not competing as fiercely as they should…

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The Economist, Nov. 16, 2017

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

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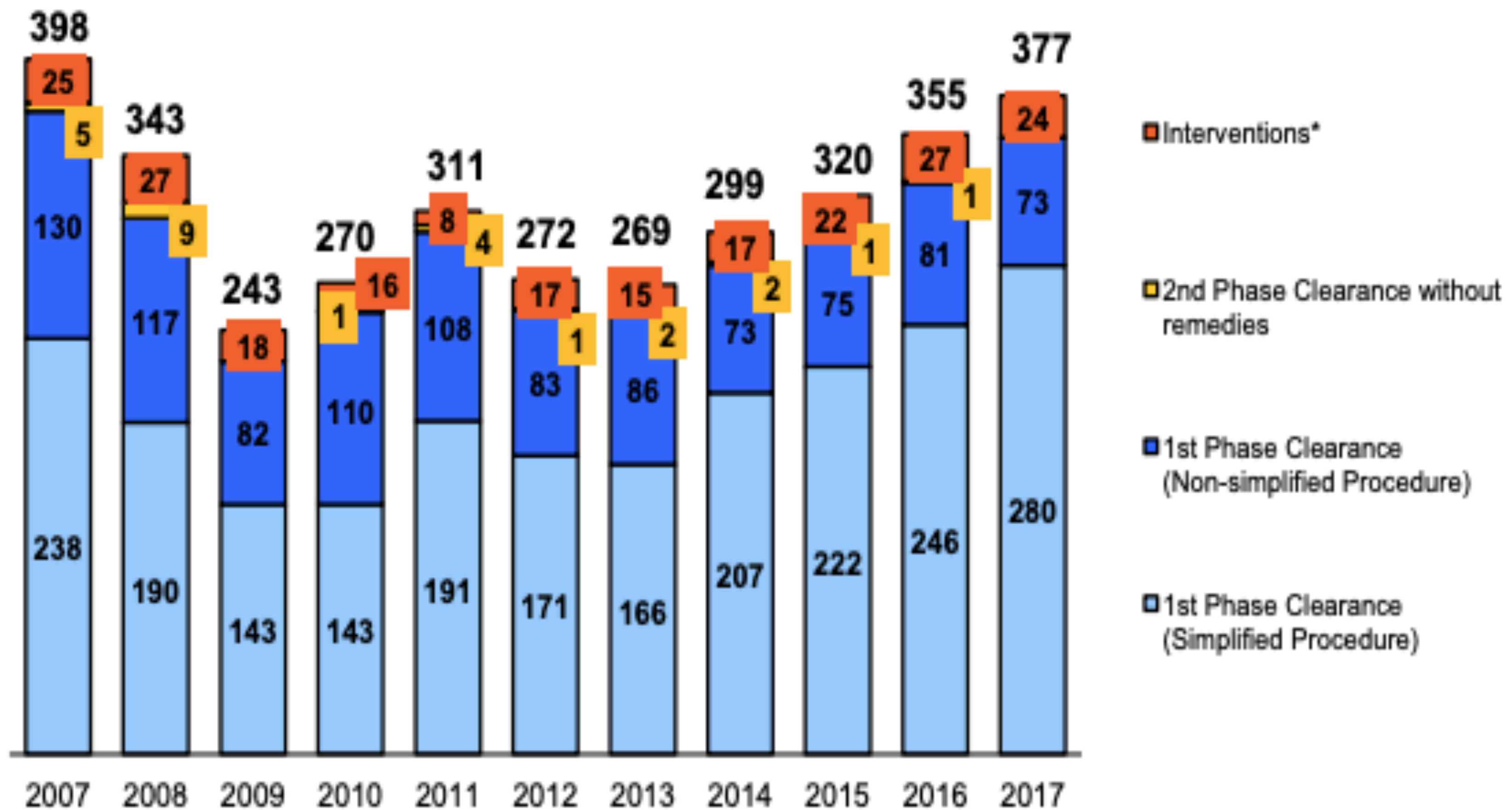
Rising concentration and profitability: what reasons?

- Globalisation: successful firms gain more
- Technological progress: IPRs and network effects matter more ➔ concentration rises
- Fiscal policy: firms have benefited of lower corporate taxes, and multinationals of fiscal advantages
- **Too weak competition enforcement?**
  - **Has merger control been too lenient?**
  - Rare abuse of dominance enforcement in the EU (completely non-existent in the US)

Merger enforcement, the Commission decisions 2007-2017:



* Interventions in merger cases include prohibition decisions and mergers cleared subject to remedies, as well as withdrawals in Phase II;

Prohibition decisions: one in 2007, 2011, 2012 and 2016. Two in 2013 and 2017;

Source: Directorate-General for Competition

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Some empirical evidence

- Kwoka (2012): "meta-study" of US merger retrospectives. 76% anti-competitive; remedies were inadequate.
- FTC: 4 out of 5 hospital mergers price increases: even non-profit organisations raise prices.
- Even ex post assessment of some mergers (e.g. S-PVC, mobile) by EC and National Agencies points to price rises…

  (!) Not representative samples!

- Event studies: Duso et al. (2013) find unconditional approval of *anti-competitive* mergers in 2/3 of the sample (and it may be an under-estimation, see also Kwoka and Gu, 2015)

Take with pinch of salt, but still picture of under-enforcement…

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What do we know from theory?

- Vertical and conglomerate mergers are *perhaps* 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)
  - 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

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Merger under-enforcement, I

- EC and NCAs are under-staffed
- Strong interests at stake → huge pressures on CAs
- Prohibition perceived as exceptional, and last-resort…
  → increasingly complex remedies (see below)
- CAs 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 often be 'strategic' about it

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Merger under-enforcement, II

- Over-reliance on entry as a mechanism which will redress competition
- There may be a reason why potential entrants have not entered the industry yet
- Even if barriers to entry are low, entrants know that post-entry the incumbents will decrease prices
- Some anecdotal evidence (ex post done by the CMA; some EC cases)

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Merger under-enforcement, III

- Concerns even if parties' market shares barely overlap:
  - *Potential competition*: if firms want to grow, likely they will enter each other market. But need for internal documents… May economics help establish the counter-factual?
  - *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?
  - [Cunningham et al.(2018): "Killer acquisitions"]
  - *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)

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Merger under-enforcement, IV

- Rare coordinated effects cases in the EU after the Airtours judgment (→"Overshooting" by the EC)
- Recently, almost exclusively cases where there was past history of attempted or successful collusion in the industry

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Under-enforcement, V: remedies

- "Complex interventions": "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 purchaser; innovation and product portfolio matter; also, parties have incentive to select a weak buyer.
- CAs redesign industries with remedies: But, are they good at it?
- More generally, why should competition (and consumers) bear the risk that remedies are insufficient?

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Under-enforcement, VI: expected values

- In most cases, AAs and courts do not reason in terms of expected values
- Suppose the merger remedy would leave us with ΔCS=0, but the remedy works with probability 51%. If it does not work, then ΔCS=-10%. In expected terms, E(ΔCS)=-5%, but a preponderance of evidence standard would lead the AA/judge to allow the merger
- Similar reasoning for the impact of potential competition, likely entry etc..

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Summary, and implications

Theory: horizontal mergers unlikely to be pro-competitive

Empirical evidence consistent with merger under-enforcement

A more sensible approach would be:

- *de minimis* rule for mergers involving small firms
- Reversal of burden of proof for any other horizontal merger (including cases where market shares barely overlap but parties are above certain thresholds)
- More work is needed on vertical and conglomerate mergers