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ICN Merger Workshop

BOS 6 - Economic theory and evidence in analysis of vertical mergers

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Your speakers today

ALEX BAKER
Director
Fingleton Associates

JAEWON KIM
Economic Advisor, Office of the Chief Economist
Konkurrensverket

NOAM DAN
Senior Economist
Israel Antitrust Authority

ALÍPIO CODINHA
Deputy Director of Merger Department
Autoridade da Concorrência

A primer on vertical mergers

PRESUMPTIVELY PRO-COMPETITIVE

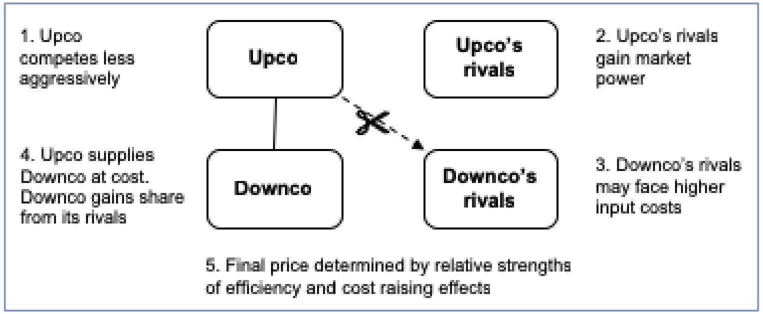
- No direct loss of rivalry (in pure cases)
- Efficiencies / elimination of double marginalization
- Reduced contracting/transactions costs
- Mitigation of hold-up problem
- Elimination of free-riding
- Improved information flow/co-ordination

POTENTIAL ANTI-COMPETITIVE EFFECTS

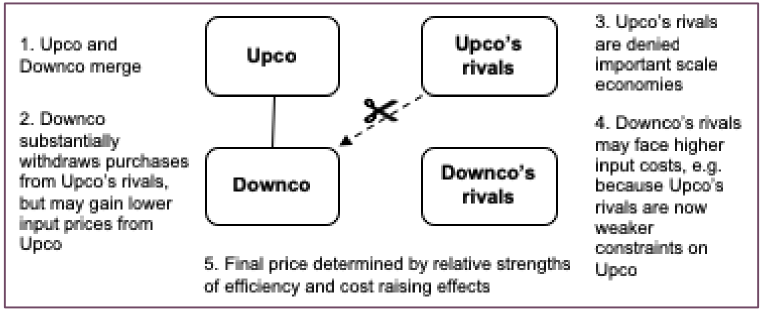
- Input foreclosure (refusal to supply/supplying on worse terms)
- Customer foreclosure (refusal to purchase/supplying on better terms)
- Increased likelihood of coordination
- Access to confidential information

Common theories of harm in vertical mergers

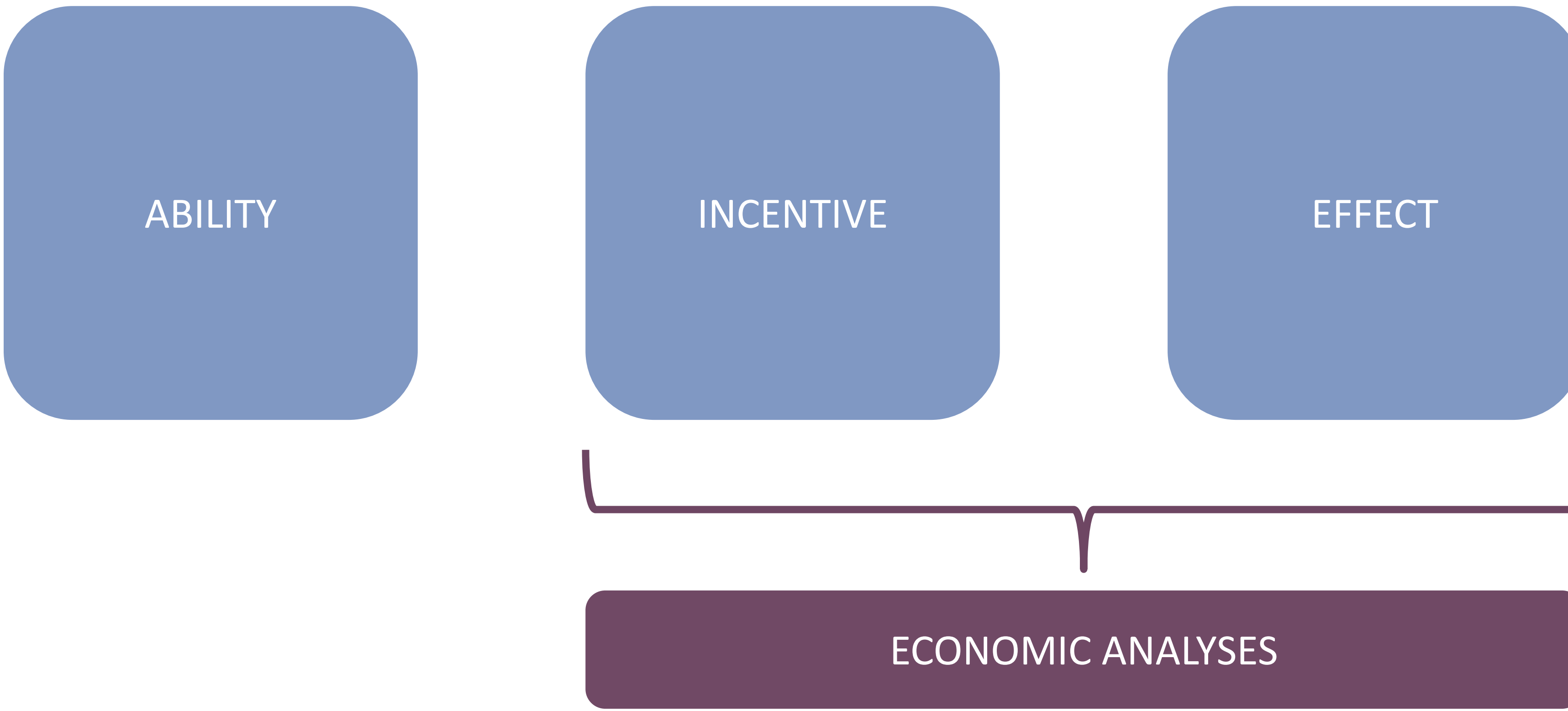
INPUT FORECLOSURE



CUSTOMER FORECLOSURE



Framework for assessing vertical mergers



Potential vertical merger analyses

VERTICAL ARITHMETIC

- Critical loss analysis
- Comparison of profits forgone in upstream and downstream markets from pursuing a foreclosure strategy (i.e., estimate of incentive to engage in strategy)

NASH BARGAINING MODEL

- Based on Nash Bargaining Solution, whereby parties split surplus between agreeing an outcome to disagreeing
- Assesses changes in relative bargaining strength from merger (i.e., changes in relative value of agreement/disagreement)

vGUPPI

- Based on horizontal merger GUPPIs
- ‘Incentive scoring device’ of first-round effects
- Allows assessment of incentive of entities to raise upstream and downstream prices

MERGER SIMULATION

- Equilibrium price effects in upstream and downstream markets

ICN/CMA Vertical Mergers Survey (2018)

CMA Competition & Markets Authority

International Competition Network

ICN Vertical Mergers Survey Results

SUMMARY

1. This paper presents the initial findings from a new workstream for the ICN Mergers Working Group (MWG) on vertical mergers.

2. The ICN has previously undertaken significant work to provide consolidated guidance on merger analysis, with a focus on horizontal mergers. ICN products from this workstream include the Merger Guidelines Workbook (with an introduction to vertical mergers); Recommended Practices for Merger Analysis (2017); Investigative techniques handbook for merger review (2005); and the Implementation Handbook (2006).

3. An important part of this new work has been to conduct and analyse results from a survey of member agencies looking at existing practices in vertical mergers analysis.

4. Key findings from responses to the survey on vertical mergers are:

   (a) Most National Competition Authorities (NCAs) reported that they had intervened in at least one vertical merger in the past three years. However, compared to horizontal cases these interventions are relatively rare, accounting for around 1 in 10 cases in which NCAs intervened.[1]

   (b) Broadly there is a consistent approach by NCAs to the assessment of vertical mergers. Specifically, most NCAs consider input and customer foreclosure theories of harm, use an ability/incentive/effect framework, consider similar factors such as the importance of the input for downstream firms and the existence of alternatives, and also assess efficiencies.

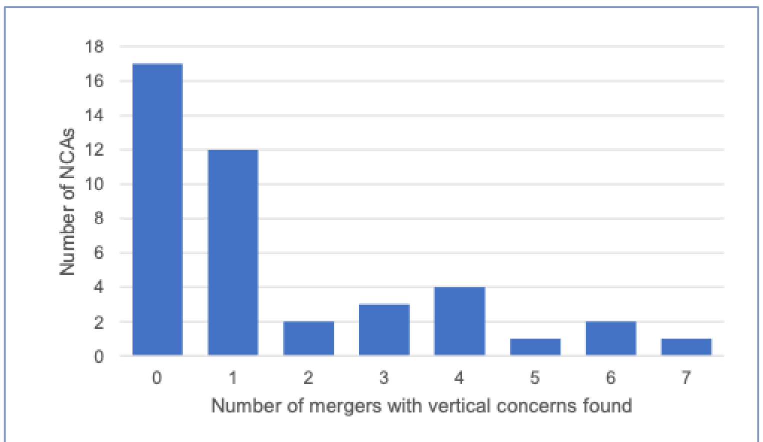
   (c) One of the areas of greatest variation between NCAs is in their use of more detailed economic modelling techniques to analyse foreclosure incentives. While a number of NCAs indicated that they sometimes or always use these techniques, such as vertical arithmetic and vertical

[1] Note that this figure includes purely vertical mergers and mergers where theories of harm include both horizontal and vertical issues.

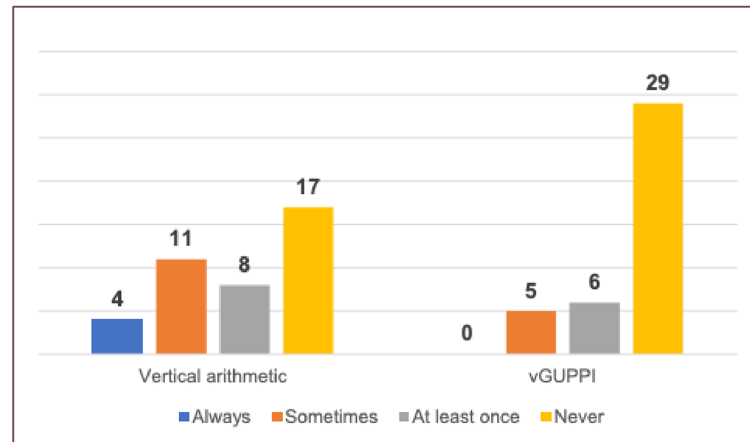
1

ICN/CMA Vertical Mergers Survey (2018)

MERGERS WITH VERTICAL CONCERNS FOUND IN THE LAST THREE YEARS



FREQUENCY OF USE OF VERTICAL ARITHMETIC AND vGUPPI



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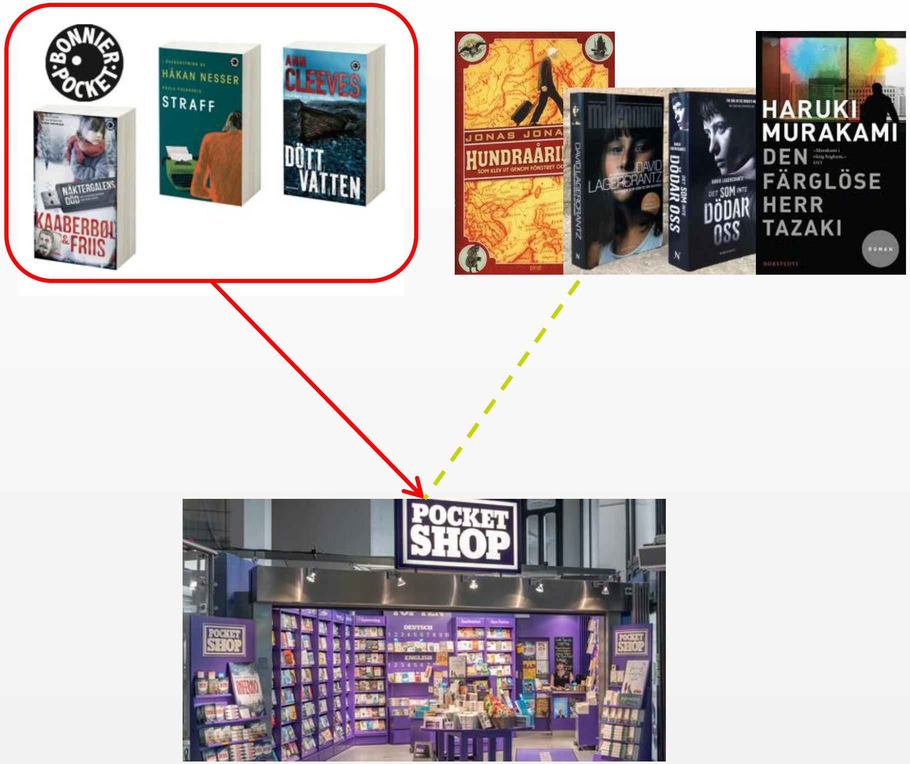
Bonnierförlagen/ Pocket Shop (2012)

Jaewon Kim

Bonnierförlagen/Pocket Shop (2012)



- Market for ”impulse buying”?
- *”Would Bonnier have incentive to foreclose other publishers in Pocket Shop stores after the merger and to sell only Bonnier paperbacks?”*
- (+) Bonnier’s benefit from selling their own paperbacks in Pocket Shop
- (-) Loss due to that customers leave the store when they were not able to find what they wanted to buy
- Customer survey: to answer diversion from other books to Bonnier’s

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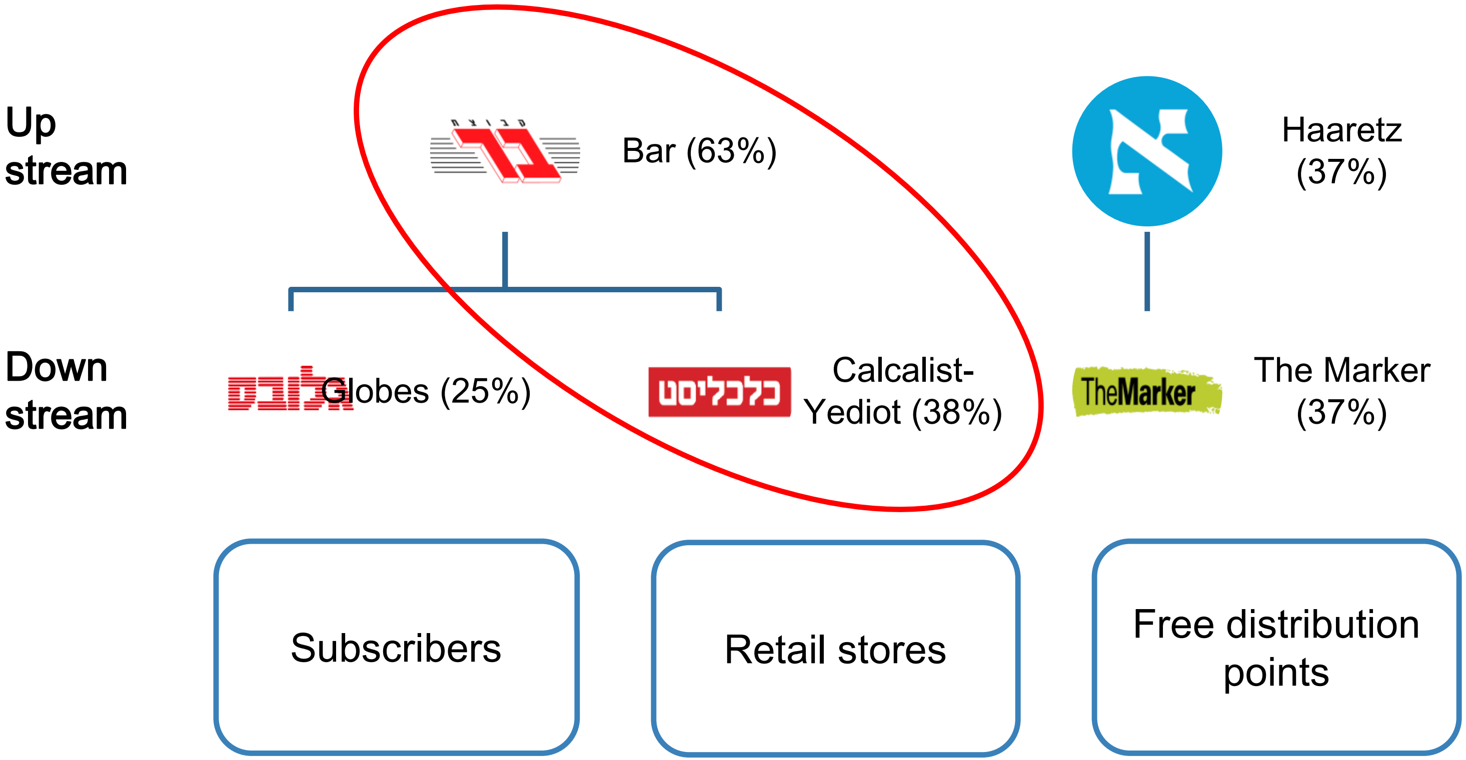
Bar Distribution / Yediot (2016)

Noam Dan

Market Structure



Hard-to-block

The buyer already has 24.9% share in the seller

Input foreclosure

Seller has significant ability as a monopoly

Existing incentive?

The buyer claims: “There will be no profit in foreclosure”

Assumptions

1. Full foreclosure – 'Bar' loses all the revenue from distributing rival newspapers

2. DR by market shares of remaining firms (50-50)

3. No recoupment (competitive constraint from digital)

The Trade-off Equation

$$R_y - MCp_y - MCd_y + AD_y \geq R_{bx} - C_{bx} - (R_{by} - C_{by})$$

Calcalist's profit from foreclosure (recapturing)

R_y = Revenues (Sales)

MC_{py} = Marginal Costs of Printing

MC_{dy} = Marginal Costs of Distribution

AD_y = Revenues (Advertisements)

Bar's loss from foreclosure (end of rival distribution)

R_{bx} = Revenues from Globes Distribution

C_{bx} = Costs from Globes Distribution

R_{by} = Revenues from selling more copies of Calcalist

C_{by} = Costs from selling more copies of Calcalist

⚠ **The rate of recapture needed to break even is 60%**

Altice / Media Capital (2018)

Alípio Codinha

- **Altice/Media Capital merger**

- **Vertical integration** between the one of the 2 **leading providers of pay-tv and multiple play services**, and the **leading provider of audiovisual contents and pay-tv channels**.

- MEO (Altice Group)
  - Former state-owned telco company with around 40% of all pay-TV subscribers and multiple-play services revenues

- Media Capital (GMC): the target
  - Television studio and content producer
  - Portuguese-speaking TV channels under the brands:

tvi tvi24 tvificção

- **Market Structures**

Telcos (multiple play MS)	
MEO	43%
NOS	39%
vodafone	14%
nowo	4%

Contents (TV Channels. *Share* of audience)	
TVI Channels	21%
SIC Channels	18%
RTP Channels	13%
FOX Channels	6%

Others...

cm TV AXN Disney ...

▪ Main theories of Harm – Input foreclosure

- Merged entity would have the ability and incentive to foreclose access by rival pay-TV platforms to tvi and/or tvi24?

Competition concern: MEO could stop GMC broadcasting TVI channels via competing pay-TV platforms and raising significantly rival's costs

- Merged entity would have the ability and incentive to foreclose access by rival telcos to advertising space at tvi and/or tvi24 ?

Assessing incentives: SEVERAL SCENARIOS CONSIDERED

- Losses uptream (advertising, customer interaction services, distribution fees)
- Gains downstream (new multiple play customers)
- Net effect?

Losses:

- Detailed audience data to estimate audience loss of TVI.
- Revenue losses from advertising and customer interaction services proportional to losses in audience

Gains:

- Incremental margins from new subscribers coming to MEO
- Consumer survey to assess departure rates from NOS, Vodafone and Nowo
- Historical data on diversion ratios between pay-TV operators

AUTORIDADE DA CONCORRÊNCIA

Departure rates from consumer survey:

Subscribers switching if losing TVI

NOS	17,29%
Vodafone	12,42%
Nowo	11,76%
Global	15,39%

Subsciber switching if losing TVI AND TVI24

NOS	20,51%
Vodafone	13,38%
Nowo	15,69%
Global	17,91%

Impacts on MEO’s profits (annual, in million €):

	Targets			
STRATEGY	**All rivals**	**NOS**	**Vodafone**	**Nowo**
TF. TVI	[>=100]	[positive]	[small but negative]	[small but negative]
TF. TVI24	[<60]	[positive]	[small but positive]	[small but positive]
TF. TVI+TVI24	[>=100]	[positive]	[small but negative]	[small but negative]

But there other forms of foreclosure >> Partial Input Foreclosure

- MEO raises its rivals' costs by increasing prices of TVI channels
- Merger strenghtens GMC's bargaining position vs. NOS, Vodafone and Nowo
- Even more if total foreclosure if a credible threat

Bilateral bargaining model – Nash static equilibrium

After the merger, will there be an agreement?

At what price will that agreement occur?

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Q&A

Useful references

- A summary of the economic theory of vertical mergers – ICN/CMA (2017)
- Vertical Mergers Survey Results – ICN/CMA (2018)

- Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings – European Commission (2008)
- vGUPPI: Scoring unilateral pricing incentives in vertical mergers – Salop & Moresi (2013)
- Potential competitive effects of vertical mergers: a how-to guide for practitioners – Salop & Culley (2014)

- Annex C, A report on the anticipated acquisition by Tesco PLC of Booker Group plc – CMA (2017)

Fingleton Associates

10 Haymarket

London SW1Y 4BP

Office: +44 20 3730 9090

Email: info@fingletonassociates.com

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