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MERGER CONTROL IN DYNAMIC MARKETS – Contribution from Japan

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Merger Control in Dynamic Markets

- Contribution from Japan[*] –

1. Introduction

1. Recently, it has become necessary to pay much more attention to how market environments would change or what kind of developments could most possibly occur in the markets in the near future, when we, competition authorities conduct merger reviews. Particularly in the digital markets where a large number of new products and services are emerging one after another, it is necessary to take technological developments into account when defining the relevant markets and evaluating the factors concerned in the merger reviews.

2. In this regard, the Japan Fair Trade Commission (JFTC) has effectively conducted merger reviews, considering various dynamic factors in the markets such as rapid developments in technology and competitive pressures from potential competitors, based on the "Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination" (hereinafter referred to as the "Guidelines").

3. In this contribution paper we will outline the relevant descriptions concerning dynamic factors in the Guidelines with brief introduction of some parts of the draft of the revised Guidelines and introduce actual cases where JFTC considered dynamic factors in its merger review process.

2. Consideration of dynamic factors under the Guidelines

4. The Guidelines provide the basic analytical framework for the merger review, indicating multiple factors to be considered, such as 1) The Market Position of the Company Group and the Competitive Situation, 2) Barriers to Entry and 3) Competitive Pressure from Neighbouring Markets when the JFTC reviews whether the effect of a certain merger may be substantially to restrain competition in a relevant market. The Guidelines also indicate several types of measures to remedy substantial restraint of competition. Some of the sections concerning these factors and remedies refer to dynamic factors as follows:

2.1. Factors

2.1.1. The Market Position of the Company Group and the Competitive Condition

5. In calculating the change of market share by a merger, in principle, the calculation should be based on the latest available market shares of the merging parties. However, if market shares caused by the merger are expected to change significantly through dynamic factors such as speed and extent of innovations in technology, the impact on competition of the merger is determined by considering these factors as well.

[*] This contribution from Japan is submitted for the break-out session 1 on competitive assessment of mergers.

6. In the draft of the revised Guidelines published on 4th October, 2019, among other things, the JFTC added a description on how the JFTC considers research and development activities of the merging parties in its review process. The part explains that, if one of the merging parties are engaged in a research and development activity of certain products and services, hereinafter “products” in this section 2, which may compete, in the future, with products currently supplied by the other merging party, the JFTC will determine the effects of the relevant business combination on competition in consideration of the actual condition of such research and development. Also, as to the conglomerate mergers, the JFTC added guidance on how to review business combination with potential competitors. Although one of the merging parties doesn’t have specific plan to enter the other party’s service market, if it possesses important inputs such as data, it could become a powerful competitor of the other party after they actually enter the market. In such case, the merger would eliminate the possibility of the entrance of the party with important data and thus greatly affects the competition in the market in the future.

2.1.2. Barriers to Entry

7. In determining whether there is a sufficient entry pressure, the JFTC considers if an entry would occur in a certain period of time responding to the increase of the price by the merged company and become a factor to prevent the company from controlling the price and others to a certain extent. In this regard, "a certain period" is generally considered to be two years, but it can be shorter or longer depending on the characteristics of the industry. In the consideration, the JFTC takes all entry-related conditions into account.

8. The JFTC regards that entry pressures would be higher, if other suppliers are already planning to enter the market with a sufficient scale or if there are potential entrants who are highly likely to build new facilities and supply their products in the market depending on the degree of price increase by the merged company.

9. In addition, generally, products with a dynamic market structure – such as products supplied to a growing market with a high likelihood of significant demand expansion in the future, products whose markets are facing frequent technological innovations, products with short life cycles, and products requiring active investments in the development of new replacement technologies – are subject to stronger entry pressures than products without a dynamic market structure.

2.1.3. Competitive Pressure from Neighbouring Markets

10. If there is a vigorous competition in neighbouring markets, or when competing products, that is, the one with relatively similar utility to users, could highly replace demand for the products supplied by the merged company in the near future, it will be counted as a factor stimulating competition in the market. These competing products can partly prevent the merged company from controlling the price and others conditions. It depends on extent of similarity in the respects of users’ preference, price and distribution networks.

2.2. Remedies

11. Although appropriate remedies are considered case by case depending on the facts of individual cases, the remedies should, in principle, be structural measures such as divestiture of business which could restore competition hampered as the result of the merger. However, in a market with a feature of rapid change in structure through

innovations in technology, there may be cases where it is appropriate to take certain types of behavioural measures.

3. Actual cases assessing dynamic factors

12. JFTC has flexibly considered dynamic factors in various cases of merger review, and this section presents some of such cases.

3.1. Western Digital/SanDisk (2015)

13. In the case of Western Digital Corporation (hereinafter referred to as "WD") and SanDisk Corporation (hereinafter referred to as "SanDisk"), where WD notified the JFTC of its plans to acquire the shares of SanDisk, the JFTC took the frequency of technological innovation into account in its review, which had the possibility to change the market shares drastically in a short period of time.

14. WD and SanDisk were both manufacturing and selling various types of solid-state drives (SSDs) used for storing electronic data, and they were competing with each other in the market of these products.

15. Among solid-state drives markets, the JFTC focused its review on the market for "SAS enterprise SSDs[1]" in detail, as its combined share of WD and San Disk would amount to approximately 75%.

16. In the course of the review, the JFTC found that the product cycle of SAS enterprise SSDs was approximately 15 months, which was relatively shorter than those of other SSDs, and that manufactures were always competing for higher performance and lower price through the introduction of new technologies. In addition, the JFTC also found that there was a strong pressures from the users of the products demanding for further lower prices. The market of SAS enterprise SSDs was deemed to be exposed to lively competition for performance and quality, and we had seen frequent technological innovations in the market.

17. Based on such facts that there had been frequent innovations in technology in the market, as well as an existence of rapidly growing competitors and strong pressures from users of the products, the JFTC concluded that this merger would not substantially restrain competition in the market.

3.2. Takeda/Shire (2018)

18. In the case of Takeda Pharmaceutical Company Limited (hereinafter referred to as "Takeda") and Shire Plc (hereinafter referred to as "Shire"), where Takeda notified the JFTC of its plans to acquire all voting rights of Shire, the JFTC considered a possible competition in a nascent market, which had a dynamic factor as it was expected to grow rapidly in a short period of time in the future, as well as existing markets in its review process.

19. Takeda and Shire were both manufacturing and selling various types of prescription drugs for inflammatory bowel diseases such as drugs for Ulcerative colitis and Crohn's disease, and they were competing each other for these products.

[1] "SAS enterprise SSDs" are sold to enterprise customers for SAS, Serial Attached Small Computer System Interface.

20. In the course of its review process, the JFTC defined the market for Anti-integrin inhibitors, the nascent market for a biopharmaceutical used for patients of Ulcerative colitis and Crohn's disease in moderate or severe conditions, as well as the markets for other drugs.

21. In Japan, pharmaceutical companies were making every efforts to develop Anti-integrin inhibitors, as conventional drugs for the treatment of Ulcerative colitis and Crohn's disease did not work well for patients in moderate or severe conditions. Therefore, the market was considered extremely promising and was expected to grow rapidly in a short period of time once pharmaceutical companies started to launch the products in the market. In this regard, Takeda had been developing Anti-integrin inhibitors, and obtained marketing approval from the Ministry of Health, Labour and Welfare to launch some of the products in the Japanese market. On the other hand, Shire had also been developing Anti-integrin inhibitors, which were in the final stage for the approval process in Europe and the U.S., and it seemed possible for Shire to launch the products in the Japanese market in the near future. Taking into account these situations, the JFTC conducted a thorough review in the market of Anti-integrin inhibitors, although both Takeda and Shire hadn't launched their products in the market yet.

22. As a result of the review, the JFTC found that Shire had no specific plan to launch Anti-integrin inhibitors in the Japanese market in the near future, and that there was some likelihood of other pharmaceutical companies to launch Anti-integrin inhibitors in the market, which could be competitive pressures for Takeda and Shire. Consequently, the JFTC concluded that the consolidation would not likely to substantially restrain competition in the market.

3.3. Fukuoka Financial Group/ The Eighteenth Bank (2018)

23. In the case of Fukuoka Financial Group, Inc. (hereinafter referred to as "FFG"), and The Eighteenth Bank, Ltd. (hereinafter referred to as "EB"), where FFG notified the JFTC of its plan to acquire the shares of EB by obtaining more than 50% of EG's voting rights, the JFTC carefully checked the existence of Fintech companies as a possible competing company in its review process because the merging parties insisted that Fintech companies might be strong competitive threats to themselves. So, the JFTC reviewed recent activities of Fintech companies from the point of views whether they could be a dynamic factor in the concerned market.

24. Both FFG and EB were operating banking business in Nagasaki prefecture, and they were competing with each other in the various fields such as business lending, non-business lending, deposits, foreign exchange, investment trust sales, insurance agents and credit cards.

25. Regarding the fields other than business lending, the JFTC recognized that there were sufficient pressures from the other competing companies, and thus concluded that the consolidation would not substantially restrain competition in these markets.

26. On the other hand, as to the field of business lending, which seemed to have the biggest competitive influence by the consolidation, the JFTC focused its review on whether there would be competitive pressures sufficient enough for small- and medium-sized companies to secure alternative lenders after the consolidation.

27. In addition to ascertaining whether conventional financial institutions worked as competitive pressures, the JFTC also confirmed if there was any performance of Fintech companies offering business lending services in the market. The Fintech companies could

exert a competitive pressure against the consolidated company and even change the market environment entirely in the future. However, based on the result of the survey, the JFTC concluded that there was no sign of such activities by Fintech companies.

28. As no sufficient competitive pressure by competitors was found, the JFTC conveyed its concern to FFG that the consolidation might substantially restrain competition in the field of business lending in Nagasaki prefecture. Responding to the JFTC's concern, FFG proposed remedies such as selling a significant amount of loans to competitors to reduce market share. Eventually, the JFTC concluded, based on the premise that the FFG and EB would duly implement the proposed remedies, that the consolidation would not substantially restrain competition in the market.

4. Conclusion

29. It is extremely important for competition authorities to keep an eye on rapid and drastic developments in the markets, in order to precisely and effectively review merger cases. The JFTC has been flexibly considering various dynamic factors on a case-by-case basis and will continue to do so to ensure competition in the markets.