



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

**DAF/COMP/WD(2011)50
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ROUNDTABLE ON IMPACT EVALUATION OF MERGER DECISIONS

-- Note by the Delegation of Japan --

This note is submitted by the delegation of Japan to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 29-30 June 2011.

JT03304002

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ROUNDTABLE ON IMPACT EVALUATION OF MERGER DECISIONS

-- Note by Japan --

1. Introduction

1. The Japan Fair Trade commission (hereinafter, “the JFTC”) employs two approaches related to the impact evaluation of merger decisions. One is the evaluations conducted by the staff in charge of merger reviews (Mergers and Acquisitions Division, hereinafter referred to as “M&A Division”) and the other one is conducted by the Competition Policy Research Center (hereinafter, “CPRC”)¹ in which external experts participate.

2. The M&A Division evaluated past cases from the viewpoint of further elaborating the merger reviews and published a report. In this evaluation, analyses of publicly available data and interviews with the parties concerned were employed as the evaluation method.

3. Outside experts played central roles in conducting the analyses in the evaluation by the CPRC, with a view to actively introducing economic analyses to the enforcement of the AMA and the planning/designing of competition policies. The purpose of the analyses was to focus mainly on the aspect of “efficiency” achieved by mergers. The analyses were attempted on the extent of achievements of efficiencies resulting from mergers and on the changes in market performance after mergers through actually applying economic methods by referring to the methodologies conventionally employed by economists and the competition authorities in the U.S.

4. In the following, we will introduce “Ex-post evaluation of the merger review” (Japan Fair Trade Commission, 22 June 2007)², which summarizes the analyses by the M&A Division, and “Empirical Studies of the Effects of Mergers and the Implications for Competition Policy” conducted by the CPRC.

2. *Ex-post* evaluation of the merger review

5. In this report, analyses were made mainly from two viewpoints.

6. One is the “ex-post evaluation of import pressures.” In this analysis, import data was analyzed across items with regard to cases in which import pressures were evaluated as a factor to promote competition. In addition, detailed data analysis and interviews about the degree of import pressures after the mergers were conducted with regard to a past case in which potential import pressures were positively evaluated.

¹ The Competition Research Center, established in June 2003, has the objective to reinforce theoretical and empirical foundations for enforcing the AMA and related laws as well as planning, proposing, and evaluating competition policies. Its activities are developed with a view to build functional and sustainable cooperative platforms through joint studies among outside researchers, practitioners, and staff of the JFTC.

² Available at <http://www.jftc.go.jp/pressrelease/07.june/070622-tenpu.pdf> (Japanese version only).

7. Another is the “ex-post evaluation of remedies” in which the licensing of patent rights as a remedy in a past case was reviewed. More detailed data analyses and interviews were conducted about the status of the implementation of a remedy after mergers and its effects, etc.

2.1 Ex-Post evaluation of import pressures

8. In this analysis, assessment of import pressures during the merger review was evaluated ex-post.

9. More specifically, with regard to past cases in which import pressures had been recognized as having high possibility of working after the mergers, evaluations were made on whether import pressures were actually realized by analyzing the trends of import ratio across products and conducting detailed examination of a case in which the existence of import pressures was evaluated as a factor to be considered.

2.1.1 Analyses on the trends of import ratios across items

10. First, the analysis focused on the trends of import ratios across products with regard to 20 cases/26 products for which data can be easily gathered from public information, etc., extracted from cases in which import pressures were evaluated as having high possibility of working after the mergers (27 cases/49 products). The sample was selected from major merger cases in each year (hereinafter referred to as “major published cases”) which were published by the JFTC over a decade from 1994 until 2003 (119 cases/280 products).

11. As a result, imports were realized for 7 products after mergers and a certain amount of imports was observed for 8 products. For these products, it was considered that a certain degree of import pressures had functioned after mergers except for cases in which import products cannot be substituted for domestic products due to their low quality.

12. On the other hand, the ratio of imports after mergers remained at low levels for 11 products. It is necessary to determine the existence of import pressures after analyzing the reasons why the ratio of imports remained so low in each case.

2.1.2 Analysis on a case in which import pressures were evaluated positively

13. In response to the results of the above 2.1.1, detailed analysis was conducted for a chemical product called “phenol” in a merger case between Mitsui Petrochemical Industries and Mitsui Toatsu Chemicals³ in which import pressures remained at a low level despite the positive evaluation on import pressures at the time of the merger review⁴.

14. The above analysis focused, in terms of the ease of substitution between domestic and import products, on points such as degree of institutional barriers, degree of import-related transportation costs and existence of problems in distribution, degree of substitutability between imported products and domestic products, potential for supply from overseas, and correlation between domestic and overseas prices.

15. As a result, with regard to “phenol”, the ratio of imports was low at the time of the merger review and remained at a low level except for imports of certain goods.

³ Available at <http://www.jftc.go.jp/ma/jirei2/9nendo.pdf> (page3-5)(Japanese version only).

⁴ Interviews were conducted during January and February 2006.

16. However, it was evaluated that there were potential import pressures from overseas because certain conditions are satisfied such as little differences in product brands, grades and qualities between domestic and overseas goods, low switching costs resulting from repeated use, etc., and existence of many relatively-large-scale users observing overseas markets through their overseas operations.

2.1.3 Conclusion

17. As a result of the analyses in the above 2.1.1, in terms of the cases where import pressures were positively evaluated in merger reviews, it was suggested that they are in fact a mixture of two types of cases, that is, cases where import pressures are regarded to actually work and those where import pressures are not.

18. Therefore, in future merger reviews, it is important to evaluate import pressures deliberately through data analyses and detailed interviews, especially in cases where the ratio of imports is low.

2.2 Ex-post evaluations of remedies

19. These analyses reviewed the contents and effects of remedies.

20. More specifically, the analyses categorized/sorted out the characteristics and the effects of remedies by type and evaluated a past case by gathering documents/data as well as interviewing parties' competitors and users.

2.2.1 Categorization and analysis of past remedies

21. Contents of remedies were analyzed with regard to the published cases during the decade from 1996 to 2005.

22. As a result, competitive problems were pointed out or some kinds of remedies were proposed in advance by the parties for approximately 40% of the cases, while approximately 25% of the total was approved on condition that remedies are implemented.

23. Therefore, in light of the results of the past merger reviews, it was shown that (1) competitive concerns were solved by some kinds of remedies in many cases and (2) secure implementation of remedies were important for maintaining competitive markets.

2.2.2 Analysis of a case in which remedies were implemented

24. In this analysis, "Acquisition of shares of Sanyo Electric Vending Machine CO., LTD. by Fuji Electric CO., LTD."⁵ was reviewed as a case where the licensing of patent rights as one of the remedies was taken.

25. It evaluated "the decision on substantial restraint of competition" and "the design for remedies" through gathering documents/data and conducting interviews from parties, competitors and users⁶.

- Evaluation regarding the decision on substantial restraint of competition

In the field of vending machines sales, shares of the parties had declined after the merger. Factors such as the continuation of users' policies to purchase from a plurality of sellers and various attempts concerning purchasing methods such as bidding/joint purchase were identified as the background of the decline.

⁵ Available at <http://www.jftc.go.jp/ma/jirei2/H13jirei9.html> (Japanese version only).

⁶ Interviews were conducted during November and December 2005.

As a result, the overall sales prices of the product declined and it was considered unlikely that the merger substantially restrained the competition. Therefore, it was considered that the view on the impact on sales competition by the merger was reasonable.

- Evaluation regarding the necessity of remedies

Because there had been no application by competitors for the licensing of patents at the time of the analysis, it was possible to view the remedy as being unnecessary.

However, another view was considered possible that convenience for users and consumers is achieved as a result of ensuring entry pressures through securing the disclosure of patents by the party because of the existence of indispensable patents for new entry.

2.2.3 *Implications from the evaluation*

26. The results of the evaluation suggest the following points to be remembered for future cases in which remedies will be necessary. Firstly, it is important to consider whether remedies are sufficient to solve competitive concerns resulting from mergers. In addition, when a remedy such as the licensing of patent rights is implemented, there is a possibility that such a remedy does not function properly if extremely high license fees are required in applying for the license. Therefore, it is necessary to examine the conditions on disclosing technologies to other companies, such as the fee and the period, as well as to revise such conditions in response to changes of market conditions, etc.

27. Moreover, it was pointed out that, when remedies are implemented after mergers, it is necessary to publicize the remedies and research in advance of potential candidates applying for licenses.

3. **Empirical studies of the effect of mergers and the implications for competition policy**

28. This study was conducted by a team consisting of several researchers (including outside experts) of the CPRC, which is a research institute belonging to the JFTC, and made public at an international symposium regarding competition policies convened on March 4, 2011.

29. During the period of this study, a merger between the two biggest companies in the iron steel industry in Japan (the business integration of Nippon Steel and Sumitomo Metal) was announced on February 3, 2011.

30. According to the press release, both parties concerned aimed at the following: “Improvement of the profitability”, “High evaluation from shareholders and capital markets”, “Competitiveness in technology, quality, and cost”, “Better response to the needs of customers”.

31. To analyze the achievements of such aims in past mergers, this study conducted empirical studies on the effects of mergers on (1) profitability, (2) stock prices, (3) R&D, and (4) selling prices.

32. However, these analyses had the following limitations.

33. First, although the study was based on public information except for the price study, the number of samples was limited because many actual merger cases concern non-public firms for which financial reports and share price data were unavailable. Second, because of short post-merger periods, there is a possibility that it is insufficient for the mergers to exert their effects. Finally, because the motives and types of mergers are diverse and quite a few seem to have been made to rescue failing companies for example, there is a possibility that the mergers do not have enough impacts.

34. For these reasons, it should be noted that the conclusions of this study cannot necessarily be determinative.

3.1 Empirical results

3.1.1 Evaluation on the effects of mergers on profitability

35. In this section, direct influence of mergers on corporate performances (profitability) was evaluated. Analyses were made on six mergers among first regional banks and second regional banks consummated between the period of 2000 and 2006.

36. The change in corporate performances was analyzed by employing the propensity score matching method in which control firms, that is, firms that have similar characteristics to the merged firms except for experiencing mergers, were selected to compare financial indicators of merged firms to those of control firms. The method was used because a simple comparison of pre- and post-merger changes in financial indicators between merged firms and non-merged firms may not capture the effects of mergers alone.

37. The results of the analyses revealed that although statistically-significant differences were not found, there were many cases in which their ROEs deteriorated after mergers. They suggest that mergers rarely contribute to increases in profitability.

3.1.2 Evaluation of effects on stock prices

38. In this analysis, the extent of influences of a merger on stock prices was analyzed by employing an event study method.

39. By applying the stock market model, the rates of returns on respective stocks were estimated as linear functions of the rate of return on the market portfolio by controlling the effects of the price changes of overall market portfolio. Abnormal rate of returns (AR) were calculated as the difference of the actual rate of return from the expected rate of return obtained by the above procedures and then cumulative abnormal rate of returns (CAR) were worked out. As the object of analyses, 15 cases in which the parties were listed on the first section of the Tokyo Stock Exchange and available for analysis were selected out of the merger cases after 2000.

40. The result of the analyses revealed that there were many cases in which stock prices rose on the day of the merger announcement but eventually became negative after several days. Therefore, the cumulative influences were not significantly different from 0 in the majority of cases.

41. Theoretically, a merger is expected to raise the efficiency of the merging firm and thereby its long-run profitability so that the merger announcement should raise its stock price and result in a positive CAR. However, such effects were not found in these cases.

3.1.3 Evaluation of effects on R&D expenditures

42. To analyze the impact of mergers on innovation, R&D expenditures and the number of published patent applications were studied.

43. As the objects of the analysis, 39 major cases were selected from merger cases in the manufacturing industry in Japan after 2000.

44. The result of the analyses revealed that although both the R&D intensity and the number of published patent applications decreased in many cases, increases in R&D intensity were found in some cases, especially in R&D-intensive industries.

45. However, a detailed survey, such as a review on specific cases, should be necessary because R&D intensity and the number of published patent applications alone were not sufficient as indices for such studies.

3.1.4 *Evaluation of effects on prices*

46. In this study, price effects of mergers were examined by analyzing how retail prices of goods in the market changed before and after the mergers.

47. As the data for the analyses, scanner data was used for 3 selected items such as household flavor seasoning, sugar, and instant noodles.

48. Although the number of items subject to the survey was limited to three, average market prices (including products by companies other than the parties) increased to a greater or lesser extent (0.16% in household flavor seasoning, 5.28% in sugar) in two of them and the average product prices of the parties increased further in all three.

49. In addition, in product differentiated industries, there were some cases in which the parties used both price increases and price cuts depending on the brand to further differentiate itself among the brands sold by the parties concerned.

50. It was suggested that it is necessary to examine not only the effects on the average price but also the effects on the product composition and positioning that a merger may cause, which means the necessity of considering the possibility that some of the consumers may benefit whereas others may be hurt from the mergers.

3.2 *Conclusion*

51. These empirical studies suggested that the priority for competition agencies should be to watch the impacts on prices, that is, the impacts on the users (consumers) in merger reviews. On the other hand, the parties need to show detailed plans together with the scope of their implementations concerning the improvements of efficiencies and ‘long-term competitiveness.’

52. Moreover, it was pointed out that more economic and quantitative evaluations should be exploited based on econometric analyses because merger reviews in Japan have tended to be based on qualitative evaluations based on interviews, etc.

4. **Final conclusion**

53. As presented above, there are two types of impact evaluations of merger decisions in Japan, that is, the ones conducted by the JFTC and the ones conducted by outside experts.

54. Both of them were voluntarily conducted to refine merger analyses⁷. Although certain suggestions were obtained from them with regard to the merger review, some limitations concerning the analyses, such as the number of cases, data, the periods for evaluations, etc., were pointed out.

55. Therefore, accumulation of ex-post evaluation cases and studies regarding evaluation methods are expected in the future.

⁷ Note that policies are evaluated in Japan according to the “Government Policy Evaluations Act” (Act No. 83 of 2001, and hereinafter referred to as “the Act”) so that swift (within 30 days with regard to the first reviews and within 90 days with regard to the second reviews) and appropriate reviews on mergers (acquisition of shares, mergers, divisions, joint transfers of shares, acquisitions of businesses, etc.) are conducted in order to maintain and promote fair and free competition by preventing certain mergers that may be substantially to restrain competition in a particular field of trade. In addition thereto, evaluation of achievements is implemented with regard to transparency in merger reviews by publishing major merger cases, etc.