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Theories of Harm for Digital Mergers – Note by Japan

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More documents related to this discussion can be found at
https://www.oecd.org/competition/theories-of-harm-for-digital-mergers.htm

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1. Introduction

1. The Japan Fair Trade Commission (hereinafter referred to as the "JFTC"), as well as competition authorities around the world, has in recent years focused on competition issues in the digital sphere, including digital mergers.

2. This note introduces key points in terms of theories of harm for the merger case (hereafter referred to as the "Case") of Z Holdings Corporation (hereafter referred to as "ZHD") and LINE Corporation (hereafter referred to as "LINE"), which is one of the major digital mergers reviewed by the JFTC in recent years[1]. Theories of harm for this case were different from typical ones, in light of the characteristics of the digital field including a two-sided market, indirect network effects and the importance of data. Also, the content of the remedies for the Case was unprecedented, reflecting the difficulty in predicting the impact of the merger on future competition.

3. The Case should be helpful for competition law practitioners outside Japan as well in considering how to deal with digital mergers.

4. The major services reviewed in the Case were news distribution service, advertisement-related service and code-based payment service, and among them, this note discusses the code-based payment service because it has the above-mentioned characteristics of digital services best.

5. The sections 2-4 below outline the factual backgrounds and the JFTC's analysis of the Case described in the press release, and the section 5 below discusses the points regarding theories of harm. In this note, the terms "ZHD", "LINE" and "the merging parties" include group companies that have a joint relationship with each merging company.

2. Relevant Market

2.1. Code-based Payment Service

6. A code-based payment service is a service to provide consumers and member stores with a payment method that execute payment by electronically reading payment information of the consumer stored in the form of bar code or QR code. It is a type of cashless payment methods, and other cashless payment tools include credit cards and card-type electronic money.

7. The JFTC defined two relevant markets regarding code-based payment services[2]: one is a market for consumers as users and the other is a market for member stores as users.

[1] For the details of the Case, see the full English translation of the press releases (https://www.jftc.go.jp/en/pressreleases/yearly-2020/August/200804.html).

[2] In other words, the JFTC defined the relevant markets as distinct markets for respective segments of users. In 2019, the JFTC amended its Merger Guidelines to declare that, in principle, markets are defined for each segment of users for platforms that form a multi-sided market. See Merger Guidelines, 1, Part II (https://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines_files/191217GL.pdf).

The geographic markets for the two were defined as "all regions of Japan," respectively. The JFTC also defined that cashless payment services other than the code-based payment service are not included in the relevant markets but evaluated as competitive pressures from adjacent markets.

2.2. Market Shares in the field of Code-based Payment Service

8. The table below shows the approximate market shares in the field of Code-based Payment Service based on the amount of money paid through code-based payment.

Table 1. Approximate market shares in the field of Code-based Payment Service

Undertaking	Approx. Share (in increments of 5%)					
	Apr. 2019	Rank order	Sep. 2019	Rank order	Jan. 2020	Rank order
ZHD	50%	1	50%	1	55%	1
LINE	25%	2	10%	4	5%	5
Company A	10%	3	15%	2	10%	3
Company B	5%	4	10%	3	15%	2
Company C	5%	5	5%	5	5%	4
Company D	0-5%	6	5%	5	5%	6
Company E	0-5%	6	0-5%	7	0-5%	7
Others	5%	-	5%	-	5%	-
Total	100%	-	100%	-	100%	-
Total share of merging parties [HHI]	75% [5850]	1	60% [4025]	1	60% [4025]	1

3. Analysis of the Merger Effect

3.1. Perspectives and Economic Analysis (Outlines)

9. The JFTC reviewed the Case taking into account the fact that indirect network effects bidirectionally arise between the two relevant markets, i.e. one with consumers as users and the other with member stores as users.

10. The JFTC determined to judge whether the merging parties will attain market power as a result of the merger in the relevant market for consumers as users, and whether it enables the merging parties to raise the payment service fee of member stores (merchant fee) through indirect network effect. To this end, the JFTC developed a structural estimation model to estimate the price elasticity and the magnitude of the indirect network effect of respective demands at consumers and member stores, and requested the data necessary for the analysis thereof. In response to this request, the merging parties reported that they did not have a portion of the data required and, in the alternative, conducted another type of economic analysis on their own and submitted the results to the JFTC. The JFTC assessed and verified the analysis by the merging parties.

11. What the JFTC decided is summarized in 3.2 to 3.5 below.

3.2. Code-based Payment Service for Consumers as Users

12. Although LINE's market share has declined to only about 5% as of January 2020 (2.2. above), LINE's competitive position is stronger than it appears in its market share because of the facts including:

- - the number of active users and frequency of payment have increased,
- - the number of total members and member stores is larger than that of competitors, and
- - in the code-based payment service field, while cash-back campaigns have tended to significantly increase the number of consumers as users, LINE has significantly reduced marketing expenses, which are the source of cash-back campaigns, since July 2019, and may recover its market share by implementing cash-back campaigns again in the future.

13. The merging parties allege that severity of competition among them is not particularly strong, based on their economic analysis with diversion ratio. However, the low diversion ratio between the merging parties may have resulted from the fact that LINE hadn't conducted any large-scale cash-back campaigns since July 2019.

14. Although it is recognized that powerful competitors exist and are placing a certain level of competitive pressure, the JFTC found some cases where the merging parties respectively imposed on, or offered to, member stores exclusive dealing conditions. If the number of member stores subject to such conducts will increase after the merger, it would decrease the number of member stores which are able to do business with competitors and, given the indirect network effect, it will decrease competitive pressure from competitors in the market of code-based payment service for consumers as users.

15. Among services in adjacent markets, credit card services are not found to be working as strong competitive pressure, because historical usage data shows that there is no relationship between an increase in the usage rate of code-based payment services and a decrease in the usage rate of credit cards, but rather that the both continued to increase, so it cannot be recognized that they are competing with each other for customers. In addition, other types of cashless payments, such as card-type electronic money, have some common features and a certain level of competitive relationship with code-based payments, but the competitive pressure is not found to be so strong, because of the results of diversion ratio analysis and the fact that the degree of multi-homing at the consumers' end are not high.

16. Competitive pressure from users is not found to be so strong because of the reasons including:

- in the code-based payment service, data on the past payment amounts suggest that consumers may be locked-in to a certain degree to the service they have used, although a certain level of multi-homing is observed at the consumers' end, and
- given the relevant facts including that diversion ratio from cash to ZHD's code-based payment service is remarkably high, code-based payment services are now taking users from cash on a unilateral basis, and it is unlikely that existence of cash as an alternative means for payment is working as competitive pressure against code-based payment services.

3.3. Code-based Payment Service for Member Stores as Users

17. In light of the fact that member stores value the number of users as a factor to be considered for selection of a provider of code-based payment service, the market position of the merging parties is found to be extremely strong.

18. With the presence of some powerful competitors, a certain level of competitive pressure is found. However, as described in 3.2. above, it has been found that there were cases where each merging party imposed or requested exclusive dealing conditions on member stores. If the number of member stores subject to such conducts increases after the merger, this should reduce the competitive pressure from competitors in the market of code-based payment service for member stores as users.

19. Adjacent markets are not found to have strong competitive pressure. The reasons include that they are in the same situation as stated in 3.2. above.

20. The degree of competitive pressure from member stores as users is not found to be strong. The reasons include the fact that it is difficult for member stores to switch transactions to competitors from the merging parties with large total number of members, because there is indirect network effect from the market of code-based payment service for consumers as users.

3.4. Other Factors to be Considered

21. In addition to the above, the following points were considered in this case:

- the JFTC found internal documents of the merging parties that can be regarded as indicating that they were considering raising merchant fees after the merger,
- it is difficult to accurately predict future market conditions because the market of code-based payment is immature and the growth of the market and changes in the environment are rapid.
- the merging parties may have an advantage over the competitors in the amount, scope and frequency of data collection after the merger, and the business capabilities of the merging party may improve after the merger depending on their decision how to integrate, share and utilize data after the merger.

3.5. Interim Assessment based on the Antimonopoly Act

22. Based on the factors discussed above, the merger is not assessed as immediately and substantially restraining competition at present. However, depending on future market conditions and ex-post conducts of the merging parties such as handling of exclusive dealing conditions and utilizing data, the merging parties may easily have market power.

4. Remedies

23. The JFTC shared the view described in 3.5. above with the merging parties. In response to this, the merging parties offered the following remedies.

1. The merging parties will report the followings once every year for three years after the merger. If the JFTC points out any competitive concerns based on the report, the merging parties will discuss with the JFTC and will study the solution.
    - Market size, position of the merging parties and competitive situation, etc.

  - Status of merchant fee set by the merging parties
  - Status of utilization of data in the merging parties

2. As a general rule, the merging parties will not engage in exclusive dealing with member stores for a period of three years after the merger.

24. The JFTC concluded that, if the merging parties will implement the remedies above, the merger is not assessed as substantially restraining competition in the relevant markets of code-based payment services.

5. Points on Theories of Harm for the Case

25. Theories of harm concerning the code-based payment services for the Case can be primarily recognized as follows:

1. In the two-sided market with two user groups of consumers and member stores, the indirect network effect works bidirectionally under the circumstances of B) or C) below. In particular, the merging parties first gain market power in the market where consumers are the users, and through the indirect network effect also gain market power in the market where member stores are the users thereafter.
2. Exclusive dealing by the merging parties with member stores after the merger may decrease competitive pressure by competitors in either of the two relevant markets
3. The merging parties may gain market power easily, depending on ex-post conducts of them including integration, sharing and utilization of data, as well as future market conditions which are difficult to accurately predict at the time of the merger review.

26. Theories of harm above include factors that are of frequent occurrence in digital markets in particular, such as two-sided markets, indirect network effects, and the importance of data.

27. In December 2019, the JFTC amended the Merger Guidelines to announce the policy that, if indirect network effects work in a multi-sided market through a platform, the effects are also taken into account when the JFTC assesses the impact of mergers on competition[3]. Such a policy was carried out in considering theories of harm for the Case.

28. As a remedy, the merging parties will discuss with the JFTC and will study the solution when the JFTC points out competitive concerns. This is a different measure from typical ones, considering that it is difficult to predict the future of the relevant market partially because the code-based payment service is immature and the merging parties have not decided how to utilize the data after the merger.

3 See Merger Guidelines, 2(1) G, Part IV (supra note 2).