# Conglomerate and Vertical Mergers

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# Tying and Bundling in Conglomerate Mergers

## Most frequent theory of harm in conglomerate mergers

- Tested in: Intel/McAffee; Microsoft/Linkedin; UTC/Rockwell Collins; Essilor/Luxottica, and more
- Merged entity ties both products in order to increase joint sales/profits

  Wide interpretation of 'tying': integration, bundling, better interoperability, promotion in online settings

## Typical elements of assessment of ability and incentives to tie

- Dominance in one of the markets (tying market)
- Degree of product complementarity & customer response
- Competitive setting of the tied market
- Fixed costs and minimum efficient scale in tied market
- Customer heterogeneity

# Tying for Bargaining

**A merger of producers of complementary but non essential components can be anticompetitive**

Features on a product, apps on a smartphone, news sources on website

- Marginal utility of each component decreases as number of components increases
  - This happens when there is a service offering possible choices or options of products that may not be related but will not all be used.

- Bundled sales prevents buyer to extract rent with sequential pricing (ie bargaining with each producer as if they were the last one in the sequence)

**Relevant when negotiating with powerful counterparties (ex: platforms or network)**

# Indirect Feedback with Bargaining

**Recoupment via indirect mechanisms: across markets, across value chain**

- Recoupment is not necessarily by raising rival's cost but rather
- Raising customer's rival cost (more of this on this panel)
- Lowering suppliers' rival cost (less costly to switch)?

**These effects might work across products in concentrated markets with multiple inputs and many complementary products. As markets become more complex, such mechanisms might very well appear.**

**Untested and facing high burden for credibility**

- **Likely to require many substitution assumptions**
- **Issue of dimensionality of effects: are they strong enough to matter?**

# Vertical Foreclosure

## Input foreclosure theory

- Show ability: there are no equivalent substitute to the foreclosed input
- Show incentive: profits from new customers gained from foreclosed competitor downstream must more than compensate for loss of profits from sales to that competitor

## Bargaining theory: impact on prices, no foreclosure required (ATT/Time Warner)

- Theory based on change in the cost of no deal
- Incentives: how important is the credibility of the threat to not transact?

# Dynamic Effects, Innovation, and Entry

**Merger for R&D efficiencies that prevent entry**

- Internalization of R&D externalities - Equivalent to solving R&D Cournot complementarity
- Requires complementarity of products in the case of conglomerate mergers
- Increases R&D effort of merged entity, decreases likelihood of entry

- But effect depends on a series of factors including:
  - degree of complementarity
  - shape of innovation costs
  - value of innovation

# Dynamic Efficiencies

## R&D efficiencies in mergers

- When duplication is costly (no rapid decreasing returns of R&D effort)
- When innovation is drastic

(limits to the FLV model: we still don’t have a structure-conduct model for innovation)

## New or improved products

- Recombination of assets and products

  e.g. IP for a new use resulting in product innovation
- Integrating into data analytics capabilities

  e.g acquisition of behavioral data, channel for customer engagement

## Business model innovation

- Ex: Amazon/Wholefoods

# Cautionary Tale

**In conglomerate merger, there is no prediction of the direction of the effect**

- Predictions in conglomerate mergers depend on the relevance of economic phenomena in the case
- The models assumptions need to be credibly demonstrated quantitatively or qualitatively.

**Efficiencies are likely to play a key role in mergers**

- Efficiency opportunities impact the appropriate model to use
- Efficiencies must be part of the analysis at the start

**Chosen theory needs to be consistent with industry reality regarding trends, threats, and opportunities**

- The credibility of the assessment is important since the scope for error is much larger than in horizontal (and even vertical) mergers.

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**Dr. Eliana Garces** is an economist with broad experience in antitrust enforcement and regulatory design. While she was in the cabinet of Vice President Joaquín Almunia, the European Commissioner responsible for competition policy in 2010-2014, she supervised antitrust and merger investigations in financial services, information technology, telecommunications, and energy markets. Before joining The Brattle Group she was the deputy chief economist in DG Internal Market and Industry. She is the co-author of a widely used manual 'Quantitative Techniques in Competition and Antitrust Analysis' and has written on the analysis of platform business models.

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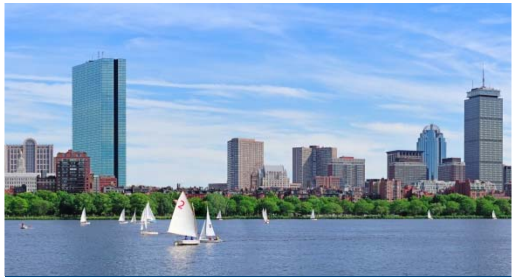
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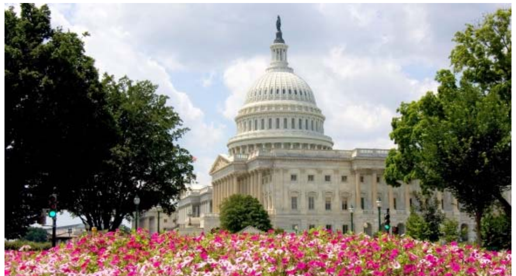
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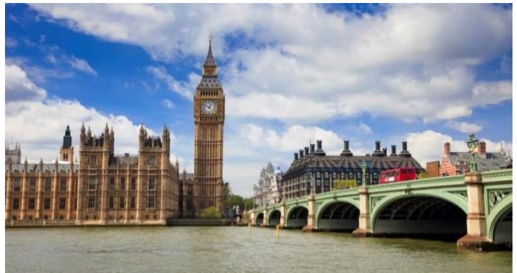
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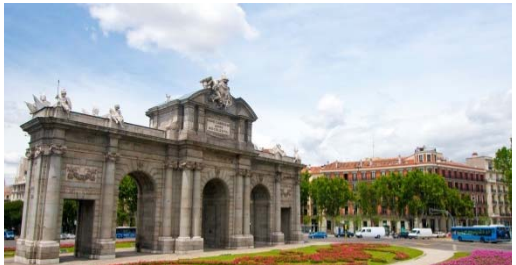
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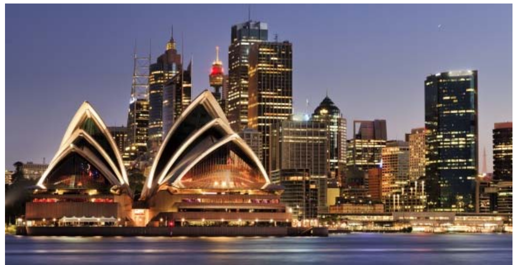
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