OECD GOING DIGITAL TOOLKIT

POLICY NOTE

Making online markets more competitive: The benefits and challenges of conglomerate merger review

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Making online markets more competitive: The benefits and challenges of conglomerate merger review

Digital technologies are transforming the environment in which firms compete online. While this change has delivered wide-reaching benefits for consumers, it has also given rise to potential competition concerns. One such area of concern relates to conglomerate mergers, which occur between firms that are neither product market competitors nor in a supply relationship. This Going Digital Toolkit note describes how merger control, and in particular the review of conglomerate mergers, can be an effective tool for making online markets more competitive.

Digital technologies are transforming the environment in which firms compete online, through e-commerce and online platforms in which personal data is exchanged for "free" services. Strengthening competition, including by opening access to markets, benefits consumers through lower prices and a greater variety of goods and services, and supports trade and investment. Competitive markets also underpin digital transformation by spurring innovation, new business models, business dynamism and productivity, driving structural change across the economy (OECD, 2019[1]).

Merger review is an important element of the competition policy toolbox. It seeks to prevent transactions that would lessen competition in a market, or enable anticompetitive conduct. The assessment of mergers can be challenging, as it generally involves analysing the likely effect of a transaction before it takes place. However, since competition harm cannot easily be undone, merger review can be a powerful way to protect consumers and to foster the benefits of competition for the economy more broadly.

While mergers can in many cases increase efficiencies and enable innovation, they may also have anticompetitive effects. Often, these anticompetitive effects result from horizontal mergers – mergers between firms that are direct competitors (or likely to become competitors in the future). Other potential harms relate to vertical mergers, or mergers between a firm and its supplier, although these harms may only apply in a limited set of circumstances (OECD, 2019[2]). A final type of harm can result from a conglomerate merger — a merger between firms that are neither product market competitors nor in a supply relationship (OECD, 2020[3]).

The idea that a merger can harm competition even if it does not involve competitors, or essential inputs, gives rise to several analytical challenges. Economic theory suggests that this harm will only emerge in very specific situations. Specifically, a firm with market power may use a merger to enter another more competitive market, leveraging its position to exclude competitors in this new market.

Take the stylised example of a world in which there is only one coffee producer in the world. That coffee producer could merge with a coffee machine manufacturer, and only allow consumers to purchase coffee if they also purchase the firm's machines. This would render it impossible for rival coffee machine producers to compete. However, the potential harms are rarely this straightforward, especially in online markets, making the analysis of conglomerate mergers a complex technical exercise. Some jurisdictions therefore focus exclusively on horizontal and vertical harms when reviewing mergers.

Conglomerate mergers first attracted competition authorities in the 1960s and 1970s (Goldberg, 1973[4]). A wave of economic literature followed: Chicago School economists found that these mergers do not harm consumers, while subsequent studies have identified scenarios in which this conclusion may not be valid (Neven, 2005[5]).

Digital transformation, and in particular competition concerns arising in online markets, has breathed new life into the debate about conglomerate mergers. Competition authorities face the challenge of reviewing mergers in rapidly-changing markets, in which it is not always clear whether two products are competing or not. Some commentators and practitioners have expressed concerns that merger laws are being under enforced.[1] In this context, competition authorities have commissioned a range of digital expert panels[2], and have begun examining some mergers that have already been completed (US Federal Trade Commission, 2020[6]).

Several of these concerns are particularly relevant to the consideration of conglomerate mergers. The links between digital products, both on the demand side and the supply side, could make anticompetitive conglomerate strategies more common. This is particularly the case when firms operate an online platform, or an ecosystem of interrelated digital products (e.g. a set of connected applications with different functionality). Further, many online markets exhibit substantial economies of scale, network effects (that is, the gains enjoyed by consumers of a product when more consumers use that product) (OECD, 2019[7]), and consumer usage patterns that lead to concentrated markets. This could mean that the impacts of anticompetitive leveraging strategies may be more pronounced than in online markets, and lead to "tipping" of markets into monopolies (Stigler Committee on Digital Platforms, 2019[8]).

Relatively few competition authorities have applied conglomerate theories to mergers in online markets so far, but there is growing interest (OECD, 2020[3]). In particular, some commentators have advocated for more frequent consideration of conglomerate harms in online markets (Bourreau and de Streel, 2019[9]). This Toolkit note describes how merger control, and in particular the review of conglomerate mergers, can be an effective tool for making online markets more competitive.

How can conglomerate mergers harm competition in online markets?

There are several ways in which a conglomerate merger could theoretically harm competition in online markets. The most established theory relates to what is called *tying* in competition economics. A merger could bring together producers of two different products, and the post-merger firm could, through a tie, compel consumers to purchase them both together. Tying can take several forms, including sales contracts, limitations to technical compatibility, and even steep discounts. These strategies can give rise to competition concerns only when the post-merger

[1] See, for instance, Aranze (2019[18]), Cabral (2020[19]), and the UK's Digital Competition Expert Panel (2019[20]).

[2] See, for instance, *https://oecdonthelevel.com/2019/12/02/charting-the-way-forward-for-digital-competition-policy/*.

firm has market power[3] in at least one of the markets, since it may use this strategy to push competitors out of the other market. It can also be used to protect a firm's market power for its original product (OECD, 2020[3]).

Tying to exclude competitors from a market may only pose competitive risks in particular situations. These include when: 1) one of the products will be purchased repeatedly (Carlton and Waldman, 2005[10]); 2) there are alternative uses for one of the products (Church, 2008, pp. 1529-1530[11]); or 3) there are network effects associated with the products (Kühn, Stillman and Caffarra, 2005[12]). Each of these conditions may arise in online markets, particularly when online platforms or digital ecosystems are involved.

For example, digital products are subject to repeat purchase cycles, such as when new versions or upgrades are introduced. In addition, tying can be an easier strategy to implement because digital products can be designed with limited compatibility, or other technical features that prevent mixing and matching. Box 1 sets out one example of a digital conglomerate merger review in the European Union (EU) and the United States (US). Although it focuses on physical components rather than online markets (and thus there are no consumer data implications, for example), the analysis can be of relevance to conglomerate merger review in online markets.

Box 1. The assessment of the Broadcom/Brocade merger in the EU and the US

In November 2016, Broadcom announced its intention to acquire sole control of Brocade. Broadcom produces connectivity chips used in a wide range of products, from mobile devices to servers. Brocade was active in the production of networking switches, software and storage products. The parties' businesses did not present any horizontal overlaps, but antitrust agencies were concerned about the complementarity of their products. In the EU, the European Commission (EC) permitted the transaction to proceed subject to commitments by the parties.

First, the EC took into account the complementarity of one of Broadcom's products (Host Bus Adaptors, or HBAs) with one of Brocade's products (fibre channel storage area network switches). The EC was concerned that the merged entity would degrade the interoperability of Brocade's switches with third-party competing HBAs, for instance by delaying or failing to transfer the necessary information and equipment about their next generation products to other FC HBA suppliers. This would lead to reduced interoperability of future generation competing HBAs with the merged entity's switches.

Second, the EC was concerned about the possible leakage and misuse by the merged entity of confidential information related to competing HBAs. HBA

[3] Tying is the ability of firms to unilaterally set [and maintain] prices above, or quality below, the competitive level (OECD, 2019[7]).

suppliers usually provide certain information to switch suppliers to ensure interoperability of their respective products. Post-transaction, the merged entity's business unit producing switches could pass on this information to the unit responsible for FC HBAs in order to use it to favour its own FC HBAs to the detriment of competing vendors.

To address these concerns, Broadcom committed to co-operate closely and in a timely manner with competing HBAs suppliers to achieve the same level of interoperability as its own HBAs and to protect third parties' confidential information.

Similarly, the US Federal Trade Commission raised concerns about Broadcom's potential use of Cisco's competitively sensitive confidential information to co-ordinate action between Brocade and Cisco (the two de facto competitors in the highly concentrated market for FC switches), thus increasing prices for customers purchasing FC switches. The FTC imposed a firewall remedy to address this concern (i.e., separate facilities and a separate information technology system with security protocols that allow access only to authorised individuals), thus avoiding any possible use of such confidential information for any other purpose than designing, manufacturing and selling FC products for Cisco.

Source: (OECD, 2020[3]); (European Commission, 2017[13]); (US Federal Trade Commission, 2017[14]).

A unique type of tying strategy in online markets is called *envelopment.* It refers to the ability of a dominant online platform to merge with another online platform in a different market that has an overlapping user base. Competing platforms may be unable to match the post-merger firm's user base and economies of scale and scope (Bourreau and de Streel, 2019[9]). These strategies can be profitable even if the firm provides the platform services to users at a monetary price of zero. For example, a dominant firm may impose broad data collection terms on its consumers, and use this data to its advantage in other markets (Condorelli and Padilla, 2019[15]).

When tying creates a set ecosystem of digital products, it can make it harder for new firms to enter the market, and may reduce innovation overall (Bourreau and de Streel, 2019[9]). In particular, tying products together could mean that a new firm must provide all of the products in order to compete. Thus, innovative new entrants producing standalone products may be excluded from the market. Since the post-merger firm may, as a result, face less competitive pressures in both markets, it may have fewer incentives to innovate (Neven, 2005[5]).

Alternatively, a conglomerate merger in an online market could result in anticompetitive strategies based on limited interoperability, defaults or pre-installation. One such theory of harm was investigated in the European Commission's review of the Microsoft/LinkedIn merger (Box 2).

Box 2. Interoperability concerns in Microsoft/LinkedIn

In October 2016, Microsoft notified to the European Commission (EC) its intention to acquire sole control of LinkedIn. Microsoft is one of the leading suppliers of operating systems (OSs) for personal computers and mobile devices. LinkedIn operates a professional social network (PSN).

The EC's conglomerate concern was that Microsoft would pre-install LinkedIn on all Windows personal computers and combine all user databases, while driving LinkedIn's competitors out of the market by not providing them with the necessary technical information to ensure interoperability with Microsoft's products. In the EC's view, the pre-installation practice would substantially increase the user membership of LinkedIn, while OEMs would have no incentive to install a second PSN application that would be perceived as a superfluous duplication of LinkedIn.

For the same reason, users would not spontaneously download a second non-pre-installed application serving the same purpose ("end users' inertia"). Post-merger, the foreclosure effects of rival PSNs would be further strengthened by network effects: more and more users would be attracted and generate content on LinkedIn while fewer users would have an incentive to join rivals' smaller networks, thus leading to market tipping in favour of LinkedIn.

To prevent foreclosure of standalone PSN competitors, Microsoft undertook amongst others:

- To grant rival PSN providers access to Microsoft Office's application programming interface (API), to allow them to compete effectively with LinkedIn, for instance by developing similar functionalities as those that Microsoft was envisaging to introduce in relation to LinkedIn; and
- Not to force PC manufacturers and distributors to pre-install LinkedIn on Windows PCs and to allow users to remove it, should the manufacturer or distributor decide to pre-install it. This commitment generally aimed to ensure an effective choice at both the OEM and the user level as to whether or not to have the LinkedIn application installed.

Source: (OECD, 2020[3]); (European Commission, 2016[16]).

A final, and potentially growing, concern is that a conglomerate merger may be a mechanism for removing a potential future competitive threat. In particular, a merger can address the threat of firms that are not currently a competitor, but could become one in the future. This could be particularly important if the target firm is active in a market that could be a stepping stone to challenging the acquiring firm in its primary market. In online markets, it may not be clear whether emerging competitors, or start-ups, will become direct competitors, in which case the merger could be a potential "killer acquisition" (OECD, 2020[17]), or if the merger should be assessed as a conglomerate merger in terms of bundling or tying.

What types of benefits can conglomerate mergers generate in online markets?

While conglomerate mergers can harm competition and consumers in certain specific situations, they may also generate significant efficiencies and consumer benefits. Thus, competition authorities face the challenge of balancing the risk of potential harms with these benefits.

For example, when a merger creates a broader product ecosystem, it can make it harder for rivals without a matching portfolio of products to compete. However, it can also be beneficial for consumers, by creating a "one-stop" shopping experience (Chen and Rey, 2018[18]) and a common user interface (Condorelli and Padilla, 2019[15]). Consumers may also value the ability to select a product portfolio based on their trust in a given brand, which they may use as a signal of quality across multiple products.

More broadly, a conglomerate merger can improve market outcomes by creating conditions that are more favourable to investment and innovation. When the merger involves products that complement one another, for example, it may lead to more efficient decision-making and more certainty for investments (including investments in interoperability), compared to situations in which the complements are produced by separate firms (Church, 2008[11]). In a similar way, a conglomerate merger may enable more efficient pricing strategies that benefit both firms and consumers, although some have questioned whether a merger is really needed for this outcome to be achieved (Spulber, 2016[19]).

Economies of scale and scope, while they may amplify the effect of tying, can also generate significant benefits to firms and, if passed on, to consumers. Economies of scope may be particularly strong when the products of the merging firms require similar inputs, such as data or software (OECD, 2020[3]). A post-merger conglomerate firm may be better able to make the most use of its valuable assets, distribution channels, management skill, and internal experience (Condorelli and Padilla, 2019[15]). Compared to a standalone firm, a firm that undergoes a conglomerate merger may also be in a better position to share technologies and resources across different product markets (Bourreau and de Streel, 2019[9]).

What are the main challenges to reviewing conglomerate mergers in online markets?

Competition authorities face a range of challenges when reviewing conglomerate mergers. First, competition harm will emerge in fewer cases than more straightforward mergers involving competing firms. Thus, identifying the minority of potentially anticompetitive conglomerate mergers can be difficult – firms may leverage market power into new industries by bundling products that are not obviously complementary, for example. Some preliminary indications that can be used are set out in Bix 3 below.

Box 3. Assessing when to investigate conglomerate mergers

Preliminary indications that a conglomerate merger may merit further investigation include:

- The products involved are complements and there are alternative uses or repeated purchases (e.g. due to upgrades) of one of the products.
- The products have substantial overlaps in consumer base.
- Tying is common in the affected markets, or at least one of the firms has engaged in bundling or tying in other markets.
- It is feasible to use technological means to tie products together.
- There is a significant likelihood that one of the markets involved in the merger could be used as a stepping stone to challenge the merging firms' market power in another market.
- There are indications, due for example to public comments by the merging firms' management, that the post-merger firm's strategy will centre around combining data sets, cross-subsidising markets and denying rivals network effects.
- There have been several past occurrences of anticompetitive conduct in the markets affected by the merger.

Source: (OECD, 2020[3]).

If there are some preliminary indicators that a conglomerate merger could give rise to competition concerns, a competition authority must next determine what information to gather to conduct its investigation. This can be a major challenge, since it is generally easier to identify products of merging firms that compete with one another (i.e. are substitutes) versus products that might be used to implement tying strategies (in which case they could be complements, or unrelated but have overlapping user bases). Parties may criticise overbroad information gathering by competition authorities as a "fishing expedition". One possible approach to address this concern is for authorities to structure their initial information gathering efforts around understanding the main motivations for the transaction (for example, using the firm's internal documents), and particularly whether it relates to the creation of product ecosystems, bundling, or leveraging data and network effects into new markets (OECD, 2020[3]).

The in-depth analysis of conglomerate mergers presents additional challenges. First, theories regarding conglomerate merger harms focus on the potential for the post-merger firms to engage in certain specific strategies (particularly tying or degrading interoperability with rival products). Thus, competition authorities evaluate the effect of the merger on the *ability* and *incentive* of the post-merger firm to engage in strategies that could result in competition harm (Neven, 2005[5]). This requires an understanding of the relationship between the firms and their consumers, a firm's business strategy (including the rationale for the transaction, and how a firm monetises products provided at a monetary price of zero), and the technical feasibility of implementing a tie.

If it is determined that the post-merger firm will have the ability and incentive to engage in tying, an assessment of the overall *effects* of this conduct on consumers will be needed. This will require an authority to consider the *dynamic* effects of the conduct. In other words, whether the merger will cause the exit of efficient competitors from the market and make it difficult for new ones to enter. In online markets, this will depend on a range of factors, including: patterns of consumer decision-making (and inertia or biases), the susceptibility of the market to tipping into monopoly due to very strong network effects and economies of scale, and the necessity of data to compete (Bourreau and de Streel, 2019[9]). These effects must then be weighed against the efficiencies and benefits to be expected from the merger.

What are the benefits of using merger review to address potential conglomerate merger harms?

Despite these significant analytical and practical challenges, merger control may be the best tool to deal with some competition concerns associated with conglomerate mergers. First, as noted above, merger control plays a preventative role. Thus, while competition authorities can address tying conduct that has anticompetitive effects in separate enforcement proceedings after a merger, this approach has several disadvantages. In particular, the conduct may have already harmed consumers (Church, 2008[11]). Further, abuse of dominance enforcement cases can be lengthy and costly both for competition authorities and the targets of an investigation. Merger control allows the merging parties to proactively identify solutions to address potential competition concerns, and avoid later infringement proceedings, which carry the risk of fines (Proctor, 2015[20]).

Second, conglomerate merger concerns may be addressed through what are called *behavioural remedies* – that is, a commitment by, or orders to, the merger parties not to engage in the type of conduct that might harm competition. For example, in a recent merger decision, the EC accepted a commitment by Microsoft to ensure interoperability on its operating systems with rivals to LinkedIn, which it acquired (see Annex). These types of remedies are less burdensome than remedies that require firms to divest portions of their business to address competition concerns, which are more common in horizontal merger cases. Thus, the potential efficiencies of a conglomerate merger could be maintained if behavioural remedies are found that address the underlying competition concerns.

However, identifying appropriate behavioural remedies can be a significant challenge, and these remedies can require monitoring for compliance while giving rise to disputes on technical issues that can be difficult for competition authorities to arbitrate. Thus, behavioural remedies should be designed with clear-cut terms that do not have ambiguities leading to differing interpretations. If this is not possible, structural remedies involving divestitures may be necessary.

Annex. A selection of merger cases in digital sectors involving conglomerate theories of harm

Edenred/Benefit

Responsible entity: Competition Council of Romania

Description: In September 2019, the Competition Council of Romania assessed the acquisition of Benefit group, a supplier of management services of workers' benefits through a proprietary online platform, by Edenred Group, a company offering payment solutions in the workforce field. The Competition Council was concerned that, after the acquisition of the platform, the merged entity would foreclose Edenred's competitors by blocking their access to the online intermediation platform that facilitates the interaction between employers and employees.

Following its assessment, the Competition Council found that such risk was not likely, given that employers have the option of directly contracting with Edenred's upstream competitors and the platform's success is based on network effects that increase if there are as many benefit providers as possible using the intermediation service. Therefore, the Competition Council eventually cleared the merger without any remedies.

Read more: *http://www.consiliulconcurentei.ro/wp-content/uploads/2019/11/decizia_61_din_09092019_confidentializata.pdf*.

Intel/McAfee

Responsible entity: European Commission

Description: In January 2011, the European Commission reviewed the proposed transaction between Intel, the leading CPU and chipset supplier, and McAfee, a technology company active in the design and development of security products for internet-connected devices. The European Commission found that there was a serious risk that, following the merger, Intel would tie its hardware to McAfee's software and degrade the interoperability between its products and the security software provided by McAfee's competitors (and vice versa).

To address these concerns, it cleared the merger subject to behavioural commitments. More specifically, Intel committed to offer in a timely manner all instruction, interoperability and optimisation information to third-party vendors to allow them to produce security software that could run on Intel's hardware. Similarly, the merged entity committed not to degrade its security solutions when operating on non-Intel microprocessors. A monitoring trustee would oversee compliance with these commitments.

Read more: *https://ec.europa.eu/competition/mergers/cases/decisions/m5984_1922_2.pdf*.

M3/Nihon Ultmarc

Responsible entity: The Japan Fair Trade Commission (JFTC)

Description: In October 2019, the JFTC reviewed a transaction between M3, a digital internet-based platform operator providing doctors with free-of-charge drug information (e.g., on proper dosage, prescription, advertisement of drugs) on the one-side of the platform, and pharmaceutical companies with fee-based marketing support service of their drugs to doctors on the other side of the platform, and Nihom Ultmarc, a small-sized medical personnel information database provider with data on medical institutions, doctors and other healthcare professionals.

The JFTC considered that there was a risk that post-transaction, the merged entity would integrate the medical personnel information database and the marketing support service on the drug information platform, and provide the bundle at a discounted price. Given that medical personnel information were necessary to customise marketing plans to each doctor and medical institution, pharmaceutical companies would have most likely adopted the merged entity's bundled service, thus possibly foreclosing competitors.

The JFTC accepted the proposal of remedies from the merging parties against conglomerate foreclosure effects, whereby they would not require customers (mainly pharmaceutical companies) to purchase the bundle nor sell it under the condition of not using rival's drug information platform services, and would not set preferential treatment on customers such as selling the bundle at a discounted price.

Read more: *https://www.jftc.go.jp/en/pressreleases/yearly-2019/October/191024.html*.

Microsoft/LinkedIn

Responsible entity: European Commission

Description: In December 2016, the European Commission reviewed a merger between Microsoft, the leading supplier of operating systems (OSs) for personal computers and mobile devices, and LinkedIn, the operator of a professional social network.

First, the European Commission was concerned that Microsoft would pre-install LinkedIn on all personal computers, thus making it superfluous for original equipment manufacturers to install a second professional social network application performing the same functions as LinkedIn. Second, the European found that there was a serious risk that the merged entity would not provide LinkedIn's competitors with all the necessary technical information to ensure interoperability of their products with Microsoft's OSs. Such potential foreclosure effects would be strengthened by network effects: more and more users would join LinkedIn while fewer users would have an incentive to use other professional social networks, thus driving them out of the market.

To address these concerns, Microsoft committed to: (1) grant all professional social network providers access to its application-programming interface and allow them to develop their interoperable software, and (2) not force original equipment manufacturers to pre-install LinkedIn and to ensure freedom of choice to both manufactures and users.

Read more:
https://ec.europa.eu/competition/mergers/cases/decisions/m8124_1349_5.pdf.

NVIDIA/Mellanox

Responsible entity: European Commission (EC)

Description: In November 2019, the EC reviewed a merger between NVIDIA, which sold graphics processing units for gaming, professional visualisation, datacentre and automotive applications, and Mellanox, which provided products and solutions to facilitate data transmission for data centres.

The merger was cleared by the EC without conditions, but it did consider several different conglomerate theories of harm. In particular, the Commission identified several markets in which either NVIDIA or Mellanox had market power, and investigated the potential for that market power to be leveraged into other markets to foreclose competitors. The EC assessed both the ability and incentive of the post-merger firm to engage in bundling/tying and to degrade interoperability of its products with those of its competitors. It found that the post-merger firm would not have both the ability and incentive to engage in this conduct, and thus that the merger did not raise serious competition concerns.

Read more:
https://ec.europa.eu/competition/mergers/cases/decisions/m9424_778_3.pdf.

Qualcomm/NXP Semiconductors

Responsible entity: European Commission

Description: In January 2018, the European Commission assessed the acquisition of NXP by Qualcomm. The former is a supplier of Near Field Communication (NFC) and Secure Element (SE) technology that allows smartphones to communicate with close devices, for instance to enable contactless payments; the latter produces baseband chipsets (BCs) enabling radio functions and connectivity for smartphones.

The European Commission found that there was a serious risk that post-transaction the merged entity would leverage its significant market power in BCs and NFC markets through bundling strategies, for instance by bundling NXP's IP to its patent portfolio and allowing it to charge higher royalties to access other connectivity technologies. Furthermore, it was concerned that Qualcomm could degrade the interoperability of NFC and SE products with competing third party BCs, thus favouring its newly acquired products.

To address these concerns, the merging parties committed to enable the same level of interoperability between Qualcomm BCs and NXP products also in corresponding products of other suppliers, and to continue offering to third-party NFC and SE producers the licences necessary to access its technology on terms at least as advantageous as those available at the time of the transaction.

Read more:
https://ec.europa.eu/competition/mergers/cases/decisions/m8306_3479_3.pdf.

Worldline/Equens/PaySquare

Responsible entity: European Commission

Description: In April 2016, the European Commission assessed a proposed transaction between Worldline, a payments and transaction services company, and Equens, a payment service provider offering merchant acquiring services in several EU countries through its subsidiary PaySquare.

The European Commission was concerned that post-transaction the merged entity would bundle its point of sale (POS) terminals and its merchant acquiring services. Although the European Commission considered that there were certain advantages in having one single contact point for the purchase of terminals and merchant acquiring services, it found that the bundle would have further strengthened Worldline's position in the merchant acquiring services market in Belgium, and possibly foreclosed its competitors in the POS provision market.

The European Commission cleared the merger, subject to the divestiture of the merchant acquiring business of PaySquare in Belgium, including the entire customer portfolio, to enable a competitor to enter the market with an already viable business and thus compete effectively.

Read more:
https://ec.europa.eu/competition/mergers/cases/decisions/m7873_1821_3.pdf.

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