Global Forum on Competition

ECONOMIC ANALYSIS IN MERGER INVESTIGATIONS

- Executive Summary -

9 December 2020

This executive summary by the OECD Secretariat contains the key findings from the discussion held during Session III of the 19th meeting of the Global Forum on Competition on 7 – 10 December 2020.

More documents related to this discussion can be found at oe.cd/eami.

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Executive Summary

By the Secretariat*

From the discussion at the GFC Expert Panel held by Competition Committee on 9 Dec 2020, the delegates’ submissions, the panellists’ presentations and the Secretariat’s background paper, several points emerged:

1. Economic analysis is a key part of merger control, although this analysis must be guided by an understanding of legal frameworks and standards.

Economic models and analysis can play a central role in a competition authority’s merger review process. As a result, several authorities discussed the importance of having economists on staff, either assigned to a merger as part of an ad hoc team or situated within a specialised economics unit. Some have reported that it is useful to have a separate team of economists that can be a fresh pair of eyes and provide views from the outside of the case team.

Clear communication between economists and lawyers are needed to ensure that the legal arguments advanced in a case match the underlying economic insights. This is particularly important in merger review given that it is a forward-looking exercise, meaning there are no certainties, only likelihoods. Thus, data, documents and witness evidence must all be structured into a coherent view of a case.

Further, caution is needed to ensure that economic models are not misused by either competition authorities or the merging parties.

First, competition authorities should not be tied to the assumptions inherent in a single economic model, and they may need to consider several models in order to grasp the realities of a sector. In particular, given that it is generally not possible to build an entirely new model focused on each market under review, authorities may need to use multiple established approaches flexibly to make their assessment – even if merging parties seek to tie them to a single model. For example, analysis using a model that assumes homogeneous goods may need to be complemented by one with a differentiated product framework.

Second, claims made by parties about likely competition impacts that rely on theory may need to be examined in terms of their inherent assumptions, applicability to the markets at issue, and empirical support. For example, in sectors with no obvious barriers to entry and yet no easily-identifiable potential entrants, merging parties may rely on theoretical arguments about contestability that do not fit the realities of the market in order to dismiss competition concerns. Another example relates to arguments by merging parties about the competitive constraints of potential imports based on international trade models. There is a risk that these arguments will not reflect realities in a market. In particular, evidence that the parties compete for sales prior to the merger would contradict the notion that imports determine market prices and thus impose competitive discipline on the market.

* This executive summary does not necessarily represent the consensus view of the Global Forum participants. It does however identify key points from the discussion at the Roundtable, including the views of the expert panellists and the participants’ oral and written contributions.
2. **Economics can be useful throughout the merger review process, and to undertake ex-post evaluation after an investigation has been completed**

Economists’ insights will be valuable throughout a merger review process. In the early stages, economists can help in the formulation of information requests and other evidence gathering exercises, including identifying key questions according to potential theories of harm and formulating detailed data requests.

For jurisdictions that have a multi-phase merger review process, economic analysis in the first phase could be focused on developing preliminary indicators of potential harm, whereas an in-depth review, if deemed necessary, would involve more sophisticated techniques. Several experts also emphasised the usefulness of economic expertise in assessing qualitative, as well as quantitative, analysis.

Some authorities emphasised the approach to evidence gathering and the techniques used depends on the case at hand and should be assessed on a case-by-case basis. The Covid-19 crisis has meant that authorities have needed to adapt their techniques. The digital market also brings new challenges as traditional techniques may not be appropriate.

For evidence gathering, surveys are used to different extents depending on the authority and their enforcement regime (i.e., in some jurisdictions surveys may lack evidentiary value in legal proceedings). Survey design is of upmost importance. The involvement of economists and of merging parties is key, as is the need to minimise bias and sampling issues.

The expert panel described a range of economic techniques used when assessing theories of harm and evaluating the claims and economic evidence offered by the merging parties. Several experts discussed the use of event studies, in other words taking advantage of natural experiments in a market, to obtain insights about competitive dynamics without requiring overly burdensome analysis and data access.

Another example related to issues of geographic market definition. In this example, the merging parties argued for a broad geographic market, which the competition authority disproved with a pricing analysis using an exogenous variable (specifically, seasonal changes in the availability of hotel rooms, which affected the supply available during religious holidays for which the calendar date varied). The competition authority then conducted a diversion ratio analysis (using an instrumental variable regression), which suggested that there was not significant substitution between the merging parties, thus supporting the approval of the merger.

Economic techniques can also be valuable for ex-post analysis, specifically to evaluate current tools according to how well they predicted the impact of past mergers. These findings can help decision-making in future cases with respect to efficient resource allocation, and the selection of appropriate economic models.

Competition authorities have conducted ex-post assessments of a wide range of merger decisions, and in particular the performance of various economic techniques, such as merger simulations, screening methods (such as HHI, diversion ratios and upward-pricing pressure indices), and reduced-form approaches. One example of the latter is the type of analysis employed in certain retail sector mergers, which used entry and exit events to estimate the impact of a change in competition on prices in a market. A recent analysis regarding local grocery markets in the US, for example, found that the price effects of entry and mergers in markets of similar concentration have a similar magnitude, which supports using entry events as a predictor of merger effects.
3. **Competition authorities face the challenge of deciding how best to allocate limited economic resources**

While economic expertise can be useful throughout a merger review process, authorities will need to prioritise mergers that are most likely to be harmful when allocating scarce staffing resources. The availability of internal resources can often create limitations, given that the small size of chief economist teams can limit the type of analysis that can be conducted.

The panel also discussed how smaller jurisdictions may face both challenges and opportunities with respect to the use of economic analysis: on the one hand, economic resources may be more limited; on the other hand, however, additional types of granular analysis may be more feasible in smaller economies.

4. **Sophisticated methods of analysis should be selected carefully, and focused on situations in which simple analysis is not sufficient to assess a given theory of harm**

In particular, sophistication in methodology, such as the use of merger simulation, should not be confused for precision, and authorities should not set undue expectations regarding the predictive value of any single technique on its own.

In a similar vein, caution is needed regarding the quality of inputs, given that the validity of model results will be only as good as the underlying data. Thus, closely verifying data received from parties will be necessary, and cross-checking with other sources (including public datasets) can be helpful. In addition, financial and accounting data may need to be adjusted to be meaningful in economic terms. However, these adjustments, for example to capture economic value-added, can require some judgment.

When sophisticated analysis is deemed necessary (including when an authority must evaluate the analysis provided by merging parties), several experts emphasized the need for it to be clearly explainable to lawyers and potentially courts. Analysis should be rooted in facts and evidence rather than purely theoretical or subjective arguments. Further, competition authorities should be prepared to grapple with questions about whether uncertainties associated with economic models mean they do not meet the requisite standard of proof.

One approach is for competition authorities to start with the simplest economic method (including assessing descriptive information and key statistics), and moving to more complicated ones only if a simple method does not fully capture the issues presented by the merger. More sophisticated techniques can simply be used to verify an economist’s basic understanding of the issues, at which point a choice must be made about whether this analysis is kept out of the decision, published as an appendix, or placed at the core of the argument. Caution may be warranted in the latter case given the challenges of explaining complex analysis in court. One guiding principle could be the need to be able to explain the analysis to the general public, particularly if the case may receive public attention or it is likely to be reviewed in court.