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ECONOMIC ANALYSIS IN MERGER INVESTIGATIONS – Contribution from Hungary

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More documentation related to this discussion can be found at: oe.cd/mergerinv.

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Economic Analysis in Merger Investigations

- Contribution from Hungary –

1. Introduction

1. This contribution briefly explains the role of economists and economic analysis in merger cases at the Hungarian Competition Authority (Gazdasági Versenyhivatal – GVH). The paper first describes the institutional structure of the GVH, the merger review process and the usual ways in which economists are involved in such cases. The next section focuses on the use of surveys in merger investigations, while the final section demonstrates how other quantitative and qualitative methods have been applied in specific merger cases.

2. Merger review process

2. At the GVH the Merger Section is responsible for reviewing all notified transactions. The Merger Section is composed of lawyers and economists. Typically, two case handlers will be assigned to a case, one economist and one lawyer, but this can vary depending on the nature of the case in question.

3. The GVH also has a separate chief economist team (the Competition Economics and Market Research Section), whose members are economists. The chief economist team is involved in those merger cases where there is a concern that the transaction may substantially lessen competition. Nevertheless, they are not involved in every Phase II case; their participation is usually limited to those cases that may require a remedy or prohibition or the use of economic analysis to support market definition. Although it is rare for merging parties to use external economic experts, if they do the chief economist team is tasked with checking the validity and reasonability of their economic arguments.

4. The chief economist team is generally involved in the investigation at the earliest possible stage, most commonly in the pre-notification phase. The economists from the chief economist team participate in the examination of the notification materials and give their opinion on the issues that should be clarified. During the proceeding, depending on the importance and difficulty of the merger, they advise the case team at various points of the case or write individual assessments on the whole merger or on specific aspects of the case (i.e., providing a detailed market definition or conducting a competitive assessment on one of the affected markets).

5. The GVH does not engage the services of external economists in merger investigations for the purposes of market definition assessment or competitive analyses. The only external experts the GVH uses in merger investigations are market research companies. These companies, which have special expertise in conducting consumer surveys, are contracted by the GVH when the need arises.

3. Surveys in merger cases

6. Due to the very strict schedule of the merger review process and the time needed to execute a survey, the GVH only rarely uses consumer surveys in merger cases. Their use is mainly limited to those cases where understanding consumers' perceptions and reactions

is crucial for evaluating whether there is a chance that the merger in question will result in a loss of consumer welfare. The GVH places increased emphasis on the use of consumer surveys as part of sector inquiries. The findings of these surveys can then also be used in merger cases if applicable. Recently, the chief economist team became responsible for customer surveys, with the aim of strengthening their role in the authority's decisions.

7. One merger case where the GVH made use of a survey was the Blikk/Bors case (Vj/155/2008). This case, which concerned the proposed merger of the two market leading Hungarian daily tabloids in 2008, raised serious competition concerns primarily on the readers' side. The GVH aimed to understand the similarities between the two tabloids affected by the merger and the degree of competitive pressure they exerted on each other. The GVH initially assessed the similarities between the tabloids and other related newspapers (e.g., non-daily tabloids, country newspapers, electronic gossip sites) by issuing requests for information (RFI) to the merging parties and other relevant third parties. Furthermore, in order to understand customer perceptions, reading habits and their potential reaction to a price increase, a quantitative customer survey was carried out by an external market research company. Stratified sampling ($N = 401$) was applied that was representative for Hungarian tabloid readers based on gender, age, education level, region and settlement size.

8. As a result of the RFIs and the customer survey, the GVH identified the relevant market as the daily (printed) tabloid market, where the proposed merger would have created a near monopoly in the market. Furthermore, the survey results also revealed that post-merger the merging parties would have been in the position to significantly increase prices. In its statement of objections, the GVH stated that it was planning to prohibit the merger based on all the available evidence. Subsequently, the notifying party withdrew its notification and the GVH terminated the proceeding.

9. In another case (Magyar Telekom/Vidanet case – Vj/158/2008), which concerned the telecommunication market, the incumbent company (Magyar Telekom) aimed to acquire a regional fixed line service provider (Vidanet) in 2008. In this merger case a consumer survey exploring demand substitution between fixed and mobile services, focusing in particular on the provision of broadband internet, played an important role in defining the market(s) affected by the transaction. The findings of the consumer survey did not support the view that mobile broadband internet was a sufficiently close substitute of broadband internet provided through a fixed network. Responses suggested that for a number of consumers the two types of services complemented rather than substituted each other. The merger was blocked but the parties appealed and the court ordered a new investigation on the ground that potential competition had not been sufficiently assessed.

10. At the time of the repeated merger investigation (Vj/72/2012) the GVH did not consider the original survey to be sufficiently up to date. By that time mobile broadband internet in Hungary had become significantly faster, cheaper and more reliable (although there was still a gap between the quality and price of fixed and mobile broadband, as the former had also become faster and cheaper). Furthermore, an increasing amount of mobile internet usage involved mobile phones and tablets (i.e., "small screen" use) that partially relied on public Wi-Fi networks, while in the original case the term "mobile internet" basically referred to "mobile sticks" inserted into PCs and laptops (i.e., "large screen" use).

11. In other words, there were arguments that mobile broadband internet might have become a significantly closer substitute, but it was not clear whether this was in fact the case. Therefore, the GVH decided that the repeated merger investigation required a new survey.

12. The new survey relied on the design of the original one as far as possible; however, some questions were updated (e.g., speed and price categories) and certain new issues were also addressed (e.g., effect of public Wi-Fi networks). The survey took the form of an online survey on a sample of 1,000 respondents (who used internet regularly at home) and a boost of 300 respondents who used mobile internet. The survey, inter alia, explored the price sensitivity of subscribers, their switching habits and the cross use of fixed and mobile internet. The respondents were asked hypothetical questions and questioned about their personal experience. The results of the new survey were very similar to those of the original one: despite technological developments and changes in consumer habits, the findings of the new survey did not support the view that mobile broadband internet could reasonably be considered as a sufficiently close substitute for consumers, with a number of consumers using the two types of internet connection simultaneously.

13. Based on our experience (also arising from sector inquiries), we identified two important challenges associated with consumer surveys. First, consumer surveys constitute a useful tool if historical data and secondary information sources are not sufficient for a proper market definition or competitive assessment. This may be due to a lack of shocks or other events that can shed light on substitution, poor data quality or a lack of data about all the potential substitutes. However, in such cases consumers often do not have experience either, hence they might not be able to properly judge a hypothetical situation, e.g., a 10% price increase or the effect of the termination of a service. This makes the results of the surveys less reliable than, for example, a result from a natural experiment or shock analysis. Naturally, this problem can be partially mitigated by a professionally designed questionnaire.

14. Second, consumer surveys are often time consuming and it is difficult to manage them within the very strict time frame of a merger review. Since consumer surveys are often useful in defining the relevant market and identifying diversion ratios, the GVH is currently assessing the feasibility of using quick and short surveys.

15. Finally, in B2B markets, RFIs can be designed as surveys. In these markets, RFIs can be used to help understand customers. This represents a somewhat faster approach, as there is no need to involve an external market research company, with the authority able to execute this task on its own.

4. Economic analysis in merger cases

16. Apart from surveys, the GVH often relies on economic evidence and analyses in merger cases. In a simple case only market shares are calculated, while in more sophisticated cases a number of other analytical tools are also used. Economic analyses are applied as part of both the market definition process and the competitive assessment. However, the GVH would like to highlight that these economic analyses have so far never been contested before a court of law.

17. Regarding the relevant geographical market definition, it has often been identified either by analysing export and import data and calculating the LIFO (little in from outside) index, for example, in the Holcim/VSH case (Vj/153/2009) or based on transportation distances and costs, such as in the Messer/Air Liquide case (Vj/92/2015).

18. More recently, price correlation analysis was used to support geographic market definition in a retail gasoline market merger. The Hungarian incumbent oil company (MOL) planned to acquire five retail gasoline stations from a local competitor, Mobil Petrol (Vj/46/2018). The five stations were scattered around the country and four out of the five stations did not reveal any competition concerns regardless of the size of the relevant

geographic market. However, it was determined that the acquisition of the fifth station would lead to a monopoly if the catchment area was considered to be on the settlement level, and a combined market share of 50-60% for the parties if the catchment area was 20km wide. Nevertheless, if the geographic market was considered to be wider (with a radius of at least 40km), the combined market share of the parties would only be 30-40% with an increment of 0-10%.

19. However, at the beginning of the price correlation analysis (after subtracting input prices from retail prices) it became apparent that margins were almost flat with very little variation. This meant that the price correlation analysis was unreliable. Nevertheless, it could be observed that while margins varied across stations, stations located in the same city had very similar margins. Also, margin changes – although they occurred rarely – only seemed to influence the pricing of those gas stations that were located nearby. These findings were consistent with a narrow, or even a settlement-level geographic market; however, since margins only constitute a small portion of the retail price, the differences in margins did not lead to a substantial difference in the retail price. Hence, the margin differences were not significant in terms of the SSNIP test. All things considered, the analysis could not reach a definitive conclusion regarding the extent of the geographical market; however, it helped the Competition Council to find a suitable behavioural remedy addressing the pricing mechanism of the concerned gas station.

20. As regards to the competitive assessment phase, the GVH has applied various methods over the years. The complexity of the analysis adopted has depended on the nature of the case in question.

21. The Digi/Invitel merger case (Vj/43/2017, Vj/42/2018) concerned the fixed line telecommunications sector. As competition in telecommunications in Hungary is infrastructure based (i.e., service providers provide services mostly on their own local network, rather than through access to the local networks of others), the mapping of the presence of the parties' and competitors' networks in each settlement where the merging parties had overlapping networks was considered as a first step in the competitive analysis.

22. The chief economist team calculated market shares and gross add shares for each settlement as local geographic markets according to the number of residential customers. The use of gross add shares was inspired by the decision of the EU Commission in the Orange/Jazztel merger case (M.7421 – Orange/Jazztel, 19/05/2015). Gross add shares are similar to market shares but disregard customers who are already tied to particular service providers due to loyalty contractual clauses – in other words, gross add shares are market shares calculated for the contestable part of the market. In the Digi/Invitel merger analysis gross add shares played a supplementary role.

23. While the market shares and gross add shares provided a relatively accurate static picture of the market, the chief economist team promoted a more dynamic approach given that the market participants were constantly extending and upgrading their networks. This meant that the static picture would not provide an accurate representation of the market 2-5 years after the merger, which was when its impact was likely to take effect. While this could easily be incorporated into the theories of harm, its soundness relied solely on the market participants' development plans, which were not always of high quality. In the case of certain market participants these plans were historically unreliable, while in other cases they were quite general and vague. Consequently, the development plans and data were taken into account on a mostly qualitative basis.

24. A number of more sophisticated tools have been used in recent years, such as regression analysis, merger simulation and bidding analysis. The GVH conducted regression analysis, for example, in the DDC/Readymix case (Vj/37/2017), which

concerned a merger between two important players of the Hungarian ready-mixed concrete market. The horizontal effects of the merger were analysed on the local markets of ready-mixed concrete (25km catchment areas around the cities where the plants were located); while the merger was also found to have vertical effects on the market of cement, aggregates and paving stones.

25. The GVH carried out a regression analysis to explain the prices of the acquiring party (DDC) using OLS methodology. Results showed that larger buyers and contracted partners received more favourable prices. Furthermore, the results also suggested that Readymix could be considered as the closest competitor of DDC because in its presence DDC*, ceteris paribus,* applied much lower prices. This was an additional input to the competitive assessment of the GVH which also supported the necessity of a structural remedy.

26. A recent case where the GVH conducted a merger simulation was the Flaga/TOTAL case (Vj/19/2015). This merger affected the markets of industrial gases, where the main overlapping areas were the supply of PB gas products and the refill of cylinders. In this case, the GVH used PCAIDS and nested logit demand functions in the simulation model. Revenue, quantities sold, prices and variable costs were used to estimate the potential price increase post-merger (using R). Most of the models used in the simulation resulted in a minor, less than 5% increase in prices, so none of these estimations showed economically significant price effects.

27. Finally, in bidding markets the GVH has also applied bidding analysis to estimate the closeness of competition between merging parties. In the HTTC/Matel case (Vj/19/2007), which involved the merger of two telecommunication companies, the main concern was the supply of internet access and data communication services for large business and government customers. In this case, the GVH carried out participation tests, runner-up tests and a win/loss tests, which indicated that the two merging parties were not each other's closest competitors. RFIs also provided similar conclusions.

28. Bidding analysis was also used by the GVH in the Magyar Posta/Díjbeszedő Holding case (Vj/62/2013). This merger concerned the market of personalised mail preparation services. These types of services consist of printing and enveloping mail products, mostly invoices. The GVH also carried out participation, runner-up and win/loss analyses. The analyses showed that although the parties participated in almost half of the tenders (and the proportion was higher in the larger ones), the resulting correlations did not reveal that the parties were close competitors.