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ECONOMIC ANALYSIS IN MERGER INVESTIGATIONS – Contribution from Kenya

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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 Kenya –

1. Introduction

1. The Competition Authority of Kenya ('the Authority') safeguards competition by regulating market structure and market conduct. Regulation of market structure involves analysis of mergers, while regulation of market conduct involves investigation into restrictive trade practices and conduct, such as abuse of dominance, price fixing, bid rigging, among others.

2. Besides, the ongoing COVID-19 pandemic has posed various challenges to competition agencies towards achieving competitive markets. Some of these challenges, particularly in the merger regime, include; inability to effectively investigate gun jumping cases due to constrained movements, challenges in conducting filed investigations and surveys in order to corroborate submitted information and collect stakeholder views, limited physical meeting for evidence presentations and hearing conferences and challenges regarding effective implementation of public interest tests.

3. In order to ensure markets remain competitive, competition law and policy tools need to be adjusted to accommodate the market dynamics. Some concerns which are likely to arise in the review of mergers amidst Covid-19 pandemic are: competitive assessment of mergers in times of significant and rapid change in market circumstances; implementation of adequate remedies; and evaluating failing firm defense, among others. On this note, the Authority recognizes the importance of developing and using procedures in order to achieve effective economic analysis in merger investigations, as we attempt to demonstrate in the next sections.

2. Economic Analysis in Merger Investigations

4. It is worth noting that economic analysis is key in a merger investigation, and typically requires defining the market, determining the market shares and market concentrations, assessing unilateral and coordinated effects, and analyzing countervailing buyer power, entry, expansion, repositioning and efficiencies. The ongoing covid-19 pandemic has left most competition agencies re-strategizing their approaches towards economic analysis in merger investigation. It is imperative that key principles of merger investigations remain unchanged. However, adjustment of merger techniques swiftly foster the decision-making process, while economic analysis needs to remain transparent and factor in the crisis conditions.

3. The Kenyan Context

5. The Authority has developed the Consolidated Guidelines on Substantive Assessment of Mergers¹ to aid in the economic analysis. These Guidelines highlight a number of important characteristics that economic evidence should exhibit. It strains on the

¹ <https://cak.go.ke/sites/default/files/guidelines/Consolidated%20Merger%20Guidelines.pdf>

fact that economic evidence should be based on clear economic theory; should make clear what question it seeks to answer and why this question is relevant. Additionally, it should be transparent and replicable, so that the wider group of the economy can understand the analysis and reassure themselves that the analysis is sound; and it should ideally be intuitive so that one is able to understand the significance of the analysis for competition.

6. The guidelines consider tools like market definition, concentration, theories of harm and price pressure indexes (GUPPI) in assessing the level of competition in a market. However, one of the difficulties it faces in assessing competitive effects in fast-evolving markets is the likelihood of wrong market definition or narrow definition of markets, whereby some vital market players are falsely left out in the merger investigation.

7. The first and essential task undertaken by the Authority is market definition, which involves delineation of the product market by identifying all the products that buyers regard as reasonable substitutes for the product under investigation (“Focal Product”). The next step is to identify all the sellers who supply the focal product and substitute products, or who could potentially supply them. Therefore, a relevant product market comprises all those products which are regarded as reasonably interchangeable or substitutable by the consumers, by reason of the products' characteristics, their intended use, production methodologies involved, raw materials used, and route to market, among others.

8. The identification of product market(s) is then followed by defining the geographical market, which may extend beyond the area under investigation and in which the product is sold. The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services (“Focal area”), in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.

9. For complex merger cases the Authority initiates an investigation plan which has an implementation matrix highlighting the theories of harm, areas to be investigated, facts/information to be obtained, sources of information, evidence gathering method and analysis of the information received.

10. It should be pointed out here that all merger cases in Kenya are handled by economists who give the economic perspective from making the initial decision on in-depth review, preparing information requests and negotiating remedial measures, as may be appropriate.

11. In line with the current pandemic, the Authority has considered a mechanism in ensuring proper economic analysis in merger investigation. It has encouraged prioritization of enforcement and advocacy actions to deal with the crisis. The measures should focus on sectors most bombarded by the pandemic by providing initiatives that help speed up the recovery of the economy. As extrapolated, the initiatives include promoting incentive mechanisms for markets to respond to and limit market responses that would otherwise harm the consumers or slow down the recovery process of the economy. First, it is important to classify the economy into three classes:-

- i. Sectors not affected by the crisis;
- ii. Sectors temporary negatively affected by the crisis; and
- iii. Sectors likely to be adversely affected, i.e. the effect of the crisis is not just transitory.

12. Competition assessment is then made according to which sector is likely to be affected by the merger. The first category does not require adoption of new strategies and

tools, however, transactions in the second categories can be permitted with temporary behavioural remedies rather than structural. The third category would be the main focus of the competition authorities with the anticipated rationale for mergers being the failing firm claim.

13. In addition to competition assessment, the Authority undertakes Public Interest Test (PIT). This focuses on the extent to which a merger would affect: ability of SMEs to gain access or to be competitive in any market; ability of national industries to compete in international markets and a particular industrial sector and extent to which a proposed merger would be likely to affect employment. Generally, in any case involving a public interest assessment, the Authority attempts to establish whether there is a *prima facie* case adducing evidence of the relevant negative impact to any of the public interest factor(s) set out under the Act.

14. The covid-19 pandemic had differentiated negative effects on (economic) sectors of the Kenyan economy, such as; agriculture (e.g. horticulture, flower industry), airlines and tourism, among others. Intuitively, PIT plays a pivotal role in the assessment of mergers in the post-Covid 19 period. Therefore, most of the effects of the pandemic, such as employment and impact on small businesses, can well be addressed using remedies provided for under this test. For that reason, these considerations within the context of the Kenyan economy suffice jointly with fast-tracking of mergers in sectors that have been greatly affected.

3.1. Applicable cases of economic analysis of merger investigations in Kenya

15. The Consolidated Guidelines which is a key policy guide in competition assessment in Kenya has reiterated that economic efficiencies are an important pillar of the competition test applied by the Authority when reviewing a proposed merger. The extent to which the negative effects of a proposed merger compensates for economic efficiency are evaluated on a case-by-case basis, and it would appear only acceptable where there are no likely competition concerns.

16. The Consolidated Guidelines specify that the Authority investigates all plausible theories of harm that would apply to each merger on a case-by-case basis. The Authority investigates market dominance and in so doing defines and identify the market of the goods and services produced by the parties to the proposed merger. It also assesses the unilateral and coordinated effects of the proposed merger where it is investigating a horizontal merger, and the vertical and conglomerate effects where it is assessing a non-vertical merger.

17. In all instances, the Authority's primary concern is to ensure that the impact of the merger does not result in the prevention or lessening of competition by allowing the creation or increasing of market power or assisting in its exercise.

18. Additionally, the stated objective by the Authority is that any remedial package it imposes on a proposed merger (including a requirement for divestiture), is meant to 'restore or maintain competition while allowing for the realisation of merger-specific efficiencies and benefits'.

19. The implementation period for each remedial package is decided upon by the Authority on a case-by-case basis. Moreover, each remedial package agreed to by the Authority (whether structural or behavioural) must include the following elements: address the major areas of competition concern; have a low level of risk of not being successful; be capable of practical implementation and monitoring in Kenya; and be capable of resolving the identified areas of concern within a specified, preferably short, time frame.

20. In the event the remedial package includes a divestment, the Authority may require the appointment of divestment trustees to ensure the business to be divested is sold off to a suitable purchaser where the merging parties have been unable to offload that business within the agreed divestment period.

21. The Authority has handled several transactions in Kenya in relation to economic analysis, requiring proper economic analysis. Some of these cases have been in the telecommunication, banking, beverages and cement industry.

22. **Competition in the Telecommunication Sector- Airtel and Telkom** – The Authority in its assessment defined the relevant product markets as the markets for (i) Telecommunication Infrastructure, (ii) voice calls and SMS, (iii) data (iv) mobile financial services, (v) leasing of telecommunication lines² and (vi) Market for Spectrum. There were only three (3) major players in the aforementioned markets. The proposed merger of two of these players would result in a duopoly market structure, which is more concentrated than the current Oligopoly market structure. This implies that the competitiveness of the telecommunications sub-sector would worsen due to the likely coordinated conduct likely to result from the new market structure of two market players.

23. In its analysis, the Authority illustrated the price effects of the merger by decomposing how the acquiring telecom firm prices the different elements of its various packages (length of contract, bandwidth, quotas, etc.) and then using this pricing policy to estimate the price increases for the packages offered by the target firm. It also considered issues such as Access Spectrum Holding, Revenues, Mobile Communications Subscription, Mobile Voice Traffic, Mobile Money Subscriptions, Number of Transactions, Value of Transactions and Number of Agents. In considering access to spectrum, which was a key competition concern, it evaluated the spectrum policy in Kenya and the effect of the merger with regards to the spectrum allocation in the post-merger period.

24. Additionally, the Authority was able to use expert advice from the Communications Authority who are the telco sector regulator and are well versed with matters spectrum. This enabled the Authority to fully appraise itself on spectrum allocation and licensing agreements in Kenya.

25. Consequently, the Authority proposed structural remedies for the merger in relation to the licensing agreements and spectrum allocation due to possibility of coordinated effects in the market and the high barriers to entry in the upstream market for spectrum.

26. **Competition in the Beverages Sector- Almasi Beverages Limited and Coca-Cola Sabco** – This was a vertical merger which was inherently pro-competitive in nature, however, had key foreclosure concerns. The acquirer produces and supplies the Coca Cola concentrates either directly to its bottlers such as Equator and Nairobi Bottlers or to independent bottlers such as Coastal and Almasi Bottlers. The bottlers process these concentrates by adding water, Carbon (IV) Oxide and then bottle the same in glass and plastic containers. The bottled products are then transported to appointed distributors for onward forwarding to the consumers. Relevant product market identified was distribution of branded Non-alcoholic Ready to Drink (NARD) beverages.

27. The Authority identified theories of harm in respect to the transaction such as; customer and input foreclosure; Directly and indirectly fixing trade conditions; Dividing markets by allocating customers and areas to be covered by distributors and lending of Coolers to Retailers.

28. In its economic analysis, the Authority considered the motivation and the profit-trade off in the merger investigation. Further it conducted a survey whose aim was to determine how consumers value product attributes and make purchasing decisions and the vertical chain of distribution of the products in the merger.

29. The Authority imposed structural remedies to deal with the identified theories of harm; in other words, the merged entity shall reserve the lower deck of the refrigerators lent to the SMEs' for other non-Coca-Cola branded products. Henceforth, the distributors shall construe a fully stocked SME refrigerator to mean stocked with Coca-Cola branded products in all the decks save for the lower deck. The bottlers to expressly allow their distributors to supply other NARD without any explicit or implied constraints; and Coca-Cola to amend its agreements in the market by removing clauses which stipulate the prices and profit margins for the sale of its products.

4. Conclusion and Recommendations

30. In Kenya, there is relatively a low level of economic knowledge and understanding among private parties and their legal advisors. As a result, the legal advisors often tend to be more inclined to fixate on legalistic form rather than the effects of economic behaviour. This can act as a brake on the Authority adopting a more economics-based approach.

31. The Authority annually conducts training on economic analysis of mergers with emphasis on invoking arguments along the lines of (a) economic analysis as opposed to legal evidence in merger analysis. To focus on the key stakeholders in capacity building capacity and in remedying the situation, the Authority has between 2018 and 2020 cumulatively trained about 180 individuals in law firms, among other stakeholders.

32. The Authority in its own motion continuously publishes Guidelines such as Market Definition Guidelines and Consolidated Guidelines on the Substantive Assessment of Mergers so as to improve the economic knowledge among the legal fraternity.

33. The Authority through its merger analysis has noted that the **need for procedures to be utilized to enable the effectiveness of economic analysis** is adequately communicated to stakeholders who have limited economics training or experience with competition law. They may therefore be exposed to economic analysis early in a case through written statements and via developing procedures thus allowing them an early opportunity to ask questions raised by the written statements.

34. **Composition of tribunals or panels may affect the acceptance of economic evidence.** In jurisdictions that operate an administrative system (or where specialist tribunals/courts have been set up and are populated with experienced judges specializing in competition law), economists are with intent included in the panel of adjudicators to enable these bodies have a greater understanding of economic theory in competition cases.

35. **Economic models should be presented in a non-technical but accurate way,** with explanations as to how they work, why the one chosen is more suitable to the particular task, and how it leads to particular conclusions based on the facts of the specific case. Assumptions relied upon are disclosed, including explaining why alternative assumptions and certain parameters were not used, based on expertise knowledge, experience and evidence in the case of market specific merger investigations.