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Executive Summary of the Roundtable on Start-ups, killer acquisitions and merger control

Annex to the Summary Record of the 133rd Meeting of the Competition Committee held on 10-16 June 2020

10-16 June 2020

This Executive Summary by the OECD Secretariat contains the key findings from the discussion of the roundtable on Start-ups, killer acquisitions and merger control held during the 133rd meeting of the Competition Committee on 10-16 June 2020.

More information related to this discussion can be found at https://www.oecd.org/daf/competition/start-ups-killer-acquisitions-and-merger-control.htm

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Executive Summary of the roundtable on Start-ups, killer acquisitions and merger control

By the Secretariat[1]

On 11 June 2020, the OECD Competition Committee held a roundtable on Start-ups, killer acquisitions and merger control.

Based on the background note prepared by the OECD Secretariat, written submissions from delegates, and the contributions by expert panellists and delegates to the discussion, the following key points emerged:

1. Recent empirical work focusing on the pharmaceutical industry has identified a trend of "killer acquisitions", in which incumbents acquire nascent competitors and discontinue their products (or product development efforts).

According to the killer acquisition theory of harm, incumbents acquire and "kill" a competitors' product in order to: (i) avoid the competitive pressure the product may create if it matures under the ownership of a competitor and (ii) avoid cannibalising the incumbents' own sales by ceasing to develop and sell the product after the acquisition.

Killer acquisitions fit within a broader set of theories of harm focusing on the loss of potential competition from nascent competitors. These acquisitions, which could be a particular source of concern in digital markets, may give rise to horizontal, vertical or conglomerate merger harms.

The acquisition of nascent competitors may harm competition when: the target has recently introduced a product that directly competes with the acquirer's products; when the target's products are weak substitutes for the acquirer's but they may grow closer in time; or when the target will in the future introduce a competing product in current or new product markets.

2. The acquisition of nascent competitors, including killer acquisitions, has been advanced as one possible cause of growing mark-ups and concentration at the sector and market level. These indicators suggest market power is on the rise, and some have contended that this is due at least in part to anticompetitive merger activity.

While it is not clear that there has been under-enforcement regarding the acquisition of nascent competitors, evidence suggests that these theories of harm are not often investigated, and there are no indications of over-enforcement in this area.

One source of concern is that in jurisdictions with mandatory pre-merger notification systems that rely on revenue thresholds, acquisitions of nascent competitors may not be notified to the authority (given a nascent target may not generate any revenue). As a result, some jurisdictions have introduced transaction value thresholds to try to capture potentially anticompetitive acquisitions of nascent competitors. The rationale for such approach is that a high purchase price for a company with a minimal turnover may indicate the target is competitively relevant and the loss of competition is material.

[1] This Executive Summary does not necessarily represent the consensus view of the Competition Committee. It does, however, encapsulate key points from the discussion, the delegates' written submissions, and the panellists' presentations.

In other jurisdictions, current merger review frameworks can be sufficiently flexible to capture these transactions, including those using a share of supply test, and those allowing authorities to investigate and challenge non-notified transactions.

3. Investigating the acquisition of nascent competitors can be particularly challenging given the uncertainties involved. However, established assessment frameworks remain relevant, and certain types of evidence, including internal documents, may be particularly helpful.

One particular challenge associated with investigating the acquisition of nascent competitors is identifying the counterfactual (what would have occurred without the merger). In particular, authorities must assess the likelihood of the target emerging as a competitor on its own, whether the target is a "maverick" or disruptive competitor, and whether it would likely be acquired by another competitor or potential competitor in the market. These challenges could be less pronounced in markets with well-established product development pathways, like pharmaceuticals, compared to digital markets.

It is also relevant to consider whether IP, regulatory or other challenges could impair the target's ability of reaching commercial success. However, the evidence need not establish that the target would eventually match the scale and scope of the acquiring firm in order to demonstrate harm. Even smaller entities with a competitive product active in only one market could, depending on the market, impose a competitive constraint (and thus the acquisition of these firms may harm competition).

The assessment of nascent firm acquisitions can be particularly challenging for firms that have not yet offered their product on the market, in which case multiple counterfactuals may need to be identified. The timeframe for the assessment of these acquisitions will be crucial, since applying too short a timeframe could risk underestimating the potential for harm. While these questions involve substantial uncertainty, authorities must balance this challenge with the risks of not intervening in markets with a credible risk of competition harm.

Evidence gathering can help overcome these challenges, in particular contemporaneous internal documents that provide an understanding of how the acquirer sees the target (and the potential competitive threat it poses), and what it plans to do with the target's current research and development efforts. In addition, it can be valuable to review business plans that lay out the target's strategy in order to assess the target's future potential role as a competitive constraint. It will also be necessary to seek the views of other potential acquirers, consumers and neutral third parties. The risk of convenience bias (placing undue focus on viewpoints that are easily available) should be guarded against in evidence-gathering.

Valuation analysis has also been identified as a potentially useful, albeit challenging, approach for assessing the acquisition of nascent competitors. In particular, an authority could attempt to break down the components of the acquisition price for the target to determine whether a premium is being paid for anticompetitive effects. This could involve valuing the current cash flows of the target as well as potential synergies expected by the incumbent, and then determining whether any remaining components of the transaction value could represent gains from lessened competition. The valuation analysis of other bidders for the targets may also be helpful as a point of comparison.

Caution may be needed in recognising any efficiencies associated with the acquisition of a firm's emerging rival. For example, it is not clear that a merger could be justified on the grounds that it allows a nascent firm's product to be offered to an incumbent's large installed base. Further, it is not clear that dynamic efficiencies associated with facilitating the exit of entrepreneurs from the market would be of benefit to consumers. The concept

that the prospect of acquisition by a large incumbent incentivises innovation, for example, remains a controversial one.

4. Looking forward, several changes to enforcement prioritisation and frameworks are being considered in response to concerns about the acquisition of nascent competitors.

First, some agencies have implemented new transaction value notification thresholds to ensure the acquisition of nascent competitors are captured. However, it remains too early to say whether these thresholds have effectively identified potentially harmful acquisitions of nascent competitors. Further, there is a need to ensure new notification thresholds do not lead to a burdensome influx of notifications to authorities.

Additional proposals include the use of market share thresholds, and applying filters based on product and transaction type (acquiring products with standalone potential could, for example, be a greater source of concern than an "acquihire" transaction aimed at recruiting talent). Competition authorities could also impose extended notification requirements on firms operating in specific markets that are potentially more at risk of nascent acquisitions, such as digital markets. Furthermore, there are proposals to make use of, or introduce, powers to conduct ex-post reviews of completed transactions involving nascent firms.

Another proposal subject to debate is the reversal of the burden of proof regarding the competitive effects of mergers in some situations. For example, some call for a rebuttable presumption that acquisitions of a nascent rival by entrenched dominant companies are anticompetitive. This could help address significant information asymmetries between competition authorities and large incumbents.

Finally, some have called into question whether the balance of probabilities test for merger review (requiring, for instance, agencies to find that the nascent firm is likely to succeed as a business) risks impeding the ability of authorities to challenge anticompetitive acquisitions of nascent firms. As an alternative, proposals have been made to consider both the likelihood of harm as well as the magnitude of harms, thus ensuring that scenarios with significant potential harm are considered even if they are not assigned a probability of over 50%.