Organisation for Economic Co-operation and Development

DAF/COMP/WD(2018)25

Unclassified **English - Or. English**

2 May 2018

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Non-price effects of mergers - Note by Indonesia

6 June 2018

This document reproduces a written contribution from Indonesia submitted for Item 4 of the 129th OECD Competition committee meeting on 6-8 June 2018.

More documents related to this discussion can be found at www.oecd.org/daf/competition/non-price-effects-of-mergers.htm

Please contact Mr. Antonio Capobianco if you have any questions about this document
[E-mail: Antonio.Capobianco@oecd.org]

JT03431098

Indonesia [1]

1. Introduction

1. The non-price effect is currently an issue of global concern in merger analysis, especially since the special emphasis given by the US FTC in the 2010 US Horizontal Mergers Guidelines, which underscores the importance of non-price effect analysis. The approach has also been carried out on the impact of reductions in product quality in H&R Block and reduced innovation in the proposed AMAT/Tokyo Electron merger. The relationship between competition and non-price factors such as innovation and quality has also been studied in various literatures. Philippe Aghion's research in 2005 (*Competition and innovation: An inverted-u relationship*) proves that there is an inverted U-turn between competition and innovation, that is, at a low level of competition, the relationship is positive, while at a high level of competition their relationship is negative. That means, the higher the level of competition, the lower the innovation in the market.

2. Sectoral studies of non-price impacts are also frequent, for example in the aviation sector, studies are conducted on the impact of consolidation on measures of quality standards on flights (such as waiting times and delay). One example is a study by Mazzeo (2003) who found that routes served by more than two airlines with non-stop services, can reduce the frequency of delay.

3. The use of non-price impacts in competition analysis has indeed begun to be implemented by a well-developed merger regime, especially for those who embrace the mandatory pre-merger notification system. In contrast to conditions in many developed countries, the use of non-price impact analysis with Indonesia's current merger regime cannot be implemented and, if implemented, will provide a substantial additional burden to merging businesses. The explanation of the statement will be illustrated through this written contribution.

2. Merger Control in Indonesia

4. The provisions in the Indonesian competition law, especially Article 29 of Law No. 5/1999 and its implementing regulations, Article 5 of Government Regulation No. 57/2010, concerning Merger, Consolidation and Acquisition (hereinafter referred to as "merger") rules that any merger shall be notified to KPPU no later than 30 (thirty) working days since the date of the merger is juridical effective. However, Article 10 of Government Regulation No. 57/2010 grants the company with the right to voluntarily consult the Commission in writing or orally prior to the merger. Thus, based on Article 29 of Law No. 5/1999, Article 5 and Article 10 of Government Regulation No. 57/2010, merger control is conducted by KPPU in two forms, namely mandatory post-merger notification; and voluntary pre-merger notification.

5. The company shall be obliged to make a merger notification to the Commission when they meet the merger threshold. Such threshold includes the value of the assets of a

[1] This written contribution is prepared and edited by the Directorate of Merger, KPPU

business entity resulting from a merger or consolidation or acquisition that exceeds IDR 2.5 trillion; or the sale value of a business resulting from a merger or consolidation or acquisition exceeding IDR 5 trillion. Whereas if two or more parties conducting mergers are engaged in banking, the company shall notify its merger to the Commission if the value of the assets of the entity resulting from the merger exceeds IDR 20 trillion. If one of the parties conducting mergers is engaged in banking and other parties is engaged not in the banking sector, the company shall make a notification to the Commission if the value of the assets of the entity resulting from the merger exceeds IDR 2.5 trillion.

6. The value of the asset and/or sales value as the measure in this threshold shall not only cover the value of the asset and/or sales value of the merging company, but also the value of the assets and/or sales value of the vertically related company, i.e. the parent company up to the holding/parent companies and subsidiaries up to the lowest subsidiaries. The highest asset value and/or sales value of the parent company's highest sales are the total assets and/or sales value of all subsidiaries.

7. In the event that the company delays in submitting the mandatory notification, KPPU may stipulate a penalty of delay in accordance with the prevailing legal provisions, which is IDR 1 billion for each day of delay, with a maximum fine of IDR 25 billion.

3. The Non-Price Effect in Indonesian Merger Regime

8. Assessment of mergers and acquisitions by Indonesian competition authorities comprises 5 (five) types of analysis, namely (i) market concentration; (ii) entry barrier; (iii) potential anti-competitive behavior; (iv) efficiency; and (v) bankruptcy. Market concentration is measured through the approach commonly used by the international community, using concentration ratio and HHI.

9. In measuring market entry barriers, analysis were carried out on such matters as (i) absolute barriers of government regulation, government licensing, intellectual property rights; and (ii) structural constraints of supply and demand conditions (such as control over natural resources, technology, networks, economies of scale, switching costs, and sunk costs), and (iii) constraints of strategic advantages enjoyed by the incumbent (first mover advantage, numerous product differentiation, tying and bundling, or exclusive distribution agreements).

10. Generally, KPPU sees these barriers through the historical data of the number of companies in the relevant market from year to year, the number of potential companies entering the relevant market, the ratio of the required costs to enter the market with the expected income from the market, and the time required to reimburse such costs, and so on. The analysis is not only done by paying attention to the ease of new players entering the market, but the strength of the new player must also be sufficiently balanced in putting pressure on the competition, and the time it takes to enter the market not too long in order to put pressure on the competition.

11. Efficiency is another factor to consider. In the case of mergers aimed at improving efficiency, it is necessary to compare the efficiency resulting from the anticompetitive impact it generates. In the event that the value of anticompetitive impact exceeds the expected efficiency value achieved from the merger, a fair competition will take precedence over the efficiency of the companies. Fair competition, whether directly or indirectly, will automatically give rise to more efficient companies in the market. An efficiency argument should be proposed by a company who will conduct a merger, by

showing the efficiency calculations generated by the merger concerned, and the benefits that the consumer will enjoy as a result of that efficiency. The Commission will conduct in-depth assessment on the efficiency argument proposed by the merging companies.

12. The efficiency argument proposed by the companies may include cost savings, increased use of existing capacity, scale-up or economic scope, increased network or product quality, and other matters as a result of the merger being undertaken. Efficiency tends to impact on price reductions in the short run if a merged company makes savings on variable cost or marginal cost. Conversely, savings on fixed costs generally have no impact on price reductions in the short term, so that efficiency in this case, is not enjoyed directly by consumers. Therefore the Commission emphasizes the importance of efficiency arguments clearly distinguish between savings on variable cost, marginal cost, or fixed cost.

13. Bankruptcy may be the only non-price effect considered in merger analysis in Indonesia. In the case of a merger is to avoid the cessation of certain company to operate in the market/industry, an assessment is required. In the event that the consumer loss of the consumer is greater if the company exits the market/industry, than if the company remains and operates in the market/industry, there is no concern that the reduced level of competition in the market shall be monopolistic practices and/or unfair competition resulting from the merger.

4. Issues with Non-Price Effect

14. The non-price effect of a merger is not easy to measure, because we are talking about quantifying something that has not happened; or has the same size. For example, a merger done by a company is to improve the quality of its goods. The size for quality is quite diverse, so it cannot be measured exactly how far the produced goods will improve in quality. Nevertheless, of course quality is still something that can be measured, especially in its benefits or usage to the consumer. The impact of innovation is also the same, but the size of innovation is quite diverse. We can measure the magnitude of innovation in the birth of new products as a form of innovation, or spending on research costs.

15. Indonesia embraces the mandatory system of post-merger notification and voluntary pre-merger notification (consultation). The burden of proof of mergers and acquisitions within the regime lies with the merging companies. Included in the case of the impact of non-price merger. The merging companies must provide proof of the non-price reasons. In the case of bankruptcy size, for example, the bankruptcy argument must be filed by a company who will conduct a merger by indicating in the absence of merger, the company concerned will experience bankruptcy, and only by such merger the bankruptcy can be avoided.

16. In assessing this bankruptcy argument, KPPU will pay attention to several factors, among others: (1) the company is in an unsustainable financial condition, so that without merger it will cause the company to exit the market in the near future, (2) the company is not possible to reorganize efforts to save its survival (3) there is no other alternative that is not anti-competition other than merger in an effort to save from bankruptcy.

17. Noting that the current regime embraces the burden of proof is on merging companies, the adoption of a non-price impact measurement for mergers, will surely provide additional substantial burdens to the company. Because they have to be able to

convey evidence that their merger will have special impacts, such as improving innovation and people's quality of life. This will certainly increase the cost of implementing the merger itself. Especially since the existing KPPU merger statistics show that, most of the reported mergers are conglomerate mergers, i.e. through acquisition of shares in unrelated markets.

18. Another challenge in measuring the non-price impact is the availability of data for authorities to counter the proposals of non-price impacts submitted by merging companies. It is the duty of the authorities to ascertain or provide an assessment of the reliability of the impact analysis presented by the merging companies. In that context, the authority also needs a counter-analysis in assessing the potential impact. This becomes difficult because the data is generated from notifications conveyed by business actors, and counter data from other parties such as government and consumers. Therefore, an assessment of the non-price impact will generate additional resources, and certainly increase the value or cost of per merger case analysis.

19. Generally, a non-price impact submission is granted upon a proposed merger to obtain an exemption from the competitor authority. In such cases, companies conducting mergers will require exceptions to the competition authorities in order for their corporate actions to be exempted from competition law, as they are able to provide positive benefits to the community. This may be applicable to country adopting an approach, whereby companies can apply for exemptions to the authorities. This cannot be done in Indonesia, because the current competition regime does not recognize the opportunity for the companies to come to the competition authority, and request for an exemption to their actions. Exemptions in Indonesian business law shall be absolute and shall be limited to matters stated in law. The company does not need or cannot request an exemption from what is outlined in the law.

5. Conclusion

20. The non-price impact analysis has become an issue of concern to the international community in merger analysis, particularly in countries with advanced competition regimes and a mandatory pre-merger notification approach. But the approach cannot be fully implemented in Indonesia. The legal approach of Indonesian competition law is quite different from other countries, because it still adheres to the mandatory regime of post-merger notification and voluntary pre-merger consultation. The law does not embrace an approach whereby companies may seek an exception to the merger, even if it has a positive impact on society. Exemptions given are those listed in the law.

21. Furthermore, the use of a non-price impact approach on mergers will provide additional costs and expenses for merging companies. Because the burden of proof is on the merging companies, and they should be able to prove and convince competition authorities that the merger is doing a positive impact on the national economy or society. Data problems also pose an issue in the approach, as it will incur additional costs for the authorities to convince themselves of the merits or non-price effects of a merger.