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Vertical mergers in the technology, media and telecom sector – Note by Indonesia

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This document reproduces a written contribution from Indonesia submitted for Item 10 of the 131st OECD Competition committee meeting on 5-7 June 2019.

More documents related to this discussion can be found at

http://www.oecd.org/daf/competition/vertical-mergers-in-the-technology-media-and-telecom-sector.htm

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Theory of Harm and Market Foreclosure Issues

1. Introduction

1. Indonesia applies two approaches in her merger control, which are mandatory post merger notification and voluntary pre merger notification. Under such approach, enterprises are advised to consult their merger plan or to notify their merger when it has been effective. Failure to meet the obligation, the enterprise can be imposed with administrative penalty for each day of delay.

2. Vertical merger cases in Indonesia were not as much as horizontal merger or conglomerates. Most common features were companies acquired resources for its production, or acquired e-commerce companies to increase its choice of distribution.

2. Dealing with Vertical Merger

3. The competition authority (KPPU) assessed vertical merger by using similar guidelines as horizontal merger, but the analysis of the proposed vertical merger will be different with horizontal or conglomerate merger. The difference will take into account the possible vertical restraint of the proposed merger and the possibility of tying or bundling scheme in the relevant market. In essence, the possibility of impact from the proposed merger will be scrutinized thoroughly in order to give understanding whether the proposed merger will have competition concern.

4. In merger review, the authority considers all the possible competition concern rising from the merger transaction. It includes possible vertical merger impact on related market. As soon as it can be determined that the proposed merger has vertical effect, then it should be treated with such care to include the possible vertical restraint and any other possible competition concern over a vertical merger transaction.

5. The difference between vertical and horizontal merger by the authority would be on the analysis of possible competition concern which has different antitrust perspective. The horizontal merger focus on future concern on price movement in relevant market, while the vertical merger will also have focus on possible restraint that can be establish on either side of related relevant market, besides welfare impact on both relevant market. Additionally, it may also consider the possible future business behaviour as consequences of the proposed merger.

3. Application of the Theory of Harm

6. The theory of harm in a vertical merger is based on existing condition of the market and the consequence thereof if vertical merger should happen and the possible foreclosure inherited from the transaction.

7. Firstly in assessing vertically integrated merger we need to identify the possibility of market foreclosure in the proposed merger. Whether it will happen in the upstream or the downstream relevant market, the theory of harm will be based on these two possibilities. In verifying the upstream or the downstream market we need to elaborate the competition characteristic in respective market. It includes important indicator such as market concentration, upward pricing pressure (UPP), and merger simulation. In the end, the authority will need to summarize the impact of proposed merger which includes price effect (market power effects) and efficiency effects.

8. In detail the authority will analyze market (own and cross-price) elasticity in order to understand the characteristics of price increase in market. In some case, the demand estimation model in vertical market will be established in order to verify the possibility of foreclose and its impact on price pass through. Merger simulation will be estimated in order to reach conclusion on price, profit and efficiency. In estimating demand and merger simulation, data and information about price dynamics, quantity, product characteristics, and income level are crucial.

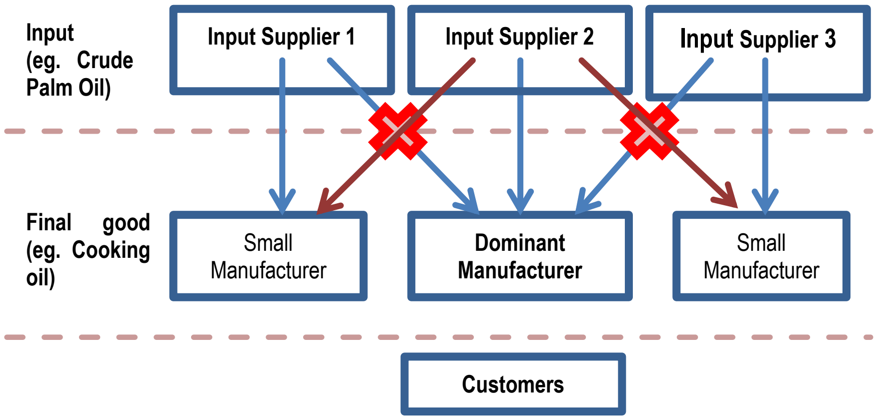
9. First hypothesis how market foreclosure works in downstream market is by an act of denying an essential input to downstream market, possible anti competition conduct occurs after the merger accomplished. By blocking selling essential input to downstream market the proposed merger is intended to give their own infrastructure to reap specialty or significant advantage that it deemed will foster their supremacy in the relevant market. In this scenario lost of sales as a consequences of foreclosed market would be compensated by the profit gain through price increase in the final product or services (profit pass through).

10. This strategy may only deemed profitable if the end result still give a positive outcome for the vertical merger. In this case, competition authority should put efforts in identifying the existence of such foreclosure in form of hard evidence by checking the changes in sales direction or sales or distribution strategy in the downstream market. After that to ensure the impact of the alleged ant competition conduct, the authority will need to estimate the price before and after the merger through some kind of demand estimation, UPP analysis or merger simulation.

11. Other hypothesis is how market foreclosure works in upstream market is by an act of denying upstream supplier a sufficient market to sell input to upstream market, possible anti competition conduct occurs after the merger accomplished. By blocking selling essential input to upstream market the proposed merger is intended to use their infrastructure to reap supernormal profit.

12. In this scenario, lost of sales as consequences of foreclosed market also would be compensated by the profit gain through price increase in the final product or services (profits pass through). This strategy may only deemed profitable if the end result still give a positive outcome for the vertical merger. Similar with foreclosure in downstream market, to ensure the impact of the alleged ant competition conduct, the authority will need to estimate the price before and after the merger through some kind of demand estimation, UPP analysis or merger simulation.

How market foreclosure works
Deny upstream supplier a sufficient market to sell inputs



Monopoly profits in upstream market

4. Assessing Vertical Merger

13. In vertically integrated merger, the authority will assess whether the proposed merger will raising concern about the ability of the merging parties to set a foreclosure strategies (power to foreclose) against downstream rivals or upstream rivals.

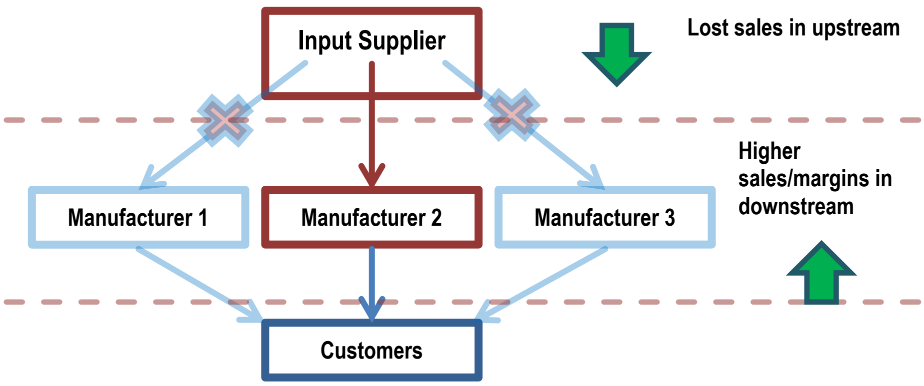
14. The assessment will be based on the existence of pre condition that need to be verified in order to make conclusion whether the merging firms have the ability to foreclose competition in the relevant market. The authority considers the merger will have the ability to foreclose if (i) there are no other sources of supply or demand; (ii) there is no possibility of new entrant; (iii) there are no other firms that can quickly substitute supply into the foreclosed market; (iv) there is significant economies of scale associated with the supply in market; and (v) there are capacity constrained issues faces by other suppliers. If all the above are met, than it will give us a hard evidence to start estimating the possible incentive design, that need to be set by the merging party in order to assess its impacts (since the aforementioned indicator will surely raising competition concern).

15. After it has been clear that there is possibility for market foreclosure, then the authority will estimate the incentive that the merging party are facing if they pursue such foreclosure strategy in order to make it profitable. Because the ability or power to foreclose competition is a necessary condition but that alone is not sufficient to make it harm to customer. A vertically integrated merger must also find it profitable to foreclose. In the end, what matters most is believe that foreclosure will only be emergence if the benefit will be greater than the lost of sales in foreclosed market.

Incentive to foreclose

Power to foreclose is a necessary condition, not sufficient. A vertically integrated firm must also find it profitable to foreclose.

- Only foreclose if benefit > lost sales on foreclosed market



16. Even if foreclosure does not result in other firms' exit, it can have a detrimental effect on competition such as (i) rivals may be forced to use a more expensive inputs; (ii) rivals may be forced to use inferior inputs; and (iii) potential entry may be discouraged.

5. Case Example and Take-out

17. The conglomerate has wide variety of business including ecommerce, content provider (production house), free to air TV, technology and paid TV. On the proposed merger scheme, the conglomerate want to acquire a content provider company specialize in TV movies (highly rated content) in Indonesia. The possible vertical merger setup is on relationship between free to air, ecommerce video content platform, or paid TV Subscription Company with the acquired company.

18. The authority was found out that the acquired company didn't has significant market power that deemed to be significantly boosting the profit if foreclose strategy to be set up in the market. It didn't pose any serious competition concern in the possible vertically integrated market as there are many other substitutes in the market.

19. What we can learn from this case was that the vertical merger requires additional information about possible vertical relationship within the parties. In the provided example, the authority need to find the possible relationship or business endeavour that may relevant for a content provider industry.

20. It was identified that there were 3 (three) possibilities: (i) possible relationship with free to air business, (ii) possible relationship with video content platform business, or (iii) possible relationship with paid TV Subscription business. These possibilities requires the authority to dig further the characteristics of each business model and based on the finding we need to elaborate possible theory of harm for each business possibilities. This eventually will require a lot of time and significant resources, because the authority will need to explore data and information for each business model and try to figure out how competition concern will arise for each of it.