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Conglomerate effects of mergers – Note by Japan

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http://www.oecd.org/daf/competition/conglomerate-effects-of-mergers.htm

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1. Introduction

1. As the public attention has been increasingly drawn to growing digital economy and its impact on competitive landscape over these years, the Japan Fair Trade Commission (hereinafter referred to as the "JFTC") has conducted several market surveys and studies such as "Data and Competition Policy"[1] in June 2017, "Trade Practices of E-commerce for Consumers"[2] in February 2019 and "Trade Practices on Digital Platforms"[3] the interim report in April and the final report in October 2019, through which the JFTC has accumulated the related information and insights about not just competitive impact of digital economy in general but also specific anticompetitive concerns, like how a conglomerate type of platforms could increase market power to exclude competitors through various strategies or how the digital conglomerates might entrench the position of each member business utilizing big data and AI within the group.

2. On the other hand, the JFTC has accepted a number of notifications of conglomerate mergers[4], e.g. 105 cases in FY 2018, some of which were digital technology and/or platform cases, and the JFTC cautiously reviewed them with accumulated insights. And, the JFTC has found that it is necessary for some cases to be carefully evaluated from the viewpoint of market foreclosure and anticompetitive concern of sharing some counterparts' business confidential information within the conglomerate businesses. See M3/Nihon Ultmarc (2019), Qualcomm/NXP (2017) and Broadcom/Brocade (2017) described from 3.1 to 3.3 below.

3. Based on these experiences, the JFTC has recognized the necessity to improve transparency and predictability of merger reviews regarding how the JFTC evaluates competitive concerns of conglomerates mergers especially in digital related cases as well as some features related to digital economy, such as multisided markets, competition in quality, network effects and value of data. In December 2019, the JFTC published the amendment of "Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination" (hereinafter referred to as the "Guidelines") after the public comment process.

4. This contribution paper is organised as follows: first, it illustrates how our newly amended guidelines explain the factors to be considered in reviewing conglomerates mergers taking account of some features related to digital economy in section 2. Then, section 3 introduces three recent cases of conglomerate mergers as mentioned above. Lastly, section 4 briefly summarises this paper.

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[1] https://www.jftc.go.jp/en/pressreleases/yearly-2017/June/170606.html

[2] Interim Report: https://www.jftc.go.jp/houdou/pressrelease/2019/jan/190129.html Final Report: https://www.jftc.go.jp/en/pressreleases/yearly-2019/October/191031.html

[3] https://www.jftc.go.jp/en/pressreleases/yearly-2019/April/190417.html

[4] The term "merger" used in this paper covers various types of transactions such as acquisition of stock, mergers, joint share transfer and acquisition of business.

2. The analytical framework of the amended Guidelines

2.1. Basic Concept

5. The Guidelines describe how the JFTC reviews conglomerate mergers as well as horizontal and vertical mergers to evaluate whether the mergers violate the Anti-Monopoly Act. The Guidelines state that conglomerate mergers are distinguished as mergers which are neither horizontal nor vertical mergers. (e.g. mergers involving companies engaging in different segments of business, mergers between suppliers of products that belong to the same product range in different geographic ranges.) The Guidelines also point out that conglomerate mergers do not entail decreasing the number of competitors in the relevant market and are generally less likely to cause competitive problems than horizontal mergers. Meanwhile, the Guidelines say that a certain type of conglomerate mergers may bring about unilateral and/or coordinated effects through some conducts such as market foreclosure or elimination of rivals from the relevant markets, and also, after the merger is consummated, the merged entity's conduct may facilitate coordination with their competitors, and thereby, may cause substantial restraint of competition in the market.

6. In addition to these basic concepts, the newly amended Guidelines add more detailed description about what kind of factors and effects to be taken into consideration to review conglomerate mergers, as explained below.

2.2. Competitive concerns to be reviewed

2.2.1. Basic analytical Framework

7. The Guidelines explain that in assessing whether the conglomerate mergers would bring about substantial restraint of competition through their unilateral and/or coordinated effects, the JFTC takes account of several factors as follows: 1) market foreclosure or exclusion by providing customers with their products in a combined manner ("combined supply" (2.2.2 (1) A. below)), or obtaining confidential information of rivals (2.2.2 (1) B. below), 2) eliminating the possibility of entry into the market by potential rivals (2.2.2 (2) below), and 3) competitive pressure or other factors (2.2.2 (3) below).

8. In addition, to review conglomerate mergers related to digitalization, it is necessary to take into consideration that digital platforms may easily enter into other different markets, rapidly develop new services covering several markets in an integrated way, and also provide services connecting business-to-customers in several ways (e.g. B2C or C2C) by analysing customers' preferences of products/services with information-technology such as Big-data, IoT and AI. In the context of conglomerate mergers, such digitalized business operations may be achieved and enhanced by acquiring companies not directly related to the core of their existing business, which may compose conglomerate. The next session also introduces some explanations which were added to the Guidelines regarding what kind of characters or effects derived from digitalization should be considered in reviewing conglomerate mergers.

2.2.2. Unilateral Effect

(1) Conglomerate market foreclosure

9. Some of conglomerate mergers may cause market foreclosure where, new business activities of the merged entity would be likely to hamper their rivals' access to markets and reduce their abilities or incentives to compete, then the new entity may raise the price of products at their own will.

Combined supply

10. Conglomerate market foreclosure may arise where, after the merger is consummated, the merged entity would be likely to supply their respective products in a technologically or contractually combined manner (e.g. by changing technological specifications of connectivity to their products so that the capability of their products can be fully attained only when they are packaged together, or by supplying different products in a bundle at a lower price than when they are sold individually prior to the merger.). Such manners of combined supply may weaken competition in the market by decreasing competitiveness of their rivals which may exit the market and by making potential entrants lose their ability or incentive to enter the market. The JFTC examines whether the merged parties would have, after the merger is consummated, the ability to foreclose market access for rivals and whether they would have the incentive to do so.

11. Additionally, in the context of digitalization, the JFTC places importance on data in analysing market foreclosure (e.g. if the merged entity will enhance the service quality with extra-value of the data accumulated by the acquired entity, it would be likely to more strongly keep customers of the acquiring company by using and analyzing data acquired by the merger.).

12. The Guidelines explain characteristics of digital service such as multi-sided market, free-services and other related factors[5] in identifying relevant market (e.g. as for multi-sided market, if a digital platform operator mediates business transactions between different user segments and causes strong indirect network effects, there are some cases where the relevant market comprising each user segment will be defined in an overlapping manner. Also, as for free-services, the JFTC will consider whether users of free-services switch from one service to another service based on their qualities or costs.).

Obtaining confidential information

13. The merging parties may, through a conglomerate merger, obtain sensitive business information of their rivals which was not available prior to the merger (e.g. in a case where, after the merger is consummated, to ensure interconnectivity due to technical factors of its products, the acquiring party obtains sensitive business information of its competitor through the acquired party, and the acquiring party takes advantage of the information to make the acquiring party's rival less competitive. Then, there may be arisen possibility of market foreclosure or elimination of rivals from the market.)

(2) Eliminating the possibility of entry into the market by potential competitors

14. Conglomerate merger may greatly affect competition in the case where the acquired party is able to enter the market of acquiring party's product and is expected to become a powerful competitor due to low entry barrier of such market (e.g. if the acquired company in the different market has input goods such as data and is expected to become competitor of the acquiring company), because there will be less possibility for the acquired party to enter the acquiring party's product market. It is also applied to the case even when the acquired party has no specific plan to enter the market.

15. In addition, in order to correspond to the increasing necessity of reviewing merger plans where acquired party is still small-sized but has certain important assets for

[5] In the Guideline, following factors are to be considered in analysing relevant market of product range and geographic range in digital service. (e.g. as for product range: contents, qualities (such as sound, image, communication speed, and the level of security), user-friendliness (such as usable languages and terminals). as for geographic range: the degree of which users can enjoy conditions, contents, qualities of services at the same level provided by a supplier or others.)

competition purposes such as data or intellectual property rights, the JFTC amended "the Policies Concerning Procedures of Review of Business Combination" to clarify the current enforcement practices in December 2019. In the amendment, it is clarified that the parties having the notification-free merger plan is recommended to consult the JFTC when the total consideration for the acquisition exceeds 40 billion yen, and the notification-free merger plan is expected to affect domestic consumers, and that the JFTC may flexibly review a merger plan with cautious consideration related to acquisitions of cash, shares, securities and other assets if the merger plan is expected to affect consumers in Japan with highly possibility.

(3) Consideration of Competitive Pressure

16. In addition to the factors mentioned above, the JFTC considers following factors, which are examined in reviewing horizontal mergers as well: a) market share of merged entity and its competitors, b) competitive situation in the market, c) competitive pressure from related markets/users or import pressure, d) characteristics of the market, and other matters.

17. Also, in the context of digitalization, the JFTC considers characteristics of the digital market, such as multi-sided market, direct/indirect network effect and switching cost, which might facilitate to raise market concentration. For example, in the case of digital platform operators with multi-sided markets, which connect different user segments, as described in the case 3.1, the case of a medical-information-platform with two different user segments: doctors and pharmaceutical companies, along with the increasing registered number of doctors in one user segment, pharmaceutical companies in the other user segment also have more opportunities to increase the revenue from targeting advertisement to doctors (indirect network effects). Doctors also have opportunity to get more various information of medicine, along with the increasing numbers of pharmaceutical companies. In this case, users of both sides are less likely to switch to their rivals which would lose their competitiveness.

2.2.3. Coordinated Effects

18. The JFTC considers whether the acquired party and its rivals are likely to engage in coordinated behaviours as a consequence of the post-merger situations, if merging parties obtain confidential information of their rival (2.2.2(1)B above), or the number of rivals decreases due to conglomerate market foreclosure (2.2.2(1)A above).

3. Recent cases of conglomerate mergers

19. The JFTC has reviewed conglomerate merger cases in accordance with the criteria in the Guidelines. Several of them have been found to have some anticompetitive concerns after the JFTC reviewed in detail. Here, three cases related to platform business and high-tech sectors are introduced in focusing on the conglomerate type of foreclosure or other anticompetitive concerns.

3.1. M3 / Nihon Ultmarc (2019)

3.1.1. Outline of the case

20. In the case of M3 and Nihon Ultmarc, where the M3 acquired all of the voting rights attached to the stocks in Nihon Ultmarc (acquired company), two features were found as bellows.

21. The first is that both of the merging parties provide certain user segments with digital information related to medical personnel or medicinal drug. M3 is a digital platform operator which provides two user segments (doctors and pharmaceutical companies) with the medicinal drug information. Nihon Ultmarc is a small sized database provider with medical personnel data. By accessing the database of Nihon Ultmarc, pharmaceutical companies and medical organizations can obtain important medical personnel information.

22. The second is that the JFTC found some anticompetitive concerns in this case, although the acquired company's domestic sales amount did not meet the notification threshold legislated in the Antimonopoly Act.

23. The JFTC finally approved the transaction on condition that the proposed remedies would be implemented.

3.1.2. Relevant Markets

24. M3 operates internet-based platform and provides doctors with medicinal drug information with free of charge (e.g. proper dosage or administration, prescription, advertisement and other relevant topics of the drugs). M3 also provides marketing support service to pharmaceutical companies intending to transmit their drug information to the registered doctors.

25. M3 is the leading company with around 75% share in the market of medicinal drug information platform, while the Nihon Ultmarc is deploying its business in the market of medical personnel-information database service (hereinafter referred to as the "MDB service") with no competitors. The JFTC reviewed whether rivals of M3 could be foreclosed from the market of medicinal drug information platform service.

3.1.3. Assessment of conglomerate aspects

26. In assessing unilateral effect in the context of conglomerate, the JFTC focused on the competitive impact of market foreclosure by combined supply described in 2.2.2(1) A.

27. Prior to the merger, pharmaceutical companies were common customers for both Nihon Ultmarc's MDB service and M3's medicinal drug information platform service. The MDB service, which is the unique medical personnel database service covering all medical institutions and doctors in Japan, is essential for pharmaceutical companies to make their marketing plans effectively customized for each doctor and medical institution. Therefore, if the merged entity integrates the MDB service with M3's medicinal drug information platform service and provide them with discount price (e.g. discount prices would be applied only to users who are not registered in M3's rival's platform.), pharmaceutical companies would be likely to adopt the service by the merged entity. Thus, the JFTC recognized that the merged entity had the ability and incentive to implement market foreclosure for its profitability.

28. Based on the assessment of conglomerate aspect, the JFTC concluded that this acquisition would not substantially restrain competition if the merged entity would keep itself from the following; 1) requiring customers to use its various services or not to use rivals' services as a condition to provide them with its MDB and other databases, and 2) setting preferential treatment on customers for the terms and conditions of MDB and other databases provision including price discounts in exchange for using the merged entity's various services, both for an infinite period of time following the date of the acquisition of this case.

3.2. Qualcomm/NXP (2017)

3.2.1. Outline of the case

29. Qualcomm River Holdings B.V., (hereinafter referred to as "Qualcomm") planned to acquire more than 50% voting rights attached to NXP semiconductors N.V. (hereinafter referred to as "NXP”), both of which manufacture and supply semiconductors to device makers. The JFTC approved the transaction on condition that the proposed remedies would be implemented.

30. Although, in this case, both of the merging parties are developing their businesses globally and the JFTC reviewed this case in cooperation with other competition authorities, the JFTC focused on the unique features of Japanese handset makers.

3.2.2. Relevant Markets

31. Qualcomm manufactures and supplies baseband chips in smartphones or tablets to handset makers globally. Baseband chips convert the data to a signal that modulates the carrier frequency for transmission between handsets and base stations. NXP manufactures and supplies FeliCa-based NFC/SE (Near Field Communication/Secure Element) chips to handset makers globally as well, which chips are necessary for electric payments by smartphones, credit cards or security cards. While the market share of NXP in FeliCa-based NFC/SE chips is unclear, Qualcomm has approximately 50% of the market share of baseband chips. The JFTC reviewed whether rivals of NXP could be foreclosed from the market of FeliCa-based NFC/SE chips.

3.2.3. Assessment of conglomerate aspects

32. As for combined supply in the context of conglomerate mergers, the JFTC reviewed whether rivals of NXP would be foreclosed from the market of FeliCa-based NFC/SE chips.

33. Prior to the merger, handset makers were common customers of Qualcomm’s baseband chips and NXP’s FeliCa-based NFC/SE chips. It is very important for handset makers to adopt Qualcomm’s baseband chips for the following reasons: Qualcomm is the only supplier of high quality baseband chips with application processors compatible with the CDMA (Code Division Multiple Access) network. Especially, in Japan, technical maintenance supported by Qualcomm is important for Japanese handset makers. Also, switching cost from Qualcomm to other baseband chip suppliers would be enormously huge especially for Japanese handset makers (e.g. at least one year is necessary for the following processes: design, test products, trial connectivity by communication carrier). Based on those facts, if the merged entity manufactures and supplies Qualcomm’s baseband chips technically tied with NXP’s FeliCa-based NFC/SE chips, which is possible, handset makers would have no choice other than adopting NXP’s FeliCa-based NFC/SE chips.

34. Thus, the merged entity would have the ability and incentive to foreclose in the market of FeliCa-based NFC/SE chips for its profitability, and the JFTC concluded that this acquisition would not substantially restrain competition, provided that the following remedies would be implemented;

1. For 8 years after the acquisition, Qualcomm would promise to maintain the connectivity between each product by the merged entity and third parties, with the same level of connectivity between Qualcomm’s baseband chips and NXP’s NFC/SE chips.

2. Qualcomm would take any necessary measures to realize the connectivity above, i.e. Qualcomm provides information if requested in writing by third parties.

3.3. Broadcom/Brocade (2017)

3.3.1. Outline of the case

35. This case was a merger of Broadcom Ltd. (hereinafter referred to as "Broadcom") headquartered in the United States, and Brocade communications systems, Inc. (hereinafter referred to as "Brocade") headquartered in Netherland. The JFTC approved the transaction on condition that the proposed remedies would be implemented. In this case, the JFTC focused on not just combined supply but also obtaining confidential information.

3.3.2. Relevant Markets

36. Brocade manufactures and supplies intermediary devices which connect several servers and storages to communication network systems, and it holds around 75% share in the intermediary device market globally. Meanwhile, Broadcom manufactures and supplies adapters installed in servers, and has around 35% share in the adapter market. The JFTC reviewed whether the rivals of Broadcom would be foreclosed for the market of adapters installed in servers.

3.3.3. Assessment of conglomerate aspects

37. Both of the intermediary devices and the adapters are supplied to the same user segments (i.e. server manufacturers), which constitutes conglomerate aspect in this case. The JFTC recognized the possibility of foreclosure or exclusivity in the adapter market. Server manufacturers have to conduct connectivity test to ensure the interoperability between adapters and intermediary devices. Brocade occupies a high share in the intermediary device market as explained above. So, if the merged entity would change the specification of intermediary devices with usability or full compatibility in combination with Broadcom's adapters, which is possible, competitor's adapters would not be adopted by customers which would avoid switching cost of intermediary devices. Therefore, the merged entity is considered to have ability and incentive to foreclose the adapter market for its profitability.

38. In addition, in the course of connectivity tests between adapters and intermediary devices, Brocade might obtain confidential information such as research and development by rivals of Broadcom, which would give the merged entity an opportunity to take advantage of such information in the adapter market.

39. The JFTC concluded that this merger would not substantially restrain competition, provided that mainly following remedies would be implemented;

1. The merged entity would ensure the interoperability of its intermediary devices with its competitors' adapters at the same level adopted in its own adapters;
2. The merged entity would strictly treat its competitors' information on the adapters with confidentiality and would not take advantage of the information for its own business.

4. Conclusion

40. It is extremely important for competition authorities to keep an eye on developments in the markets, in order to precisely review merger cases considering various

changing competitive landscapes including rapid developments of digital economy. The JFTC will advocate the revision of the Guidelines and continue to improve transparency and predictability of merger reviews, closely monitoring market environments.