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Conglomerate effects of mergers – Note by South Africa

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

Please contact Mr James MANCINI if you have questions about this document.
[Email: James.MANCINI@oecd.org]

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South Africa

1. Background

1. This note sets out the Competition Commission of South Africa's ("the Commission") response to the call by the Organisation of Economic Cooperation and Development ("OECD") for written submissions to inform the roundtable discussion on the Conglomerate Effects of Mergers to be held on 9 June 2020.

2. The background note for the Roundtable session recognises that though concerns around conglomerate mergers are not new, they have become more prominent in digital markets where they form part of large firms' strategies to develop new products, acquire new skills, or engage in the strategic acquisition of potential competitors. However, this roundtable discussion will not focus solely on digital markets. Instead, the Roundtable intends to review more broadly how agencies assess conglomerate mergers by consider the following: (i) trends in conglomerate mergers, (ii) how conglomerate mergers should be assessed including whether new theories of harm are required specifically for digital markets, (iii) how to overcome practical challenges to assessing conglomerate mergers and (iv) efficiencies associated with conglomerate mergers.

3. The note starts with a brief overview of conglomerates in the South African economy, drawing a link between concentration and conglomeration. Thereafter, it reviews the trends in conglomerate mergers in South Africa over the last four years. The third section sets out the theoretical framework for assessing conglomerate mergers, identifying the most prominent theories of harm with case examples. The note concludes with an overview of the practical challenges in assessing conglomerate mergers.

2. Brief overview of conglomerates in the South African economy

4. Conglomerates have had a long and enduring role in the South African economy.[1] Some of the older conglomerates such as Anglo American and Anglovaal Industries Limited (AVI) have their origins in the mining sector. Anglo American historically held interests in a broad range of industrials, including in beverages (South African Breweries), financial services (First National Bank), paper and pulp (Mondi), and sugar (Tongaat-Hulett). AVI expanded from mining into finance and industry and is still one of the largest fast-moving consumer goods firms in South Africa with interests spanning food, apparel, and personal care products. Its original holding company, the Anglovaal Group, was instrumental in acquiring the South African license for the Fischer-Tropsch process that would lead to the establishment of then state-owned coal-to-oil plant Sasol.

5. Several other conglomerates established in the early 20th Century, such as, Rembrandt/Remgro, Sanlam, Old Mutual, and Naspers, are still amongst the largest companies on the South African stock exchange. Remgro has interests spanning fast-moving consumer goods, banking, healthcare, finance, media, and telecommunications

[1] For a historical review of concentration and conglomerates in the South African economy, refer to Roberts, S. (2004), *"The role for competition policy in economic development: The South African experience."* Development Southern Africa 21: 227 – 243 and Roberts, S. (2004), *"Competition Policy, competitive rivalry, and a developmental state in South Africa",* in: Edigheji, O. (ed.) Constructing a democratic developmental state in South Africa Potentials and challenges. World Rights

infrastructure. Naspers, founded as a publisher and printer of newspapers and magazines, has acquired significant interests in e-commerce, entertainment and consumer internet companies. Newer conglomerates include the Bidvest Group, with interests covering food services, hygiene and cleaning services, vehicle retail and rental, construction, and financial services.

6. The lasting prominence and large market capitalisation of these conglomerates in the South African economy points to high levels of concentration not only within sectors, but also across sectors. The high levels of concentration, much of which is due to historical privileges afforded by the Apartheid government to white businesses and some of which are due to scale factors, have endured.[2] Over the past three years, several of these firms have been involved in conglomerate mergers, some of which raise portfolio effects, but others raise no notable competition concerns. These mergers do, however, point to the extent of concentration in ownership across the South African economy which increases the scale and power of a few large firms and may limit the dynamism of the South African economy overall.

3. Trends in conglomerate mergers in South Africa

7. In the four years from 2016 to 2019, the Commission considered 103 conglomerate mergers out of a total 1 445 mergers notified, thus amounting to 7.1% of mergers notified in the period. On an annual basis, the number of conglomerate mergers as a proportion of total mergers notified dropped from 9% of total in 2016, to 7% of total in 2017 to 6% of total in 2018 and 2019.

8. A review of the complexity (phasing) of the mergers, which is a reliable approximation of whether the merger raises horizontal, unilateral or vertical concerns, shows that 54 of the 103 conglomerate mergers (52%) were Phase 1 (non-complex) transactions, 34% were Phase 2 transactions and 14% were Phase 3 (very complex) transactions.

9. Phase 1 transactions are usually 'no overlap' transactions and many of the Phase 1 conglomerate mergers assessed by the Commission are acquisitions by private equity firms, asset managements or similar investment vehicles established for the purpose of the transaction. Though some of the transactions involve firms in related markets, for example a packaging manufacturing acquiring a manufacturer of lids/closures, a company focusing on locks and security solutions acquiring a firm focusing on electronic security solutions, and an engineering and project management firm acquiring a firm that provides water treatment services; neither the acquirer nor the target in these transactions had significant market shares in their respective antitrust markets. As a result, the Commission found that no anticompetitive bundling/tying of products or services would occur.

10. A sectoral analysis of the Phase 1 transactions shows that most (19%) of the Phase 1 conglomerate mergers were in the property sector, followed by manufacturing which accounted for 15%, the services sector at 11% and ICT at 9% of non-complex conglomerate mergers.

11. Turning to Phase 2 transactions, which are more complex in terms of the competition and public interest issues involved, we find that most conglomerate mergers (23%) are in the ICT sector, followed by manufacturing that accounts for 22%, and

[2] For a recent review of concentration in the South African economy, refer to Buthelezi, T; Mtani, T and Mncube, L. (2018). *"The extent of market concentration in South Africa's product markets"*. Working Paper CC2018/05.

construction as well as wholesale & retail trade at 9%. This seems to follow the general trend identified in the OECD's Background note that conglomerate mergers in the ICT sector do raise more complex questions related to the identification of potential competition, the changing nature of markets (and market definition) and the associated difficulties in establishing the counterfactual absent the merger.

12. At a sub-sector level, most of the Phase 2 conglomerate transactions (63%) were in the broadcasting sector, and 25% related to telecommunications mergers, one of which involved the acquisition of a small company producing 'internet of things' hardware and software including smart sensors and IoT gateways by South Africa's largest telecommunications firm. In this merger, the Commission was concerned that the telecommunications company may bundle its voice, data and IoT offerings post-merger to the exclusion of non-vertically integrated rivals. To prevent this, the Commission imposed conditions that ensure that the Target Firm's products should be made available to rivals on non-discriminatory terms and that customers of the IoT firm should not be compelled to procure connectivity services from the telecommunications firms.[3]

13. Finally, very complex (Phase 3) mergers accounted for 14% of all conglomerate mergers filed during the period. Most of the Phase 3 cases were in the manufacturing sector (36%), followed by ICT at 21%. Two of these cases were prohibited, one in the ICT sector and the other in the financial services sector.

14. The Phase 3 manufacturing cases mostly relate to the acquisition, by dominant firms, of firms that produce related products that are not in the same antitrust market but may be bought by the same or similar buyers. The Commission did not find any anticompetitive bundling concerns in any of the cases in the manufacturing sector, mainly because competitors could match the bundled product or customers had sufficient countervailing power.

15. In the ICT sector, the Commission recommended that one case, the MIH/WeBuyCars merger discussed below, be prohibited.

16. In the finance sector, the Commission prohibited a merger between the Johannesburg Stock Exchange (JSE) and Link Market Services (LMS). LMS provides various administrative and support services to firms including secretarial and registry services to firms listed on the stock exchange as well as custodial, settlement and nominee services to shareholders. The Commission found that some of the services offered by LMS are required by the JSE for firms to maintain their listing on the exchange. The Commission was thus concerned that the transaction would lead to the JSE being in a position to provide a range of products and services that none of the parties in the capital market will be able to mimic or reproduce, particularly since the JSE is the largest stock exchange in South Africa by far. In fact, as a result of this transaction, the JSE will be the only player able to provide end to end listing and associated services.

17. Given the above, the Commission concluded that it is likely that the JSE will have a portfolio of products and services that no other party will have in the market, post-merger. As such, it is likely that the JSE will tie and bundle different products and services across the capital market value chain to the detriment of competitors. As a result, the Commission prohibited the proposed merger. The matter is currently being reconsidered by the Tribunal.

18. In summary, the trend analysis shows that conglomerate mergers have remained in the range of 6 – 10% in the past four years, and that most of the conglomerate mergers

[3] See a summary of the Commission's decision in the Press Release available at http://www.compcom.co.za/wp-content/uploads/2019/09/Weekly-Media-Statement-08-Final.pdf.

(19% overall) were in the manufacturing sector, in line with the historical trend set out in the introduction. The next largest sector is ICT, followed by the property sector. In terms of complexity, the Commission has found that cases in ICT are most likely to be classified as complex and very complex transactions, with 69% of ICT conglomerate mergers classified as complex over the period. By comparison, 60% of the conglomerate mergers in the manufacturing sector were considered complex and only half in finance; most likely because there was dominance in at least one market.

4. Theoretical framework for assessing conglomerate mergers

19. Conglomerate effects result from the expansion of a company's product range typically across complementary markets, but also across independent or "weak" substitute markets. The combining of different product lines that have common customers within a single firm is thought to change the incentives of the merged entity to engage in exclusionary behaviour post-merger, for example by tying, bundling, full line forcing, exclusive dealings, cross-subsidization, predatory pricing, and control of information.

20. The theory of harm underlying these practices is the so-called "leverage theory", where a multi-product firm with market power in one market can gain market power in another market by leveraging off of their market power in the first market.[4] This is particularly apparent in proposed mergers that serve to unite complementary products in which at least one of the merging parties have market power.[5] Leveraging strategies may result in the restriction of buyer choice and the raising of rivals' costs to the extent that competitors may exit the market or pose an ineffective constraint on the dominant firm, such that capacity is reduced and prices increase.

21. Typically, the approach to assessing the likelihood of conglomerate effects arising is by determining whether the merged entity has the ability and incentive to engage in anticompetitive leveraging strategies, and whether the effect of such strategies results in a substantial lessening or prevention of competition. To be able to engage in anticompetitive leveraging strategies, the merged entity should have market power in the leveraging market and there should be a common pool of customers across the two markets. The merged entity is more likely to be able to engage in leveraging strategies if barriers to entry and customer transaction costs are high. The merged entity will have an incentive to engage in leveraging strategies if it is profitable to do so. The leveraging strategies will have the effect of substantial lessening or prevention of competition in the leveraged market(s) if a large fraction of market output is affected by the leveraging strategy. The effect of such strategies is likely to be mitigated by countervailing buyer power or a high likelihood of entry in either the leveraging or the leveraged markets. The effects are further mitigated by any possible efficiencies from engaging in such practices.[6]

[4] See Case No.2015Dec0660 and CT Case No.LM197Dec15.

[5] "Portfolio Effects in Conglomerate Mergers", OECD, January 2002.

[6] Possible efficiencies may arise from opportunities to spread joint and common costs across a broader range of customers; through, for instance, risk balancing across differing risk cycles, investment in product coordination to address the "hold up problem", and through the adoption of more efficient production processes

5. Conglomerate effects in digital markets

22. Conglomerate theories of harm in digital markets differ from traditional conglomerate theories in that the likelihood of foreclosure strategies is enhanced due to network effects and the leveraging of big data across multiple markets. Network effects refer to the tendency of consumers in digital markets to consumer a product ecosystem across markets due to enhanced complementarities across these markets. The combination of different datasets or different data processing capabilities can raise barriers to entries across multiple product markets.

23. In digital markets, where big data is a consideration, the products and services need not be close complements for this effect to be likely, because the markets may be intimately related due to complementarities in the types of data collected or the data processing and analysis capabilities used in the ordinary course of business in these markets.

24. Strong network effects allow the merged entity to engage in self-preferencing strategies post-merger, particularly when the merger involves a digital platform although it may also include preferential access to important data. These also take the form of feedback effects that allow the merged entity to protect the core product from future competitive threats, raising barriers to entry in the core market. The combination of different datasets or data processing capabilities can provide the merged entity with an advantage over competitors to improve on products in a way that cannot be matched. These datasets need not be in the same market for it to benefit the acquiring firm, as access to multiple data sources can improve the overall quality of the database and contribute to greater economies of scope.[7]

6. Case study: WeBuyCars

25. On 19 September 2018, the Competition Commission (Commission) was notified of a large merger whereby the Naspers Group intends to purchase a controlling stake in WeBuyCars (Pty) Ltd (WeBuyCars). Naspers is a global internet group and controls in excess of 70 firms in South Africa, including OLX and Autotrader. OLX is an online generalist classified advertising platform and Autotrader is a specialised automotive online advertising portal. WeBuyCars is a car-buying service, with a core focus on buying used vehicles from individuals at scale and then off-loading these vehicles to dealers and consumers.

26. The theories of harm considered by the Commission in light of conglomerate effects include self-preferencing, the combination of different datasets, economies of scale and scope in advertising, generating capital and technology solutions, and feedback effects. While the Commission considered the ability and incentive of the merging parties to engage in each strategy, the effects were considered in aggregate.

27. The Commission argued that three forms of self-preferencing were likely to occur post-merger.

1. First, Autotrader would preference WeBuyCars on the Autotrader platform in terms of listing positioning for the sale of used vehicles and in gaining access to consumers for the vehicles that they may have to sell.

[7] Törgren, O. (2017). "Mergers in big data-driven markets - Is the dimension of privacy and protection of personal data something to consider in the merger review?". Stockholm University, Faculty of Law. Available at: https://su.diva-portal.org/smash/get/diva2:1186978/FULLTEXT01.pdf [Last accessed on 26 February 2020]

2. Second, WeBuyCars would gain preferential access to information on private car sellers on the OLX platform.
3. Third, WeBuyCars would gain preferential (and exclusive) access to market-related data collected by Autotrader on dealers through the Autotrader platform.

28. *Regarding Ability*: The Commission found that Autotrader is an important route to market for dealers in the sale of second-hand cars to consumers. Similarly, strategic documents reviewed by the Commission indicated that OLX is the leading platform in terms of listings by private car sellers.

29. *Regarding Incentive*: Documentary evidence demonstrated the intent to utilise such a strategy. Pre-merger, paid-for preferencing on Autotrader is highly effective at generating used car sales leads. The combined expected benefits of the conglomerate strategies were estimated in strategic documents to be significant. Further, self-preferencing and the aggregation of the datasets have proven to be highly effective in other jurisdictions where Naspers has employed it at generating leads for a car-buying service. It was highlighted as one of the key motivations for the merger.

30. In addition, the Commission argued that the combination of WeBuyCars data on actual car purchases and sales, Autotrader's market data on vehicles listed by dealers and consumer behaviour in purchasing second-hand vehicles, and OLX's data on second-hand vehicles listed by private sellers would allow WeBuyCars to develop a sophisticated pricing function utilising information on real time supply and demand of second-hand vehicles. In terms of ability, the Commission evaluated the data holdings of these different entities and the capabilities of the Naspers Group at harnessing the power of big data. OLX is particularly effective at collecting and processing data on private car sellers. Autotrader is particularly effective at collecting, processing and analysing data obtained from dealership listings on its platform. In the ordinary course of business, WBC collects data on thousands of actual vehicle purchases, inspections and sales per month. The Naspers Group has extensive experience at harnessing the power of big data. The privacy policies of all Naspers companies allow for group-wide sharing of private information. GetWorth, a competitor of WeBuyCars that makes extensive use of big data analytics, demonstrated to the Tribunal how the data from these various avenues could be harnessed to improve its own pricing function and the effect it would have on its own business. Furthermore, based on extensive examination of the strategic documents of Naspers, the Commission determined that there is little doubt that Naspers has every intent of leveraging whatever synergies they can between the businesses post-merger.

31. The Commission considered feedback effects due to the well-documented intention for the transaction to improve the overall quality of service to users of the classifieds portals operated by the Naspers group. This would occur through data sharing, boosting the listings on each of the platforms and providing add-on services such as an inspection service. As the first and now dominant car-buying service in South Africa, WeBuyCars has an extensive history of data on actual used car transactions. It also purchases the largest number of used cars in the country and provides a market-tested inspection service that is a core function of its business.

32. The Commission considered the combined effect of all the conglomerate strategies identified on competition. Strategic documents contained market share calculations under two scenarios, with conglomerate strategies and without. These estimates demonstrated that the combined effect of these strategies would have a substantial impact on market shares, thereby entrenching the dominance of WeBuyCars in the market for car-buying services.

33. The Commission recommended the prohibition of this transaction. This recommendation was upheld by the Competition Tribunal.

7. Practical challenges in conglomerate merger analysis

34. Many of the practical challenges the Commission has faced in conglomerate mergers are related to the concerns of merger assessment in digital/dynamic market more broadly. The assessments typically focus on the peculiarities of the particular market under review. looking into the history of entry and exit, levels of barriers and prospects of entry (zoning in on the likelihood, timeliness and sufficiency of entry), the applicable product and process involved in bringing the product to market, creation of new markets, and whether the merger is generating any creeping effects given any prior transaction in the applicable markets. In effect, the assessment varies from market to market and from one merger to another.

35. In virtually all mergers assessed especially those that may raise competition concerns, the CCSA typically applies universally recommended ICN Merger Investigative Tools and Techniques, including for conglomerate mergers. Such tools typically include defining the applicable relevant markets, generating candidate theories of harm, applying screening tools such as market shares (using various metrics such as revenues, volumes, capacities, number of wins in bidding markets etc.),evaluating the effects of merger, any efficiencies or pro-competitive arguments and specifically public interest considerations.

36. In applying these investigative tools, there are some challenges that may arise especially if the markets concerned are in fast-evolving sectors, such that some of the metrics above may change within short periods of time. This can occur in sectors such as some services markets, high-technology sectors and most modern digital markets. Such sectors experience high barriers to entry and exit, continuous process of product innovation typified by huge capital budgets on research and development ("R&D"), which processes of innovation continuously disrupt existing business models and creates entirely new markets. However, the Commission has found that these tools are still a useful starting point and that the candidate theories of harm (including removal of potential competition, tying and bundling) are still useful in the context of conglomerate mergers in dynamic markets.