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Conglomerate effects of mergers – Note by Brazil

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1. Introduction

1. The purpose of this paper is to evaluate the application of conglomerate effects in CADE's merger analyses as of the enactment of Law 12529/2011¹. In general, conglomerate effects are not considered a concern in traditional antitrust analyses and, in many cases, these effects are examined in summary proceedings². However, there is a growing concern among antitrust authorities (CADE included) about the resurgence of large conglomerates leveraged by digital technology.

2. Conglomerate effects, by definition, do not change the structure of the market, since they do not necessarily entail horizontal or vertical integrations. Therefore, conglomerate effects may be considered indirect, since their effects do not impact the same relevant markets (horizontal integration) or vertically-related markets (in which economic agents have an actual or potential supplier-client relationship, that is, they offer products or services in different stages of the same production chain). This means that the products and/or services the parties supply in the market are, in general, either complementary or not directly related³.

3. In this sense, it is possible to classify conglomerate mergers in three: i) those intended to diversify product lines, i.e. the involved parties manufacture complementary products, since they have similar manufacture, advertisement, and/or distribution processes (product extension mergers); ii) those intended to create geographic diversification, i.e. the parties manufacture the same product but carry out their operations in different geographic markets via multiunits (market extension mergers); and iii) the remaining cases, among which are those intended to allow entrance to a new market, not yet explored by the acquiring party (pure conglomerate mergers)⁴.

4. It is possible to assert that product extension mergers are strictly related to increasing portfolio power. That is the kind of conglomerate effects CADE analyses the most.

5. It is worth noting that the term portfolio effect is not a perfect synonym for conglomerate effect, but it is one of the types of effects arising from conglomerate power.

¹ Law 12529/2011, which established a new structure for the Brazilian Competition Defence System, among other provisions, changes the analysis of mergers and acquisitions, which are no longer analyzed afterwards, but before they are carried out. Thus, CADE has taken on a preventive role in controlling the concentration of market power.

² Some examples of recent summary mergers in which portfolio power was analyzed: 08700.002780/2019-65 (Petitioners: QIAGEN GMBH and General Electric Company); and 08700.002403/2019-26 (Petitioners: Cameron International Corporation [Schlumberger Group] and Subsea 7 Holdings [US] Inc. [Subsea 7 Group]).

³ There is no standard definition for conglomerate effects, but Neven (2005) states they are related to products that may be complements, weak substitutes or independent in demand. Weak substitutes are products from neighbouring markets, which result in the so-called portfolio effects. In this sense, conglomerate effects can be considered indirect effects, since they do not take place in the same relevant market; however, they only happen when there are consumers in common. See: NEVEN, D. (2005) The analysis of conglomerate effects in EU merger control.

⁴ Source: MARKOVITS, R. S., Economics and the Interpretation and Application of U.S. and E.U. Antitrust Law, Springer-Verlag Berlin Heidelberg, 2014 and GARCIA, C. P; AZEVEDO, P. F. Should competition authorities care about conglomerate mergers? World Economics Association, 2017.

Portfolio power is related to the supply of a wide range of complementary products in a way that offering these products can have two effects: i) customer transaction costs may decrease when customers start to deal with a single company that has several types of products and brands, instead of many small suppliers, since the relationship with many suppliers affects transaction costs due to negotiations of prices and conditions for each product, execution of contracts, relationship with different sales teams, among others; ii) it becomes gradually more difficult for competitors to rival a company with such power, since their access to points of sale is hindered due to tying and bundling, for instance.

6. From the definition of conglomerate effects provided in this introduction, two relevant cases analysed by CADE will be discussed in the next section, while the third section, will address the theories of harm presented in two cases. Finally, the fourth section is dedicated to the conclusion.

2. Conglomerate effects in the experience of CADE

7. CADE has alluded to the possibility of conglomerate effects, especially portfolio effects, on many occasions. This section discusses two cases of conglomerate mergers, one related to product extension and the other to market extension. CADE General Superintendence deemed both these cases complex (Kroton/Anhanguera and Bayer/Monsanto).

2.1. Bayer/Monsanto Case

8. One of the main cases regarding conglomerate effects was the acquisition of Monsanto by Bayer⁵. Both companies carry out operations linked to the production and sale of seeds, biotechnology, and pesticides, especially related to soybeans and cotton crops.

9. Specifically regarding conglomerate effects, an increase in the portfolio power of the petitioners related to the production of biotechnologies, pesticides, and seeds was observed, which could prompt market foreclosure due to i) stronger presence of the petitioners in distribution channels and ii) increased capacity to operate as a result of integrated solutions.

10. Moreover, CADE observed that tying and bundling were very likely, since the companies would be able to create products with strict compatibility and then there would be no competitor in the market with a portfolio comparable to that of the newly created company.

11. According to the vote of the Rapporteur Commissioner, it is difficult for antitrust authorities from several countries to analyse possible conglomerate effects to market structure. The commissioner recalled that in the United States, for instance, the analysis of conglomerate mergers was fully abandoned due to the difficulties of establishing whether the portfolio combination would in fact encourage market foreclosure. In Europe, in turn, parameters have been established to promote objectivity in the analysis of conglomerate effects as a result of judicial decisions that annulled antitrust decisions regarding the control of market structures that were based on the analysis of such effects.

⁵ Merger 08700 001097/2017-49 (Petitioners: Bayer Aktiengesellschaft and Monsanto Company). Rapporteur Commissioner: Paulo Burnier da Silveira. Decision: the transaction was allowed to be carried out with restrictions (structural and behavioural remedies) on 16 Feb 2018.

12. The vote of the Rapporteur Commissioner points out that the main theoretical issue in analysing conglomerate effects is whether these effects would be enough for mergers to be blocked — i.e., whether it is possible to block a deal only because of conglomerate effects. In this case, the companies were allowed to consummate the transaction with restrictions after the signing of a Merger Control Agreement, which imposed obligations related to portfolio power, such as forbidding the company of demanding exclusivity in its sales channels; forbidding tie-in sales (seeds and pesticides) and bundling (packages); and requiring comprehensive and non-discriminatory trading of the products.

2.2. Kroton/Anhanguera Case

13. The Kroton/Anhanguera⁶ case was an agreement in which the petitioners intended to merge both companies by transferring the control of Anhanguera's shares to Kroton.

14. Even though the vote of the Rapporteur Commissioner did not directly address conglomerate effects, this particular merger concerned the acquisition of educational institutions by a multiunit company with units in several relevant geographic markets; it is therefore considered a market extension merger.⁷

15. At the time of the analysis, the petitioners owned together more than 800 higher education units and 810 associated schools distributed throughout all states of Brazil, with approximately one million students of higher and vocational education, and other educational-related activities in the country. Moreover, CADE observed that Kroton and Anhanguera were the first and second largest companies, respectively, in the distance education market.

16. Besides conglomerate effects, there were horizontal overlaps in the sectors of on-site and distance undergraduate and graduate education. CADE carried out a geographic analysis of on-site undergraduate and graduate education markets at the local level; distance-learning graduate courses at the national level; and, lastly, distance-learning undergraduate courses at both the local and national levels. A large number of overlapping markets were identified. Altogether, the markets for undergraduate and graduate education for both learning modalities totalled 393.

17. The criteria used to analyse market rivalry were, among others, the presence of competitors with significant market shares, repositioning, and sufficient idle capacity to absorb the possible loss of demand and similar quality indexes.

18. According to the vote of the Rapporteur, the on-site and distance undergraduate markets needed intervention. Regarding graduate courses of both modalities, barriers to entry and rivalry levels were enough to prevent the petitioners from having market power, especially considering the very flexible regulation imposed to these courses.

⁶ Merger 08700005447/2013-12 (Petitioners: Kroton Educacional and Anhanguera Educacional Participações). Rapporteur Commissioner: Ana Frazão. The transaction was allowed to be carried out with restrictions (structural and behavioural remedies) on 14 May 2014.

⁷ It is worth quoting the paper “Should competition authorities care about conglomerate mergers?” by Carolina Policarpo Garcia and Paulo Furquim de Azevedo, which examine conglomerates in the higher education industry in Brazil. The main goal of this paper is to measure conglomerate effects of market extensions in acquisitions of education institutions by multiunit groups. To this end, it studied the series of acquisitions carried out by educational groups, including this particular merger, and the effects of such conglomerates on price, quantity, and quality of the courses.

19. Finally, the merger was allowed to be carried out with restrictions, and structural and behavioural remedies were applied.

20. Nevertheless, it is important to mention this case due to a growing concern amongst representatives of antitrust authorities regarding the degree of concentration and verticalisation in the Brazilian education sector.

3. Theories of Harm

21. Analysing the jurisprudence of CADE regarding potential damages resulting from transactions with conglomerate effects, it is possible to observe that the theory of harm most commonly used by the agency is the theory of reciprocal dealings. Reciprocal dealings occur when a company uses its power in a given market to induce or leverage its performance in other markets, in particular concerning complementary or related goods or services.

22. According to the theory of reciprocal dealings, some practises can be motivated by the existence of conglomerates, in particular increases in portfolio power. The main practises are tying and bundling. Tying is when acquiring a service or product necessarily includes the purchase of another service or product. Bundling is when products are offered together and are part of a cohesive unit as is the case, for instance, when someone purchases a computer that includes a monitor, preinstalled software, keyboard, among other items.

23. The practices of tying and bundling are not anticompetitive on their own, as pointed out by some Commissioners⁸, and may imply the offer of services, products or integrated solutions in a way that is more beneficial to consumers, considering the possibility of transferring to consumers the economies of scope that arise from the optimisation of costs related to marketing, to the manufacturing of goods and/or services, or to suppliers, for example.

24. However, in case economies of scope do not result from the merger, practises such as tying or bundling may be considered exclusionary or market foreclosure practises. The reason for this is that reducing prices through the tie-in sale of goods and/or services, when not sustainable for a long time, may lead to the newly formed company imposing higher prices in the long term, thus recovering short-term losses.

25. Furthermore, market foreclosure does not happen only in the market in which the merged company has a dominant position, but may also extend to neighbouring markets, mostly when network effects are present.

26. These types of exclusionary practises are only possible if the company can exercise market power and if there are high barriers to market entry. Therefore, the main problem concerning conglomerate effects, besides the exclusion of current competitors (due to predatory prices or tie-in sales), is the exclusion of potential competition resulting from closing the market to new players.

27. In addition to unilateral practises being more likely because of conglomerate effects, the exclusion of competitors and market foreclosure may also increase the probability of tacit collusion, that is, of coordinated effects, considering the decreasing number of agents active in the market.

28. There are several cases in the jurisprudence of CADE in which, after analysing portfolio power in mergers, the agency has argued there was the possibility of market

⁸ See vote of the Reporting Commissioner in the Bayer/Monsanto case.

foreclosure resulting from tying and bundling. It is worth mentioning the following cases: Danaher/General Electric, Saint Gobain/Rockfibras, Bayer/Monsanto, Weg/TGM, and Tigre/Condor⁹.

29. Besides the arguments based on the theory of reciprocal dealings, other aspects related to conglomerate effects have been addressed by CADE. As an example, in the Bayer/Monsanto and Itau/XP mergers, the votes pointed out, among other aspects, the size of the economic groups involved, the degree of concentration of economic sectors and the exclusion of current and potential competitors with disruptive characteristics, with great potential to increase.

30. One approach with regard to potential harmful effects of a conglomerate merger/acquisition is observed in CADE's decision concerning the case involving Kroton and Estacio¹⁰, in which Commissioner Gilvandro V. C. de Araújo voted for the merger to be blocked, an opinion backed by the other commissioners.

31. As in the Kroton/Anhanguera acquisition, this case dealt with, besides the horizontal overlap in the field of on-site and distance higher education, market extension in which the petitioners offered the same product — undergraduate and graduate on-site and distance education — but in different geographic markets through multiunits.

32. Given the complexity of the transaction, the merger was analysed by CADE's Department of Economic Studies, which established in its Technical Opinion 7/2017 that: a) the relevance of the brand and the need for investments in marketing/advertising were major barriers to entry in this market; b) offering on-site education made it easier to attract students to distance education, which indicated a strong relationship between the two learning modalities; and c) the transaction would remove from the market an important player with a consolidated brand and the ability to invest in advertising and marketing, which contributed to increase rivalry among companies through the adoption of a low-price strategy. In sum, the aforementioned vote pointed out a decrease in competition in the field of private higher education in the future.

4. Final Considerations

33. Under the merger control conducted by CADE, some economic sectors, such as the agricultural and educational sectors, have raised competition concerns regarding conglomerate effects. In general, CADE has associated conglomerate power to the theory of reciprocal dealings, which has guided the application of antitrust remedies, most of them behavioural remedies aimed at discouraging typical tying and bundling practises.

⁹ Mergers 08700.004203/2019-16 (Petitioners: Danaher Corporation and General Electric Company), allowed to be carried out without restrictions on 4 November, 2019; 08700.04162/2018-79 (Petitioners: Saint-Gobain do Brasil Produtos Industriais e para Construção Ltda. and Rockfibras do Brasil Indústria e Comércio Ltda.), contested by the General Superintendence and, subsequently, closed after the parties backed out on 14 May, 2019; 08700.001097/2017-49 (Petitioners: Bayer Aktiengesellschaft and Monsanto Company), allowed to proceed with restrictions on 16 February, 2018; 08700.008483/2016-81 (Petitioners: WEG Equipamentos Elétricos S/A and TGM Indústria e Comércio de Turbinas e Transmissões Ltda.), allowed to proceed with restrictions on 6 March, 2018; 08700.009988/2014-09 (Petitioners: Tigre S/A - Tubos e Conexões and Condor Pincéis Ltda.), blocked on 9 September, 2015.

¹⁰ Merger Control 08700.006185/2016-56 (Petitioners: Kroton Educacional S/A and Estácio Participações S/A), blocked on 12 July 2017.

34. Concerning the theories of harm used in conglomerate effects, despite the prevalence of the theory of reciprocal dealings to counterpoise increases in portfolio power, CADE has been using different rationales, supported by theories such as the substantial lessening of competition and the entrenchment theory¹¹, which led to growing concerns in regard to certain economic sectors, such as the ones mentioned before.

35. Furthermore, it is possible to conclude that the assessment of conglomerate effects remains a challenge that tends to get more difficult, especially in sectors that are already strongly verticalised and which are linked to the digital economy. However, CADE has made progress in the analysis of these effects: i) the analyses have expanded beyond the so-called portfolio effect, now integrating other theories of harm; and ii) they have been increasingly supported by quantitative economic studies, which address issues related to efficiency, market rivalry, bargaining power, among others.

¹¹ BINOTTO, Anna. Efeitos conglomerados em concentrações econômicas: caracterização e desdobramento. 2018. It sums up the main theories of harm related to conglomerate effects.

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