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# Non-horizontal mergers: recent EC cases

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*The views expressed are those of the author and do not necessarily reflect those of DG COMP or the European Commission. Special thanks to Raphael De Coninck for kindly letting me borrow some of his slides.

# Outline of presentation

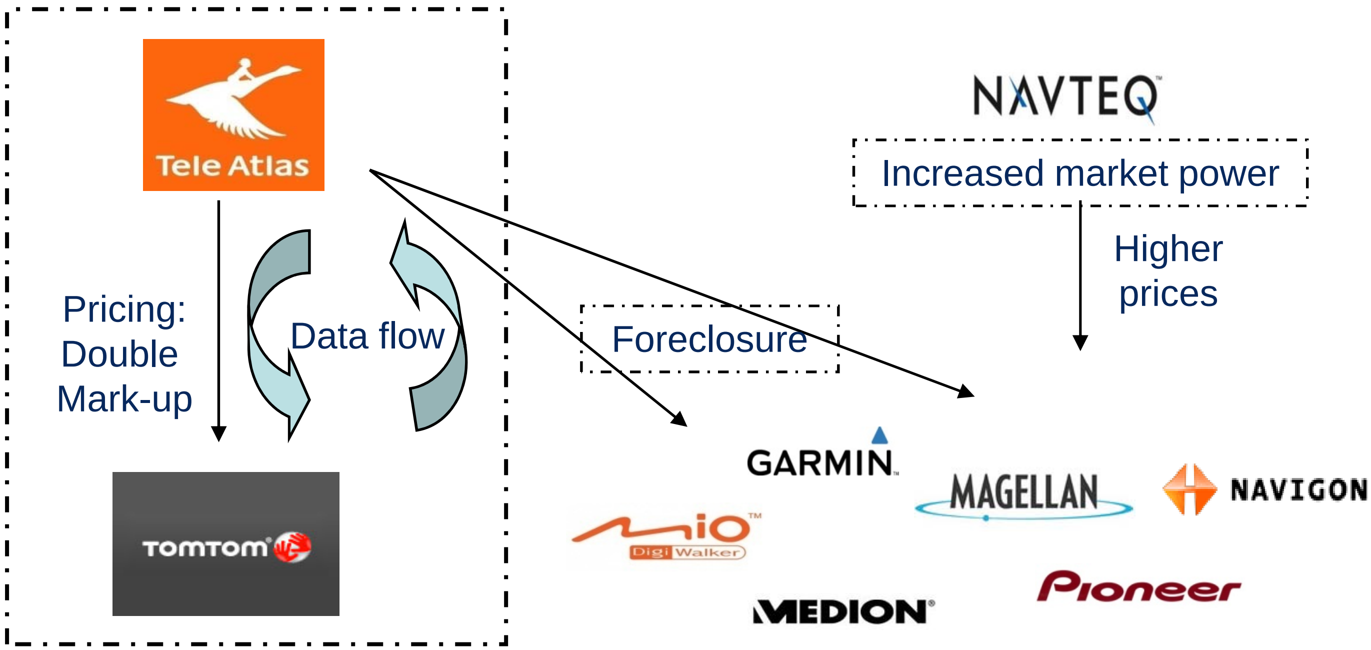
- Economic analysis and role of efficiencies in assessing non-horizontal mergers
- The NHM in action: in 2008, four non-horizontal mergers cleared unconditionally in Phase II
  - TomTom/TeleAtlas
  - Nokia/Navteq
  - Itema/Barcovision
  - Google/DoubleClick
  - *Also Thomson/Reuters (any possible vertical issues solved by remedies addressing horizontal overlaps)*

# Themes covered through cases

- Application of EC NHM in practice (efficiencies)
- Balancing test
- Role of complainants
- Merger specificity

# TomTom/TeleAtlas

- Vertical merger (backward integration)




**Result: Higher prices for PND consumers?**

# TomTom/TeleAtlas

- Merger rationale: “*Better maps (fewer errors), more quickly and cheaply*” -> improve maps using information from TomTom’s customer base
  - Error data reports are collected by TomTom
  - Probe Data with travel information

# TomTom/TeleAtlas

- Will the merged entity have an incentive to foreclose downstream competitors?
  - Trade-off between the upstream losses and the downstream gains associated with a foreclosure strategy.
- Will there be anti-competitive effects?
  - Estimation of post-merger downstream prices

# TomTom/TeleAtlas

- Total foreclosure: stop supplying maps to downstream competitors
  - Calculation of critical price increase by Navteq such that input foreclosure would be profitable (i.e. such that gained margins on downstream sales would outweigh lost margins on upstream sales)
  - Use of econometric estimates of cross-price elasticities
  - Navteq would have to raise its price by significant amount
    - Databases represent small share of PND, limited cross-price elasticities + Garmin’s long-term contract with Navteq

# TomTom/TeleAtlas

- Partial foreclosure: increase price of maps to downstream competitors (or degrade quality)
- The Commission found that prices were likely to fall slightly
- Confidentiality concerns:  same as quality degradation (similar trade-off)

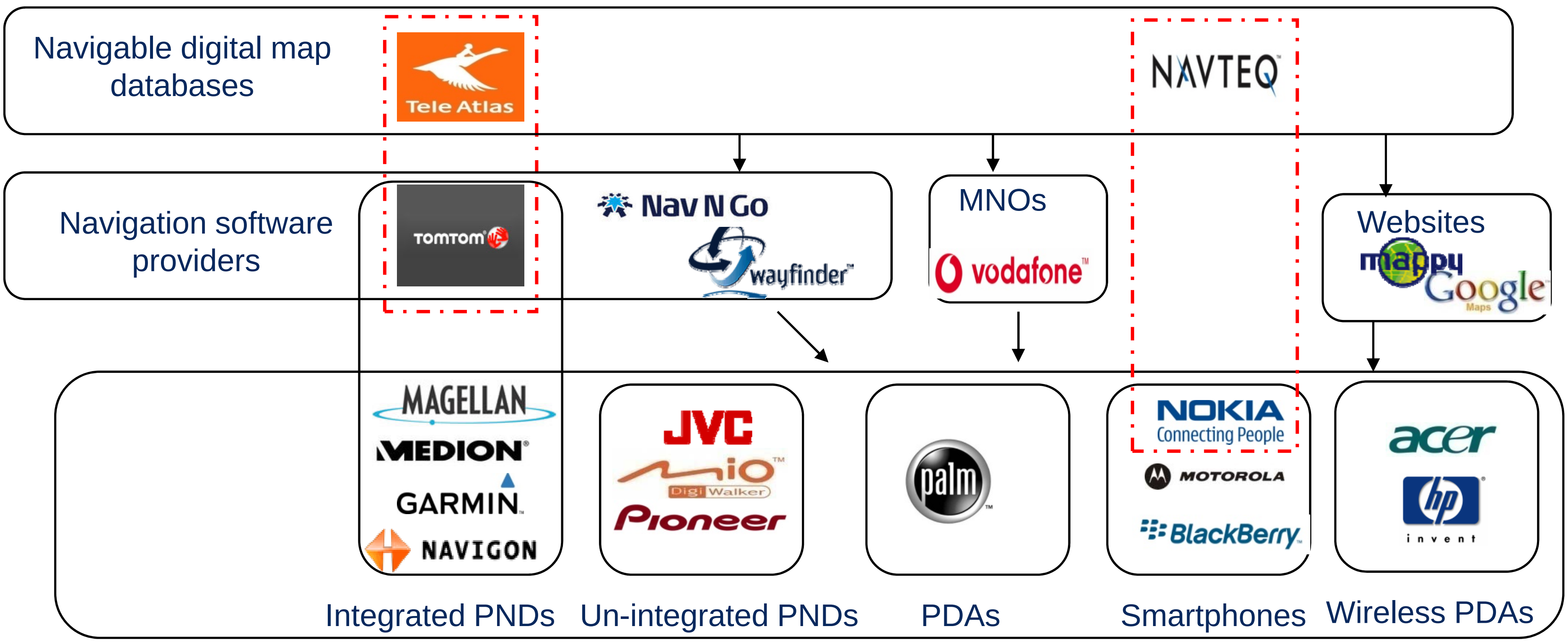
# TomTom/TeleAtlas

- Balancing test:
  - *In order to estimate the overall effect of the proposed transaction taking into account the elimination of double mark-ups, the Commission estimated pre- and post-merger equilibrium prices using a simple model with linear demand.* ***The model indicates that the overall impact of the vertical integration of TomTom and Tele Atlas, taking into account the elimination of the double marginalization by the integrated company, is a small decline in the average PND prices****. This concurs with the economic submissions of the parties. (Para 243)*

# TomTom/TeleAtlas

- Long discussion of efficiencies
- Price efficiency: elimination of double-marginalisation recognized as merger-specific
- Non-price efficiencies (“better maps quicker”): the Commission does not endorse the quantification but these are deemed merger-specific (i.e. investments unlikely due to relation-specific investments and uncertainty leading to incomplete contracts)

# Nokia / Navteq



# Nokia/Navteq

- Similar competitive concerns raised as in TomTom/Tele Atlas
- Navigable digital map not as critical an input for mobile handsets as for PNDs
- Performed similar quantitative analysis as in TomTom and reached the same conclusion (lack of incentive to foreclose)
- Pricing efficiencies merger-specific but non-price efficiencies not merger-specific

# Itema/Barcovision

- Itema, a manufacturer of winding machines ("winders") used in textile industry acquired BarcoVision, a manufacturer of sensors (optical detection) used in winders
- Input foreclosure? (Access to confidential information?)

# Itema/Barcovision

| | | | | |
|---|---|---|---|---|
| **Upstream: Sensors** | BarcoVision (Loepfe) [30-40]% | Uster [55-65]% | Keisokki [0-5]% | Premier [0-5]% |
| **Downstream: Winders** | Itema (Savio) [20-30]% | Murata [30-40]% | Schlafhorst [20-30]% | Chinese OEMs [5-10]% |

# Itema/Barcovision

- Downstream elasticities could not be reliably estimated econometrically due to data limitation
- Simple back-of-the-envelope calculation to evaluate trade-off faced by new entity based on margins, prices and market shares (calibrated without estimating elasticities): e.g. profit test assuming Uster increases prices by 50%, the price of sensor for Itema are reduced to their marginal cost and Itema’s downstream competitors face a linear demand.
- Possible counter-strategies: in-house development of sensors by downstream customers in this case

# Itema/Barcovision

- “*This section examines jointly the incentives to foreclose as well as potential effects on winder prices*” (para.71)

# Vertical mergers: conclusion

- Three vertical mergers with similar market structures: upstream duopoly and downstream firm has important presence
- Input represented small proportion of downstream product price (<10%)
- Main theories: input foreclosure (total/partial)
- Yet, only an empirical evaluation provides a response to the question at hand: are anti-competitive effects of foreclosure outweighed by the efficiencies brought by vertical integration (double mark-up)?
- Data was not available to same extent in these industries but empirical assessment is still possible
- Also need to take into account specific industry facts (e.g. long-term contract with Garmin or threat of in-house development)

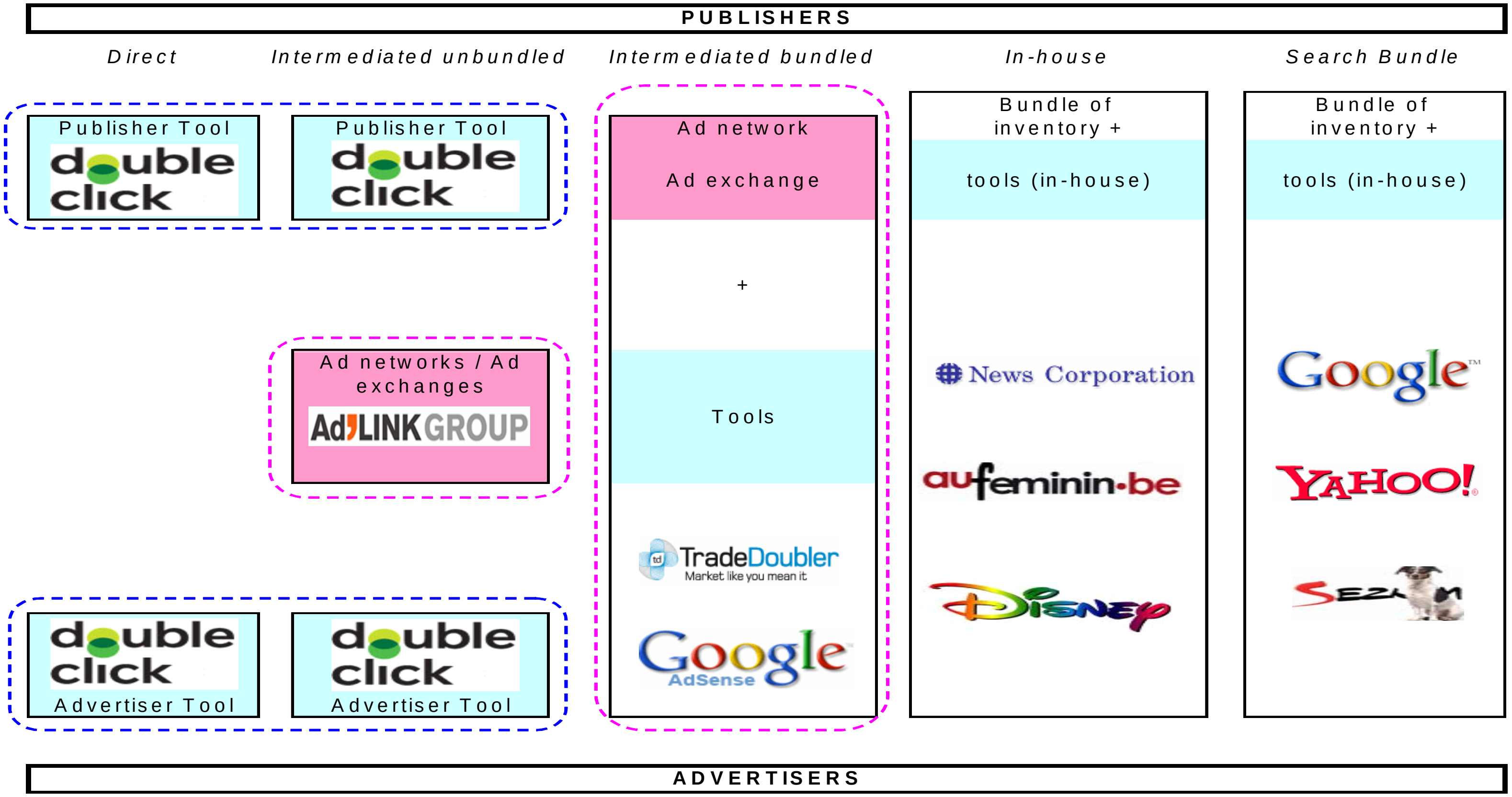
# Google/DoubleClick

- Publishers sell space on their websites
- Advertisers purchase space on website to place their ads
- Ad serving tool = Once a web space is sold by a publisher to an advertiser, the ad needs to appear (i.e. be served) at the right place, at the right time. Ad server ensures that this step is properly done. The ad serving technology also provides various sorts of reporting services.
  - Note: the sale of the space can be done directly (i.e. publishers and advertisers negotiate directly) or indirectly (through an intermediary, i.e. ad network or ad exchange)

# Google/DoubleClick

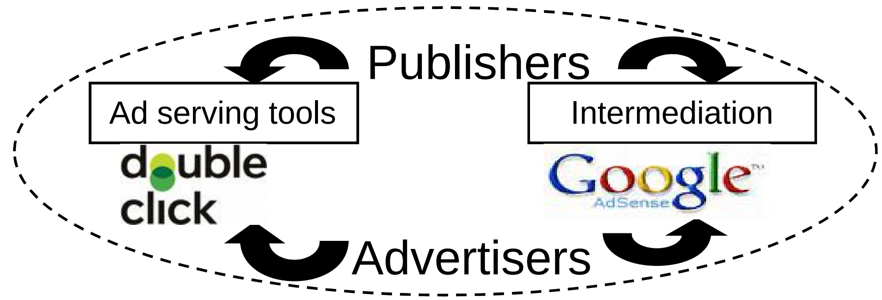
- Google activities in online advertising:
  - sells space on its website (text ads)
  - sells intermediation services (AdSense) through which (search/contextual) text ads are served on the pages of AdSense members
- DoubleClick activities in online advertising:
  - Sells ad serving technology (mostly display ads) to publishers and advertisers

# Google/DoubleClick



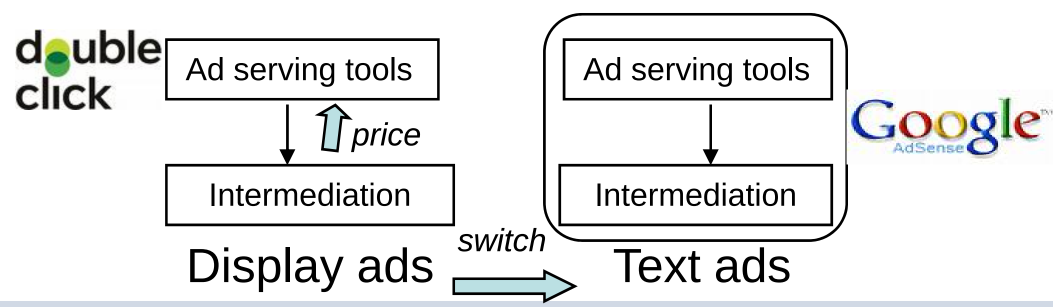
# Google/DoubleClick

- A conglomerate merger? (bundling)




- A vertical merger? (raising rival's cost)


- A diagonal merger? (raise the price of the input into competing product)



# Google/DoubleClick

- Many theories of harm put forward by complainants involved the leveraging of DoubleClick's leading position in ad serving to extend Google's position in intermediation (AdSense)
- Many strategies were described to achieve such leveraging
  - Increase the price of DoubleClick tools when used with competing ad networks
  - (Selectively) degrade the quality of DoubleClick tools when used with competing ad networks
  - Tying or bundling of DoubleClick software with AdSense
  - "Tweak" the arbitration mechanism in favour of AdSense

# Google/DoubleClick

- Many of the theories of harm put forward by complainants (mostly competitors but not only) and investigated by the Commission relied on a number of assumptions
  - Market power of DoubleClick (high switching costs)
  - Ad serving is an important input into display advertising
  - There are strong direct and indirect network effects
- Contradictory statements made by industry players had to be verified

# Conclusions

- Often strong complaints from customers/competitors in vertical cases (efficiency offence?)
- Economic analysis thus plays a crucial role: importance of gathering relevant data and information early on in the process
- NHM guidelines are useful framework enabling a structured approach
- NHM provide flexible framework: variety of empirical methods can be used to validate (or not) the theory of harm
- Integrated rather than checklist approach to NHM guidelines (also taking into account efficiencies)