# Conglomerate Mergers

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AdC Open Webinar
3 February 2021

# Conglomerate mergers: definition

- Antitrust: neither horizontal nor vertical
  - Separate product markets (non-substitutable products)
  - Same customer segments (independent / complementary products)
- EU Merger guidelines (2008)

  "Conglomerate mergers are mergers between firms that are in a relationship which is neither horizontal (as competitors in the same relevant market) nor vertical (as suppliers or customers). In practice, the focus of the present guidelines is on mergers between companies that are active in closely related markets (e.g. mergers involving suppliers of complementary products or products that belong to the same product range)."
- [Finance: broader definition – including diversification in unrelated activities]

# Conglomerate mergers: cases

- Recent wave in digital economy
  - Google / Motorola - $12.5 billion, 2014
  - Facebook / WhatsApp - $22 billion, 2014
  - AT&T / DIRECTV - $48.5 billion, 2015
  - Dell / EMC (data storage) - $67 billion, 2015
  - Microsoft / LinkedIn - $26.2 billion, December 2016
  - Qualcomm / NXP - $47 billion, January 2018
- Other sectors as well
  - ASL / Arianespace - July 2016
  - Luxottica / Essilor - €46 billion, March 2018

# AT&T – Direct TV

- Parties (US)
  - AT&T: largest Internet and telephone service provider
  - DIRECTV: second largest pay-TV supplier
- Complaints
  - American Cable Association, Biglaiser: higher prices (content)
  - Netflix: abuse of market power (interconnection)
- Defence
  - AT&T: save costs for consumers
  - Katz, Berry and Haile: benefit from one-stop shopping
- After the merger, AT&T raised prices for TV packages

# Policy divide: US

- Robert Bork (1978): no threat to competition
- US Merger Guidelines: concerns disappear in 1982
- Antitrust authorities: no prohibition in 40 years
- Deputy AAG William Kolasky on *GE / Honeywell*:
  - "After fifteen years of painful experience with these now long-abandoned theories, the U.S. antitrust agencies concluded that antitrust should rarely interfere with any conglomerate merger."
  - "US agencies simply could not identify any conditions under which a conglomerate merger would likely to give the merged firm the ability and incentive to raise price and restrict output."

# Policy divide: EU

- Concerns about exclusionary effects

- EC blocked two mergers on the basis of “portfolio effects”
  - 2001: *GE / Honeywell* (engines / avionics etc.
    - After US approval
    - Confirmed by ECJ
  - 2002: *Tetra Laval / Sidel* (carton / PET packaging)
    - Overturned by CFI/ECJ
    - No other prohibition afterwards

- *Eurotunnel / SeaFrance*
  - British and French NCAs (2012 / 2013)
  - Unbundling remedy

# Efficiency benefits

- Double marginalization [Cournot (1838)]
  - Applies to all complements (“vertical” / “horizontal”)
  - Reducing price of one component boosts demand for others
  - A merger leads to lower prices
- Can be transposed to investment, R&D and innovation
  - Reducing cost / increasing quality of one component boosts demand for others
  - A merger leads to greater investment
- Tying, technical integration
  - Pervasive (cars and smartphones are “bundles”)
  - Customization
  - *Lower transaction costs, consumption synergies*

# Theories of harm: horizontal foreclosure

[Rey and Tirole *Handbook of Industrial Organization* 2007]

- Tying as an entry barrier [Whinston *AER* 1990]

  Commitment to aggressive response to entry

- Protecting core market [Carlton and Waldman *Rand* 2002]

  Scope economies: entry in adjacent markets may ease entry in core market

- Tying and innovation [Choi and Stefanadis *Rand* 2001]

  Impose on rivals or entrants to innovate in multiple markets

- [Hold-up [Allain, Chambolle and Rey *RES* 2016]

  Create / exacerbate hold-up concerns for rivals]

# Theories of harm: bundling

- Different types of practices
  - Pure bundling: offers only the bundle *A*–*B*
  - Tying: e.g., offers *B* and the bundle *A*–*B* (does not offer *A* alone)
  - Mixed bundling: offers *A*, *B* plus the bundle *A*–*B* at a discounted price
- Price effects
  - Lower prices for bundles
  - Ambiguous impact on stand-alone prices
- Remark: mixed bundling versus quantity rebates
  - Pay-TV packages (basic, movies, news, sport, …): mixed bundling
  - Lyonnaise Câble: “star system”

# Theories of harm: bundling

- *GE / Honeywell* [Disclosure]
  - Complements: *GE* engines and *Honeywell* avionics, wheels and brakes, …
  - Calibrated model put forward by rival engine manufacturer
    - engines: two competing suppliers
    - avionics: three competing suppliers
    - demand for six “combinations”
  - Merger simulation
    - merger leads to lower market shares for rivals
    - even more so with mixed bundling (compared with no bundling)
    - but consumer surplus … increases (lower bundled prices and, to a lesser extent, rivals’ prices)

# Consumption synergies: illustrations

- Recurrent feature
  - *Aerospatiale-Alenia / De Havilland* (commuter aircraft)
    - Would have been the first to offer the full range of regional aircraft (small to large ones)
    - Airlines would have saved on spare parts and maintenance, pilot certification and training
  - *AT&T / DirectTV*
    - Save on number of setup boxes and installations (Internet + pay TV)
    - Single consumer support, billing, …
  - *Eurotunnel / SeaFrance*
    - Urgent freight: rail
    - Non-urgent freight: ferries
  - More generally: one-stop shop benefits

    Saving on transaction costs (e.g., shopping costs, learning, …)

# Consumption synergies: issues

- Pros and cons
  - Efficiency benefits
    - generates greater value
    - issue is whether they will be passed on to customers
  - Anti-competitive effect (Alenia – de Haviland; GE – Honeywell: “portfolio effects”)
    - confers a competitive advantage to the conglomerate
    - can be exacerbated by bundling strategies
- Recent paper with Zhijun Chen (“A theory of conglomerate mergers”)
  - Key feature: heterogeneous consumption synergies or one-stop shop benefits
  - Theory of harm: portfolio differentiation softens competition

# Baseline setting: competitive markets

- Supply
  - Two markets $A$ and $B$ with multiple identical firms $A_1$, $A_2$, … and $B_1$, $B_2$, …
  - Constant unit costs $c_A$ and $c_B$ for products $A$ and $B$
- Demand
  - Consumers with independent unit demands for each product
  - Homogeneous valuations $u_A > c_A$ and $u_B > c_B$
- Competition
  - No informational frictions: consumers observe all prices before purchasing
  - In each market, competition drives prices down to cost: $p_A = c_A$ and $p_B = c_B$

# Consumption synergies

- Firms $A_1$ and $B_1$ merge to form a conglomerate
  - Conglomerate offers the bundle $A – B$ (like Broadband and TV)
  - Consumers enjoy synergies from the bundle (integrated set-up box)
  - Heterogeneous across consumers
- Two scenarios
  - Mixed bundling: conglomerate also offers $A$ and $B$ on a stand-alone basis
  - Pure bundling (or technical integration): conglomerate offers only the bundle
- Welfare analysis
  - Impact on prices and consumers
  - Impact on market shares and profits

# Mixed bundling

- Conglomerate still offers *A* and *B* on a stand-alone basis
  - Competition among stand-alone offerings still drives prices down to cost: $p_A = c_A$ and $p_B = c_B$
  - In addition, conglomerate offers the bundle at a premium
- Some consumers buy the bundle, others mix-and-match
  - Mix-and-matchers are not affected: still buy the products at cost
  - Those who buy the bundle benefit (revealed preference argument)
  - The merger is profitable: earn a positive margin on the bundle
  - Rivals are unharmed: competitive (zero) profits
- Pure efficiency / “win-win” situation

# Pure bundling

- If there remains competition among stand-alone firms: same a before
  - Mix-and-matchers can still buy the products at cost
  - Consumers who buy the bundle benefit
- If there remains a single stand-alone firm in one market: *portfolio differentiation*
  - Consumers choose between the bundle and a basket of stand-alone products
  - Conglomerate has market power over the bundle
  - The remaining single stand-alone firm has market power over its basket component
  - Imperfect substitution yields prices above cost
  - Even more so with a single stand-alone firm in both markets: double marginalization

# Pure bundling (cont’d)

- Impact on prices and consumers (pure bundling and single supplier for a product)
  - All prices increase (for the basket and for the bundle)
  - Mix-and-matchers are harmed: can no longer buy the products at cost
  - Ambiguous impact on consumers who buy the bundle
- Impact on firms
  - The merger is profitable
  - Bundling is profitable (it induces each single supplier to raise its price)
  - The merger benefits single remaining supplier(s)

[softer competition due to portfolio differentiation]

# Consumption synergies: lessons

- Absent pure bundling, *or* if there remains competition among stand-alone firms
  - No consumer is harmed, and some consumers benefit
  - No rival is harmed
  - The merger is profitable
- In case of pure bundling *and* a single stand-alone firm remaining in one market
  - Mix-and-matchers are harmed
  - Total consumer surplus can be reduced
  - The merger is profitable
  - Pure bundling is profitable
  - The merger benefits single remaining supplier(s)

# One-stop shop benefits

- One-stop shoppers benefit even in the absence of bundling
  - Conglomerate cannot charge more for the bundle
  - No role for mixed bundling (same as no bundling)
- In most cases, same lessons as before
  - Pure bundling: anti-competitive if a single stand-alone firm is left in one or both market(s)
  - No bundling *and* there remains competition in at least one market (pro-competitive)
  - Particular case: no bundling and a single stand-alone firm left in both markets
    - the merger is profitable and benefits the remaining stand-alone firms
    - multi-stop shoppers are harmed
    - ambiguous impact on one-stop shoppers and total consumer surplus

# Imperfectly competitive markets

- Imperfect competition due to product differentiation
- Pre-merger
  - Each firm has some market power
  - Prices are above costs, the more so when products are more differentiated
- Post-merger
  - Mixed bundling
    - Conglomerate increases stand-alone prices (to foster demand for bundle)
    - Stand-alone firms respond by increasing their own prices: mix-and-matchers are harmed
    - Ambiguous impact on consumers buying the bundle and on total consumer surplus
  - Pure bundling
    - All prices are higher than with mixed bundling
    - Consumer surplus more likely to be reduced

# Lessons: conglomerate mergers

- Efficiency gains
  - Consumption synergies
  - One-stop shop benefits
- Portfolio differentiation effect
  - Bundle versus basket
  - One-stop versus multi-stop shopping
- In the absence of pure bundling, does not raise serious concerns
  - The conglomerate shares the efficiency benefits with (some) consumers
  - Particularly so if there remains competition from other suppliers – at least in one market
  - Analogy: innovation

# Lessons: bundling

- Mixed bundling does not appear to raise serious concerns
  - Can foster the intensity of competition
    - lower bundled prices
    - elimination of double marginalization
  - Possibly higher stand-alone prices, particularly if limited remaining competition
- Pure bundling
  - Raises more serious concerns
    - Exacerbates portfolio differentiation effect
    - Can generate higher stand-alone prices, particularly if limited remaining competition
  - Can increase conglomerate’s profit at the expense of consumers and rivals