Policies to Control Mergers

# Starter: Recap Question

**Instructions:** Test yourself with the below quick question

What is a Merger?

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What anticompetitive practices could firms use to reduce the level/effect of competition in an industry?

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*Extension:* Should the government try and control monopolies?

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# Presentation 2 – The CMA

Complete the activities below so as to have a complete set of Notes:

**Definition:** The Competition and Markets Authority (CMA)

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**Key Notes:** CMA Focuses

Three key aspects of competition law the CMA deals with:

**Anticompetitive agreements (ACA):** agreements to distort competition by cooperating with competitors, e.g. collusion

**Abuse of a Dominant Position (ADP):** normally viewed as a firm having >40% market share as this can lead to anticompetitive results such as unreasonably high prices, artificially low prices, compulsory link purchases

**Mergers and Acquisitions (M&A):** CMA must determine whether there would be a substantial loss of competition if the merger took pace

**Key Example:** *Sainsbury’s-ASDA Blocked Merger*

In 2019 the CMA prevented Sainsbury’s from acquiring rival supermarket ASDA from US company Walmart in a £7bn deal.

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# Table Task:Recent Competition Cases

**Instructions:** Read the following cases, which were all recently dealt with by the CMA or its predecessors the Office of Fair Trading (OFT) and Competition Commission (CC), and categorise them into the relevant aspect of competition law.

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| --- | --- | --- |
| Anticompetitive agreements (ACA) | Abuse of a Dominant Position (ADP) | Mergers |
| *Example numbers:*  | *Example numbers:* | *Example numbers:* |

1) In August 2003, ten suppliers of replica football kits were fined a total of £18.6m for unlawful price-fixing. The kits were all licensed from Umbro and included top-selling England and Manchester United shirts, which were sold for £40 (adult) and £30 (child). These high prices coincided with key events such as Euro 2000, when demand for the kits became very price inelastic. The unlawful agreements were enforced through a series of implicit threats, such as stock cancellations in the event of one retailer cutting prices. The businesses fined included JJB Sports, Allsports, Manchester United and Umbro.

2) In March 2005, the OFT cleared the proposed merger between Capital Radio and GWR Group, which owns Classic FM and 36 other local radio stations. Despite the merged entity having a 40% market share in radio advertising space, there did remain strong competition in most regions – except in the East Midlands, where Capital would become a near monopoly. Hence the OFT cleared the merger with an undertaking that Capital FM sells its East Midlands radio station, Century 106FM.

3) In November 2001, DuPont informed OPG, a manufacturer of hologram products, that it would no longer supply OPG with holographic film; OPG complained against DuPont’s refusal to supply. The OFT, however, cleared DuPont of any wrongdoing as the firm had no downstream business interests competing with OPG. So the refusal to supply was not aimed at eliminating competition, but was simply a case of DuPont exercising its commercial right to choose its customers.

4) In March 2004, Wm Morrison was given the go-ahead to purchase all of Safeway’s UK stores, with an undertaking to sell off 48 of them. These were in localities where the merged entity would have a very high local market share and may act as a monopoly.

5) In February 2003, both Argos and Littlewoods were fined heavily for fixing prices with Hasbro, the toy manufacturer. The agreement had each of the retailers rigidly following Hasbro’s RRP on price inelastic toys such as Action Man and the Monopoly board game. The OFT concluded that this sent a signal to other retailers not to compete on prices. Littlewoods was fined £5.37m and Argos was fined a record £17.28m – Hasbro was given 100% leniency as it came forward before the investigation began and provided the OFT with all the necessary evidence.

6) In July 2001, Aberdeen Journals was fined £1.3m for predatory pricing. The firm sold advertising space in its free newspaper, the Herald & Post, at below AVC, and with the express intention of removing its only rival, the Aberdeen Independent, from the market.

7) In July 2001, the European Commission blocked the proposed $45bn merger between US firms General Electric (a dominant manufacturer of aircraft engines) and Honeywell (a manufacturer of avionics – i.e. cockpit hardware). Among the reasons cited was a concern that the merged entity would bundle its products with such large discounts on avionics purchased with aircraft engines, that Honeywell’s competitors would lose market share with some possibly leaving the industry. And that this would continue to the extent that competition would be severely undermined, and choice severely restricted, in the market for avionic equipment.

8) In 2000, the Competition Commission rebuked Birds Eye Walls for the practice of ‘freezer exclusivity’. This involved the manufacturer providing small shopkeepers with a free ice-cream freezer (often worth several thousands of pounds) on the condition that they do not stock rival products in them. So a freezer provided by Birds Eye Walls could only be used to stock Cornetto, Magnum, Solero or any other product made by Birds Eye Walls. Small, independent manufacturers of ice-cream therefore complained that this had unfairly squeezed them out of the market. The Competition Commission was eventually successful in getting Birds Eye Walls to cease this practice of freezer exclusivity, allowing rival products to be stocked in their freezers so long as some Birds Eye Walls ice-creams were in there too.

Significantly, this judgment was later applied in another case involving Coca-Cola where the firm had supplied free ‘Coke’ branded fridges to corner shops and takeaway food outlets, on the condition that no rival soft drinks be sold in them. Coke was forced to end this practice, and now allows rival soft drinks in their fridges, so long as some of the space is used to stock Coke products.

9) In 2001, the European Commission fined eight pharmaceutical firms a record €855m for fixing the price of vitamins through a cartel that had a “formal structure and hierarchy,” including a regular exchange of sales figures and pricing data. Hoffman La-Roche of Switzerland received the largest single fine of €462m for being “the ring-leader and the main beneficiary” of the cartel. The second largest fine of €296m was levied against Germany’s BASF. The Competition Commissioner at the time, Mario Monti, defended the size of the fines, saying: “the companies’ collusive behaviour enabled them to charge higher prices than if the full forces of competition had been at play…This severely damaged consumer interests and allowed the companies to pocket illegal profits”.

# http://cdn.static-economist.com/sites/default/files/imagecache/full-width/images/2016/02/articles/main/20160206_brp501.jpgArticle Task: Mobile telecoms - Three’s a crowd

**Instructions:**

* *Read Highlight and annotate the article*
* *Answer the key questions*
* *Discuss your answers as a class*

**Article**

*Consumers could lose out in a proposed merger of mobile-phone operators*

In many respects Britain’s mobile-phone market is one of the most successful in the world. About 30 operators compete for business, ensuring that prices are among the lowest for rich countries (see chart). A number of retailers offer an almost infinite variety of bundles of services, and coverage is relatively good too. All of which helps to explain why regulators in Britain and Europe are so opposed to a proposed £10.5-billion ($15.3-billion) merger between the second-largest operator, O2, owned by Spain’s Telefónica, and the fourth-largest, Three, owned by Hutchison Whampoa, based in Hong Kong.

On the face of it, such a deal would continue a long-standing trend towards consolidation among mobile operators, both in Britain and other rich countries. It is a mature market, and since 2008 revenues have generally been falling. It has thus made sense for companies to merge, freeing up capital for investment in costly infrastructure and new technology, such as speedy “4G” networks. In Britain, T-Mobile and Orange merged to create the biggest operator, EE, in 2010. EE, in turn, has been taken over by BT, the former state-run monopoly, in a £12.5-billion deal that creates a behemoth covering mobile, fixed-line phones, broadband and television.

But enough is enough, apparently. On February 1st Sharon White, the head of Britain’s telecoms regulator, Ofcom, laid out why she opposes the O2-Three merger. The main reason, she said, was that the removal of one of these would so diminish competition that it “could mean higher prices for consumers and businesses”.

The concern is that although there are about 30 operators overall, there are only four—EE, O2, Three and Vodafone—that run and maintain the physical infrastructure for mobiles. These are known as Mobile Network Operators (MNOs) in the jargon. The other players, such as Lycamobile, are merely Mobile Virtual Network Operators (MVNOs); they rent the infrastructure from the MNOs. Virgin Mobile was created as the world’s first MVNO in 1999. Ofcom contends that the reduction of network providers from four to three will allow them to drive a harder bargain with the MVNOs, perhaps putting some out of business and driving up prices. By contrast, the BT-EE deal was acceptable because the two companies—one primarily fixed-line, one mainly mobile—complemented each other, and the new entity should not harm competition in either the mobile or fixed-line markets.

Mergers of this size are automatically referred to the European competition commissioner, Margrethe Vestager, who shares Ms White’s worries about the O2-Three case. Ms Vestager was due to send out private “statements of objections” to the two companies this week; her office should make a final decision on the matter by April 22nd.

She also shares the broader concern that consolidation from four to three network operators leads to higher prices, although there is a fierce debate about this (some say that the case of Austria, for example, which downsized so in 2012, does not bear the theory out). Ofcom’s own research in 25 countries shows that average prices were up to one-fifth lower in markets with four network operators than in those with three. On February 4th Hutchison promised to freeze prices for five years if the O2-Three merger went ahead.

Another reason for preferring the four-network model is that the smallest operator of the gang usually operates as the disrupter and innovator. This has been the case with Free Mobile in France and T-Mobile in America. Three has played a similar role in Britain. It was the first to launch a 4G service at no extra cost than 3G, in 2013, as well as a “Feel at Home” service, scrapping roaming charges in 16 countries. As Sam Paltridge, a telecoms expert at the OECD, argues, in the rapidly evolving world of the “internet of things”, companies that innovate will be more important than ever. In this particular case, four’s company and three’s a crowd.

**Key Question**

Explain why the O2-Three merger was blocked, but BT-EE was allowed?

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Presentation 2 – Evaluation of the CMA

Complete the activities below so as to have a complete set of Notes:

**Elaborate:** Elaborate on the below limitations of competition policy with regards to its effectiveness

Very few mergers and business actions are actually investigated.

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‘Single’ markets are often inadequately defined.

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Fines can damage the future prospects for firms and deter them from setting up in the UK.

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Dominant market share won’t always lead to market dominance.

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**Definition:** Regulatory capture

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**Explain:** Two processes which increase the likelihood of regulatory capture

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# Case Studies Task: To Merge or Not to Merge?

**Instructions:**

* Read, highlight and annotate both of the articles.
* Discuss as a class whether each merger should be sanctioned or not.
* Things to consider:
	+ What are the potential impacts of the mergers on stakeholders?
	+ What are the similarities and differences between the two cases?
	+ Look out for instances of regulatory captured!

**Article 1: British American Tobacco takes control of Reynolds for $49bn**

*British American Tobacco has agreed a $49.4bn (£40bn) deal to take control of US rival Reynolds, creating the world's largest listed tobacco firm.*

The UK company has been in talks with Reynolds for months about buying the 57.8% stake it does not already own.

The merger would bring together some of the tobacco industry's best-known brands, including Lucky Strike, Rothmans, Dunhill and Camel cigarettes. A merger "creates a stronger, truly global tobacco" business, BAT said. BAT, a shareholder in Reynolds since 2004, said last year that the merger was "the logical progression in our relationship". However, the UK company's initial approaches were rebuffed by Reynolds, and a $47bn offer was rejected last November.

BAT estimates that it can make $400m worth of cost-savings through the merger. Reynolds has been operating since 1875 and is the second largest tobacco company in the US after Altria, which owns Philip Morris USA. Last year, Reynolds completed its $25bn takeover of US rival Lorillard. The combined company was forced to sell off a number of brands, including Kool, Salem and Winston, to satisfy regulators. They were eventually bought by Britain's Imperial Tobacco for $7.1bn. BAT products include Rothmans, Kool and Kent, while Reynolds' brands include Newport, Camel, Pall Mall, Doral, Misty and Capri. The UK company has more than 200 brands, and is a big player in the market for e-cigarettes. The takeover will give it a further foothold in the US, and give the combined business a significant presence in high-growth markets including South America, the Middle East and Africa.

More deals?

The offer comprises $25bn worth of BAT shares and $24.4bn in cash, valuing the whole Reynolds business at more than $85bn. The sweetened deal represents a 26% premium against the closing price of Reynolds' shares on 20 October, when news of BAT's interest in taking full control of Reynolds emerged. Nicandro Durante, BAT's chief executive, said: "We have been shareholders in Reynolds since 2004 and we have benefited from the success of the present management team's strategy, including its acquisition of Lorillard, which we supported with our own investment in 2015. "Our combination with Reynolds will benefit from utilising the best talent from both organisations. It will create a stronger, global tobacco and NGP [new-generation products] business with direct access for our products across the most attractive markets in the world."

Steve Clayton, fund manager at Hargreaves Lansdown, said the takeover was a "big move" for BAT, but made "a lot of sense". However, he added: "We can't ignore the debts that BAT are taking on to fund the deal, and in the short term, the stock has become a bit more risky as a result. But tobacco is a very cash generative business and we expect the enlarged group to be able to pay the debts down quite quickly. "The sheer scale of the enlarged BAT raises the pressure on the remaining players to bulk up too, and attention is likely to turn to Imperial Brands, who look more and more like a minnow swimming in a tank of big, hungry fish."

Discussion Notes:

**Article 2: Tesco to buy Budgens and Londis owner Booker in £3.7bn deal**

*Supermarket giant’s takeover of wholesaler could cause competition concerns and led to resignation of independent director.*

Tesco, Britain’s biggest supermarket group, is to buy Booker, the UK’s largest food wholesaler and the company behind Londis and Budgens, in a £3.7bn deal.

The two companies said they wanted to create the UK’s leading food business in a £195bn market, claiming it would “bring benefits for consumers, independent retailers, caterers, small businesses, suppliers, and colleagues, as well as delivering significant value to shareholders”. But the deal will raise questions over its impact on the UK’s grocery sector and is likely to be scrutinised closely by competition authorities. Tesco owns the 850-strong One Stop convenience store chain while in 2015 Booker acquired the Londis and Budgens chains, which are operated by franchisees but are supplied by Booker. Nor was the tie-up completely unanimous among members of the Tesco board. The supermarket group’s chief executive, Dave Lewis, admitted that Richard Cousins, boss of catering group Compass who abruptly quit his position as senior independent director of Tesco earlier this month, was not supportive of the Booker deal, which took a year to negotiate.

Lewis said he respected Cousins’ decision and described their discussions as “good governance” but stressed that the rest of the Tesco board backed the deal. Tesco shares jumped 10% to 208p on the news, while Booker shares leapt 15% to 211p. Lewis told BBC Radio 4 that the deal was a “low-risk merger”, adding: “Tesco and Booker are quite different businesses we but we have a lot in common – a focus on food.” He insisted it was the right time for the deal: “We do think that the recovery in Tesco is well under way ... It’s completely on strategy, it’s the next evolution of our strategy.” Since taking the reins in 2014, Lewis has been reshaping Tesco following a damaging accounting scandal and a slump in sales. A strong Christmas performance has raised hopes of better-than-expected annual profits. Booker’s chief executive, Charles Wilson, will join the combined group’s board and act as a number two to Lewis, similar to his role as righthand man to Stuart Rose at Marks & Spencer more than a decade ago. Booker’s chairman, Stewart Gilliland, will also join the new board. Wilson owns nearly 6.3% of Booker and is swapping his holding for Tesco stock with a five-year lock-in.

Lewis said the deal was about improving price, choice and service for customers and would cut food waste. Pointing to Amazon, which is pushing into food, Wilson chimed in: “If you look around the world, you see that the food industry is changing.” Tesco and Booker expect synergies from the deal to reach at least £200m a year by the third year after completion, with a boost of at least £25m to operating profit and cost savings of at least £175m. Wilson ruled out large-scale job losses, arguing that the savings will come from greater efficiency and procurement. He was confident that Booker’s convenience store brand names Londis, Budgens, Premier and Family Shopper would remain. Under the terms of the deal, each Booker shareholder will receive 0.861 Tesco shares and 42.6p in cash, worth 205.3p a share. Booker shareholders will own 16% of the combined business. The deal has been recommended by both boards, but needs approval from regulators and both sets of shareholders.

Retail analysts at Shore Capital said: “The initial gut reaction, which is usually the best one, is that it may be sound for Tesco but far from compelling for Booker shareholders.” But they cautioned: “Tesco is not a business without a lot to do fixing the UK stores, trying to make online sustainably profitable, rebuilding profitability in central Europe and generally deleveraging. As such, whether or not the integration of Booker is an ideal strategic step is subject to debate to our minds.” Analysts believe the deal could run into competition problems, but Lewis was not concerned, pointing to Booker’s franchise model, whereby stores are owned independently by the retailer.

Retail specialist Nick Bubb said: “Our instant reaction is that the Competition and Markets Authority will have a field day with this, as although Tesco is mainly a retailer in the UK and Booker a wholesaler, Tesco does own the One Stop convenience store chain that competes with Booker’s interest in symbol groups and convenience store retailing (via Premier and Londis etc), so it is by no means clear that the CMA will allow things to proceed very far without having a good look at the overlap.” Shore Capital concurred, adding: “The non-Booker independent and wholesale trade will be up in arms on this proposed merger and so it could be a very messy process.” Booker supplies food to 450,000 caterers, 120,000 retailers and 700,000 small businesses including Wagamama, Rick Stein and Carluccio’s.

Discussion Notes:

# Assignment: Competition Policy

**Short-answer questions (Section A)**

1. The 1998 Competition Act gives the CMA the power to fine firms up to 10% of annual turnover if they abuse a dominant market position. Which of the following actions by the directors of a company would be against the public interest and therefore be likely to attract such a fine?

A The pursuit of socially responsible objectives.

B The adoption of allocatively efficient pricing policies.

C Causing unemployment by closing a factory as a cost-cutting measure.

D Forming price fixing agreements with other firms.

1. In December 2009, the Competition Commission approved the proposed merger between Ticketmaster and Live Nation. The most likely reason for merger approval is that:

A It would allow both firms to make more profit.

B It would encourage collusion between in the entertainment industry.

C It would decrease the ability of Ticketmaster to achieve economies of scale.

D Significant competition will still remain in the market.

1. The Competition Commission asked BAA in March 2009 to sell Gatwick and Stansted airports followed by either Edinburgh or Glasgow. The most likely reason for this would be

A To encourage investment and make airports more efficient.

B To reduce contestability in the industry.

C To decrease the rate of innovation in the market

D To allow Gatwick and Heathrow to share information on pricing.

**Data response (Section B)**





**Question**

Discuss the likely problems for Sainsbury’s and Morrisons if the suggested merger between them goes ahead. Refer to Figure 1, Extract C and your own knowledge in your answer. [15]

**Question:** Discuss the likely problems for Sainsbury’s and Morrisons if the suggested merger between them goes ahead. Refer to Figure 1, Extract C and your own knowledge in your answer. [15]

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| **Planning Grid: Aim = 4 paragraphs - 2 KAA points (9); 2 Eval points (6)** |
| **KAA Point 1 = signpost key point** |  |
| Application |  |
| Main concept & diagram |  |
| **Eval Point 1 = relate to your earlier point & re-read the title** |  |
| Context / evidence |  |
| **KAA Point 2 = signpost key point** |  |
| Application |  |
| Main concept & diagram |  |
| **Eval Point 2 = relate to your earlier point & re-read the title** |  |
| Context / evidence |  |