Enterprises can combine in several ways. One firm may purchase from another firm all of its outstanding securities, all or some of its operating assets, or a significant share of its outstanding securities. Alternatively, two firms may exchange securities to form one firm. Such transactions may be the result of an agreement between the two enterprises, or the takeover may be unsolicited, unexpected, or even "hostile"—that is, resisted by the target enterprise. Established practice has been to label any transaction in which two independent actors are combined into one a merger, resulting in the strengthening of one actor and the elimination of the other.

**WHY ARE WE CONCERNED ABOUT MERGERS?**

Standard theoretical analysis of competition describes a range of market structures—from a perfectly competitive market with many competing firms, none of which can influence the market price individually, to an oligopoly, in which the market consists of a few firms, each having some power over the market price but constrained by the rivalry of the others, to a monopoly, in which a single firm sets the price unilaterally. Sometimes market structures become more concentrated over time as a few firms succeed and grow while others fail. Some firms grow not because of their own competitive efforts but because of a merger.

A firm's exercise of market power can harm consumers (and other producers), through higher (rather than competitive) prices, reduced output, and poorer quality products. Competition authorities must identify and control the abuse of market power. The rationale for merger control is simple: it is far better to prevent firms from gaining market power than to attempt to control market power once it exists. Effective merger policy requires a judgment concerning the impact of a merger on competition before the merger has occurred.

Most mergers pose little or no threat to competition in any market. Many simply are investments by firms with available cash. Others seek the fuller use of an underused enterprise resource (for example, an enterprise that has developed expertise in the marketing of one consumer product may believe that it could use its expertise to market other consumer products, or an enterprise that has developed a new technology may seek new applications for that technology). Still other mergers may reduce competition, but so slightly or in a market that is so competitive that consumers are not harmed.

However, some mergers would seriously harm competition by significantly increasing the probability of exercising market power. These are the transactions that the competition authority seeks to identify and prevent. To understand why, it is useful to begin by dividing...
mergers into three categories based on their likely impact on the competitive process: horizontal, vertical, and conglomerate. Horizontal mergers take place between two firms that are actual or potential competitors—that is, they sell the same products or close substitutes. The term horizontal signifies that the two enterprises are at the identical level in the chain of production—for example, two manufacturers of steel, two distributors of beer, or two retailers of electronics equipment competing for customers within a given geographic area.

Vertical mergers take place between firms at different levels in the chain of production—firms that have actual or potential buyer-seller relationships. Examples include a merger between a brewer and a beer distributor (whether or not that brewer was using that distributor at the time), and a merger between a coal mine and an electricity generator. Finally, conglomerate mergers are neither horizontal nor vertical, that is, the firms neither produce competing products nor are in an actual or potential buyer-seller relationship.

Of course, mergers between two multi-product firms may be simultaneously horizontal, vertical, and conglomerate, and each aspect of the merger must be analyzed separately to understand the likely competitive outcome. Furthermore, even when a merger raises competitive concerns in one set of products, it may not in another set. In these situations, it may be possible to solve the competitive problems without having to prevent consummation of the entire merger. This solution is discussed below.

Do horizontal mergers hurt competition?

Almost all competition laws identify and prohibit two forms of anticompetitive conduct apart from mergers: abuse of a dominant position by a single firm and certain restrictive agreements by two or more firms. Anticompetitive mergers are those that significantly increase the likelihood of such conduct. Horizontal mergers are the most suspect in this regard, since, by definition, they reduce the number of independent competitors in a particular market. The anticompetitive effects of horizontal mergers can be separated into two broad categories: unilateral effects and coordinated effects.

Unilateral effects. A merger that has anticompetitive unilateral effects creates a single firm with substantial market power or significantly increases the market power already enjoyed by a single firm. In the worst situation a merger may create a monopoly. Even if a monopoly is not found, a merger could create a firm with high enough market power—or strengthen the position of a firm that already has market power—so that it can raise its price above the competitive level, to the long-lasting harm of consumers. In either case true market power requires not only a large market share but also barriers to entry, so that new firms, or existing firms operating in other markets, cannot easily enter the market in response to high prices and profits. In most countries mergers having this anticompetitive effect are the type frequently challenged by competition authorities.

Another type of anticompetitive unilateral effect may occur in markets with heterogeneous products. Heterogeneous products have distinctive characteristics, for example, technical specifications or brand image, that appeal more to certain buyers than to others. Thus even in a market in which many products compete and are reasonably close substitutes for each other, some may be closer substitutes than others.

In such circumstances different competitors operate as more or less binding constraints on a particular seller's pricing (for which pricing is a shorthand for all competitive behavior). If that seller were to raise its price unilaterally, it would expect to lose some sales to all firms in the market. But it would lose most sales to competitors that produce the closest substitutes.
Thus a merger between two competitors selling products that are close substitutes is likely to be most attractive to the firms involved and most dangerous to competition. Following the merger, if the firm raises its price, a large percentage of the sales that would have been lost are now kept within the same firm. The closer is the acquired product as a substitute, the more is the constraint on pricing eased by the merger, and the more likely is the result of the merger to be a unilateral increase in price for at least that product (and likely the product of the acquired firm as well). Under these circumstances, a horizontal merger may be challenged even if there are several firms operating in the market.

**COORDINATED EFFECTS.** The concerns of coordinated effects are somewhat different. A horizontal merger may reduce competition by making it easier for the firms remaining in the market to coordinate their behavior—the competitive price, quantity, and quality may not be reached. Rather, such firms earn some amount of monopoly or oligopoly profits for themselves. Examples of such coordinated behavior include both explicit and implicit agreements over the price to be charged, which seller to serve a given geographic territory, and which seller to serve particular customers (for greater detail, see Chapter 3, Agreements). One popular paradigm holds that for such an agreement to be successful it must meet four conditions:

- All significant firms in the market must be persuaded to join the colluding group.
- These firms must then be able to agree on their future anticompetitive behavior (on what price to charge, for example).
- The firms must be able to detect whether a participating firm is cheating on the agreement in order to gain more than its fair share of sales (for example, by charging a price slightly lower than the agreed price but still higher than the competitive price).
- The firms must be able to collectively punish such a cheating firm so as to maintain the terms and coherence of the original agreement.

Experience has shown that such anticompetitive agreements are more likely to occur and be successful in industries having certain characteristics: product homogeneity, open bidding, frequent sales in small volumes, and similarity of costs among firms. Moreover, given such characteristics, reaching and maintaining an explicit or implicit agreement is easier for a smaller number of firms than for a larger group. Thus in certain industries mergers may make it more likely that the remaining firms will engage in coordinated anticompetitive behavior.

A special case of horizontal mergers that sometimes causes concern is that in which the merging parties are judged to be potential rather than actual competitors. A firm that is not actually selling in a market but is perceived as a likely future seller—and may be poised to enter the market if prices rise sufficiently—is likely to have a salutary effect on the competitive behavior of firms already in the market. Of course, it is not always easy for existing competitors or competition authorities to evaluate the intentions of an enterprise that is not currently operating in the market. One often useful strategy is for competition authorities to examine the documents of the enterprise already in the market that analyze and counsel action based on the state of market competition. If the potential competitor has an impact on the behavior of the incumbent competitor—if its likely reaction is taken into account when the incumbent determines its pricing or marketing strategies—the documents should demonstrate this.

A merger between an important competitor and an important potential competitor, especially if no other firms are similarly poised, could remove the competitive discipline provided by the potential entrant. Experience shows that the loss of potential competition is likely to be of greatest concern when a dominant domestic firm
is acquired by an important multinational firm that produces the same product. Similarly, if geographic markets are local or regional, important potential competition may be provided by a significant seller of the same product in a nearby market. Note, however, that if other significant potential entrants remain after such a merger, the loss of potential competition is not likely to be significant.

**Can vertical mergers be anticompetitive?**

Vertical mergers are less likely to result in a loss of competition because they do not immediately reduce the number of competitors in a market. Economic and legal research in the past quarter century has greatly improved our understanding of the motives behind vertical agreements, including vertical mergers, demonstrating that such agreements are often beneficial to both firms and consumers. For example, they may facilitate long-term investment, enhance product quality, and enable new firms to enter the market. Nevertheless, circumstances exist in which vertical mergers may hurt competition, and these circumstances may arise relatively more frequently in developing and transition economies.

A vertical merger may enhance a dominant firm’s position by increasing the difficulty of entering its market. Consider a dominant or monopoly firm that manufactures a particular product. A smaller competitor considering expansion, for example, by building a new manufacturing facility, may need to purchase certain critical raw materials. Similarly, a potential entrant may need to contract with suppliers of warehousing, transportation, or distribution services in that market. If the dominant firm merges with suppliers of critical inputs or services, it may be able to deny these products or services to potential competitors and thus protect (or entrench) its dominant position.

Such a vertical merger may immediately harm consumers if the potential competition from one of these outside firms was constraining the pricing of the dominant firm. What is more likely is that the merger will harm consumers in the future. Potential entrants, already facing the difficult prospect of competing with a dominant local manufacturer, now would have to acquire more distant raw materials or set up their own transportation and distribution systems. Market entry in transition economies is often made difficult by more generalized factors, such as poorly operating markets for capital, land, and labor (see Annex 1, Barriers to Entry). The necessity of entering a market at two levels instead of one—say, at both the manufacturing and distribution levels—may exacerbate some of these problems and act as an effective entry barrier. Antimonopoly authorities may challenge vertical mergers if they are convinced that such mergers are motivated by a desire to entrench a dominant position.

The most important condition needed to challenge a vertical merger on these grounds is that one of the parties occupy a dominant position in its market. A second necessary condition is that control of the vertically related market by the dominant firm could increase the barriers to entry into its own market.

Another anticompetitive effect of vertical mergers is that they may facilitate collusion among firms at a given level in the manufacturing or distribution chain. Imagine, for example, that two manufacturing firms want to collude on price. If they sell a significant portion of their output to, say, wholesalers, who are free to choose their own resale prices, then one of the four conditions listed above for successful collusion may not exist: if prices diverge at the retail level, the manufacturing firms may be unable to determine with certainty whether the divergence arises because one of the firms is cheating on the cartel or simply because downstream sellers use differing markups. Acquisition of these downstream sellers might be a solution to the manufacturers’ problem and thus may worry competition authorities.
Rarely, however, is a vertical merger challenged on the grounds that it will facilitate collusion. Absent direct evidence of anticompetitive intent by the merging parties, there should be good evidence, based on the four conditions listed above, that collusion is possible and would be much more likely to occur after the merger.

Should authorities fear conglomerate mergers?

Competition authorities in most countries tend to ignore conglomerate mergers, which have neither horizontal nor vertical components. By definition these mergers involve firms operating in unrelated markets. There are a few exceptions, however.

First, in some quarters there is a fear of conglomerate firms in general, not because of their conglomerate nature per se but because of their size. The fear is that certain firms may become so large, especially in terms of assets, that they have an advantage over other firms in the competitive process: they will be able to finance larger advertising campaigns, for example, or survive longer periods of intense price competition, even to the point of predation, because of the deep pockets they have accumulated.

Although predatory behavior is certainly a concern of competition authorities, the simple fact of a firm's large size is seldom sufficient to justify action. Conglomerate mergers are rarely challenged on these grounds. Authorities widely believe that well-operating capital markets will allow other firms to finance expansion to compete with larger rivals if expansion is economically justified.

But in countries where capital markets do not work smoothly, the concern over conglomerate mergers could be more pressing. Some economies are characterized by a few large groups of diversified enterprises containing, in addition to manufacturing and service firms, large financial institutions. Absent efficient capital markets, the members of such a group may enjoy a competitive advantage over rivals in their ability to obtain capital on more favorable terms. In this case the analysis of conglomerate mergers becomes theoretically indistinguishable from that of vertical mergers. Financial capital becomes the input in short supply its control by a dominant firm may render entry more difficult. The conglomerate merger that forms such groups may then become competitively suspect.

A concern has been expressed in some quarters that conglomerate mergers can enhance the likelihood of "mutual forbearance." If conglomerate firms compete with each other in more than one market, each firm may decide independently to compete less vigorously with its conglomerate rival in a market in which it is strong because of fears that the other will retaliate in a market in which it is weak. A live-and-let-live policy may develop that is comfortable for the two firms but not beneficial for consumers. This theory is not often employed against conglomerate mergers, however, as there is usually no credible evidence that such an effect is likely to result from a merger.

How are mergers analyzed?

Since most mergers do not harm competition seriously and are themselves part of the competitive process, competition authorities must examine them quickly, particularly if a decision needs to be made before the merger is consummated. There are two basic stages in merger inquiries. The first is to determine whether the merger raises any competitive concerns. This determination can be achieved without a full analysis, and in most cases the competition authority will not take further action. But if the possibility of competitive harm is identified, a more complete examination is required. At any stage in the analysis, however, the competition authority may conclude that there is no basis for concern. At that point the investigation should be closed, both to conserve the scarce resources of the agency and to avoid
unnecessary delay in completing what could be an efficiency-enhancing transaction.

Most merger control laws are written generally. They declare that mergers are unlawful and should be blocked by the competition authority if they will "substantially harm competition." It is left to the competition authority to interpret and employ this broad standard. Given that most mergers do not harm competition, the analysis is necessarily complex. Some competition authorities have issued guidelines describing to the public the process that they will use in analyzing mergers, especially horizontal mergers. Although these guidelines differ in detail, they are broadly consistent in their approach. A well-known example is the five-step process contained in the 1997 U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines. (An excellent discussion of these guidelines is found in Ordover and Willig 1993, 139–50.) The five steps are:

- Market definition and description.
- Identification of firms that participate in the relevant market and their market shares.
- Identification of potential adverse effects from the merger.
- Analysis of ease of market entry.
- Identification of efficiencies that might arise.

**Market definition and description**

A market may be loosely defined as consisting of all goods that are close substitutes from the customers' point of view. (Of course, many customers are firms, not individuals.) The commonly accepted view is that there are two components to a market: product and geographic. Often a product market is defined first—based on which products customers consider close substitutes—and then a geographic market is defined—based on the ability of customers to purchase from different production locations. Substitutability and location are determined most accurately by the reactions of customers to relative changes in prices or sources of supply. Developing a detailed description of the chain of supply, from raw materials and manufacture to ultimate consumer, is helpful for setting the relevant market in context.

No aspect of merger analysis is more important than market definition. Frequently, how the market is defined determines whether a particular merger is judged anticompetitive and unlawful. A market that is defined too broadly, for example, can result in either of two types of errors. Two firms may be judged to be competitors when they are not, resulting in an erroneous decision to prevent a merger that is not anticompetitive. Or, a merger of two competitors may be considered insignificant, resulting in an erroneous decision not to prevent an anticompetitive merger. Similar errors can occur when markets are defined too narrowly.

Consider this example. In 1986 in the United States the Coca-Cola Company announced its intention to purchase the Dr. Pepper Company and merge their operations. Each company manufactured carbonated soft drinks with different flavors. The authorities could have determined that the relevant product markets were relatively narrow, one such market consisting, for example, solely of cola drinks. In that case the two firms would not have been actual competitors, and the merger probably would not have been anticompetitive. On the other hand, the authorities could have defined the relevant market much more broadly, including several types of beverages, such as carbonated beverages, coffee and tea, fruit juices, milk, and even water. Then, the two firms would have been competitors, but in a market so large that their merger could not be considered anticompetitive.

The U.S. Federal Trade Commission investigated the proposal and concluded that the two firms competed in a market that it labeled "carbonated soft drinks." In that market Coca-Cola
was the largest firm with more than 37 percent of U.S. sales in 1985, and Dr. Pepper was the fourth largest firm (after PepsiCo and Philip Morris, producer of Seven-Up) with almost 5 percent of U.S. sales. The commission argued that the merger would significantly reduce competition and asked a court to prevent it. The court determined that although there might be some competition among several different types of beverages, in fact the principal competition to Coca-Cola was other carbonated soft drinks, and that such drinks constituted a market. The court ordered that the merger not take place. (For a more detailed discussion of this case, see White 1994.)

**Identification of relevant firms and their market shares**

Much of competition analysis is forward looking, particularly in merger analysis, in which the purpose is to identify the likely future effects of a transaction. Thus firms considered to be in the relevant market include not only those that currently sell there, but also those that could easily begin to sell there through "production substitution"—switching production from one product to another. Likewise, the market shares of firms already producing in that market should be calculated in a manner that best characterizes their future significance.

Mergers that occur in unconcentrated markets or that do not greatly increase concentration are not likely to hurt competition. The concentration analysis is a useful screen, for use in identifying relatively quickly which transactions may be benign. While it is difficult to generalize about what level of concentration will generate concern in different countries, a merger that gives a firm a market share exceeding 35 percent or that involves a firm that already has a market share greater than 35 percent probably merits further inquiry. The competition community generally agrees, however, that a significant increase in concentration resulting from a merger is not itself a sufficient basis for preventing the merger. The competition authority must go further and determine the likely competitive effects of the transaction.

**Identification of potential adverse effects**

Within the category of harmful horizontal mergers, those that create or enhance a dominant position are the most common, especially in transition or developing economies. There, markets are likely to be highly concentrated initially, often because privatization has resulted in a single leading or dominant firm. Mergers or acquisitions by such firms, especially of new and potentially more efficient competitors, may raise concerns. Careful inquiry should be made, however, into whether the resulting firm would in fact be dominant after the merger. Although it might be much larger than its rivals, much of its capacity could be inefficient and outmoded. Then, conditions for entry and expansion of smaller firms are critical to the analysis.

The second type of anticompetitive unilateral effect discussed above occurs in markets characterized by differentiated products. It can be illustrated by a recent merger of bread companies in the United States. In many geographic markets the two enterprises that proposed merging were the leading producers of branded white bread sold in grocery stores. Other products did arguably offer some competition, including other brands of white bread, "private label" (for example, store brands) white bread, white bread freshly baked in the grocery store, and other kinds of bread (rye, wheat, or potato). But information received from both the merging parties and their customers made it clear that the two brands were the closest competitors to one another and that each engaged in competitive behavior targeted against the other that benefited consumers. The U.S. Department of Justice feared that in the geographic markets in which the two firms dominated, the merger would lead to price increases for both products,
since sales lost from one brand to the other would now be internalized by the merged firm. The department sought and won a settlement leading to the divestiture of brands and, where necessary, physical assets to other bakers in those locations.

Finally, horizontal mergers may increase the likelihood of collusion or other anticompetitive coordination. Such mergers may be observed in transition or developing economies when newly privatized enterprises, uncomfortable in a competitive environment, seek ways to return to more familiar cooperative arrangements.

Assessing probable competitive effects is difficult. The inquiry cannot be conducted in a vacuum; it must be made in the context of the affected market. Thus the competition authority should seek information from enterprises actually or potentially participating in that market, including the internal documents of the merging parties. However, the views of the merging parties should also be considered. Their bias in favor of the merger is obvious and must be taken into account. But they can still offer important insights into market operations.

Barriers to entry
In merger analysis as in other areas of competition policy, particularly those involving issues of dominance, the entry analysis can be critical to the outcome of the investigation. A merger could make certain anticompetitive conduct more likely, but if attempts at such conduct would be defeated within a reasonable period of time (such as two to three years or sooner) by new entry, the merger cannot be considered anticompetitive. Thus entry analysis attempts to determine whether and how quickly new firms would enter the market in response to the hypothesized anticompetitive activity.

Firms that could quickly and easily begin production in a market can be considered market participants since they are assumed to already influence the market. The entry analysis attempts to determine the extent to which firms not currently influencing the market would choose to enter following anticompetitive activity. The question is commonly structured as follows: if, after the merger, prices in the relevant market rise above competitive levels by a noticeable amount, would new entry occur quickly enough and at a sufficient scale to make it unprofitable for current sellers to sustain the higher price?

Consider the most important parts of this question more closely:

- **Price increase.** The price increase of concern is often described as one that is "small but significant and nontransitory." The specific example that is often used is a price increase of 5 percent that will last "for the foreseeable future." But this guide may be changed in particular circumstances. Also, the hypothesized price increase should be real, not simply inflationary.

- **Likelihood of entry.** Entry must be likely to take place following a price increase. Authorities can identify domestic or foreign firms that may be candidates for entry and interview their officials to learn more about that possibility. If the initial analysis suggests that entry is likely, but no firm can be found that would be interested in entering under the conditions hypothesized, another barrier to entry may exist that has not been identified.

- **Timeliness of entry.** Firms must be likely to enter quickly enough so that consumers are not significantly harmed by the loss of competition. Two years is often given as a criterion for timeliness, though in some cases—especially in durable goods markets—a longer period may be appropriate.

- **Sufficiency of entry.** Entry that is likely and timely must also be of sufficient scale to counteract the loss of competition that would otherwise take place following the merger.
**Efficiencies defense**

Most competition laws provide for some form of efficiencies defense. Competition experts generally agree that a merger that would significantly harm competition should nevertheless be allowed if the benefits to the public (sometimes called efficiencies) are of greater magnitude than the losses to competition. There is no consensus, however, on the specific elements of the defense. What types of efficiencies should be recognized, and how should they be measured? How should public benefits be balanced against the harm to competition? Must the efficiency gains be passed on to consumers as lower prices or better products rather than simply enjoyed by producers as lower costs and higher profits?

Identifying and quantifying efficiency gains is technically challenging. Quantifying the expected harm from the loss of competition may be even more problematic. Furthermore, most countries pose an additional requirement that the proposed merger be the least anticompetitive means of achieving the efficiencies. This means that an inquiry into alternatives must also be undertaken.

Although it is difficult for competition authorities to consider the issue of efficiencies explicitly, they should do so in appropriate circumstances. Efficiency considerations could be implicitly recognized in the standards used for determining anticompetitive mergers. Standards that are set sufficiently high, that is, standards that prohibit only mergers that are clearly anticompetitive, automatically authorize most efficiency-enhancing transactions without requiring explicit consideration of the issue.

A special form of efficiencies defense is the so-called failing-firm defense. For example, if a firm is about to go out of business, it is difficult to see how consumers would be worse off if its assets were purchased by a competitor rather than be allowed to leave the market. In many countries mergers that would otherwise be considered anticompetitive are approved if they meet the requirements of the failing-firm defense. However, just because a firm is about to go out of business does not necessarily imply that its productive capacity will leave the market. Thus the law in many countries imposes four conditions on the defense:

- The firm will be unable to meet its financial obligations in the near future.
- The firm will be unable to reorganize successfully under bankruptcy laws.
- The firm has made good-faith but unsuccessful efforts to find alternative purchasers who would keep the assets in the relevant market and not reduce competition as much as the proposed merger.
- Without the merger, the firm's assets would leave the relevant market.

**WHAT INFORMATION IS RELEVANT TO MERGER INVESTIGATIONS?**

Access to relevant information is the most important factor for ensuring that a merger assessment is accurate. In a world with perfect information an enforcement agency would need to examine only the demand and supply functions facing the merging parties to assess whether the merger would likely harm competition substantially. Unfortunately, enforcement agencies do not live in such a world and must turn to indirect sources of information.

**Assessing demand and supply**

It is important to know both demand and supply conditions to accurately predict the competitive behavior of firms. Knowing only the premerger costs of the parties and their premerger markup over costs is not sufficient to predict postmerger competitive behavior. One also needs to know how buyers and competitors will react to a firm's attempts to raise prices. If a sufficient number of buyers will turn to alternative sources of supply and make a price increase unprofitable then the merger is not like-
ly to harm competition substantially. This is true even in cases in which the postmerger market share appears to be high.

To assess demand and supply conditions, enforcement agencies must obtain the following information:

- The identity, views, strategies, and behavior of buyers and competitors.
- End uses, and physical and technical characteristics of the relevant product(s) and their close substitutes.
- Costs to buyers of switching to close substitutes.
- Costs to competitors of adapting or constructing production processes and distribution and marketing systems.
- The existence of second-hand, reconditioned, or leased products.
- Price relationships and relative price levels.
- Shipment patterns.
- Transportation costs.
- Production and sales of the relevant product over several years.
- Methods, costs, and time horizons required for entry into the relevant market.
- Regulatory practices and other government constraints.
- Foreign competition.
- Change and innovation in the industry.

This information is necessary for defining the product and geographic market, identifying competitors, calculating market shares, and determining the likely competitive effects of the merger and conditions of entry.

**Considering the special case of foreign competition**

In many countries foreign competition is an important factor constraining the ability of domestic firms to exercise market power. In theory, foreign competition can be considered when delineating market boundaries. In practice, however, it is often dealt with separately. A number of factors are specific to the assessment of foreign competition.

Foreign firms may not sell to domestic markets because of tariffs, in which case it is important to assess whether the tariff would continue to constrain entry following a postmerger price increase. Ordinarily, the significance of foreign firms to domestic competitors varies directly with the level of the tariff. Also, import quotas and voluntary restraint agreements place a ceiling on the extent to which foreign firms may participate in the domestic market. If foreign competitors are currently at or near their quota limits, they cannot be relied on to provide additional competition in the domestic market after a price rise.

In some cases import quotas are calculated as a percentage of a product's total domestic sales. The effect of such quotas could be to reduce imports after imposition of an anticompetitive price increase in the domestic market. Such a price increase is achieved by a reduction in output, which has the effect of reducing the volume of imports from the country subject to the percentage quota.

In addition to tariffs and quantity restrictions, a number of other factors could limit the effectiveness of foreign competition:

- Regulations that impose product-quality or labeling standards and specifications or that impose license or permit requirements.
- Difficulty in meeting demands for service, spare parts, or delivery.
- Threats of antidumping actions or countervailing duties.
- Government procurement or other "buy local" policies.
- Foreign ownership restrictions.
- Exchange rate fluctuations.
- Formal and informal arrangements for global market allocation within multinational enterprises that have domestic affiliates or among independent multinational firms.
- International product standardization within such enterprises.
• Terms of license, franchise, and noncompetition contracts between foreign firms and their domestic subsidiaries.
• Conditions in the home markets of foreign competitors.
• An industry's susceptibility to supply interruptions from abroad.

It may be the case, particularly in transition and developing economies, that artificial constraints on foreign entry have only recently been removed, so that foreign competition in domestic markets may not be an issue at present. But conditions may be right for such entry in the near future. Relevant factors include:
• The existence of cross-border distribution systems.
• The amount of information that domestic buyers have about foreign firms.
• Whether foreign suppliers have been placed on approved sourcing lists.
• The existence of significant excess capacity held by foreign firms.
• The similarity between the needs of domestic buyers and the needs of customers of foreign firms.
• Exchange rate trends.
• The existence of technology licensing agreements, strategic alliances, or other affiliations between domestic buyers and foreign firms.

Finally, the efficiencies and failing-firm defenses require specialized information. If efficiencies are being advanced as a rationale for the merger, the enforcement agency must obtain information related to the projected cost savings, the time frame needed to achieve these savings, investments or other costs required, and possible alternatives to the proposed merger as means of achieving the savings. If one of the parties to the merger is claimed to be a failing business, the enforcement agency must obtain detailed information relating to the firm's current and projected financial health and to the firm's efforts to solve its financial problems in ways other than the proposed merger.

WHAT ARE THE SOURCES OF RELEVANT INFORMATION?

Several sources of important information in a merger inquiry are available, including the merging parties, existing and potential competitors, customers, suppliers, and public and government sources. In a comprehensive merger investigation no single source is sufficient. Moreover, there may be different sources within a given class, such as large and small customers, requiring the enforcement agency to seek information from a cross-section of participants. Although publicly available information is useful to enforcement agencies, a comprehensive inquiry almost always requires access to private, confidential, and commercially sensitive information. Therefore, the enforcement agency must be able to safeguard confidentiality for parties that provide such information.

Merging parties

The first source of information sought—and often most important—is the merging parties. The parties' initial submissions often allow enforcement agencies to determine quickly whether the merger in question will require detailed examination. Since most mergers do not threaten competition, it is often possible to make such a determination solely from this information, assuming it is truthful and complete, or together with other publicly available information.

In some cases the merging parties are asked to provide more detailed information regarding their business activities. Enforcement agencies ask questions about internal matters such as product lines, customers, suppliers, and market shares and about external matters such as the relevant market, competitors and their market shares, the availability of substitutes, the role of foreign and potential competition, the nature of innovation and change in the market, and the extent of government regulation.
How the competition authority obtains information from industry participants, including both the merging parties and third parties such as customers and suppliers, varies across countries. The means selected depend on the legal tools that are available to the agency to extract information as well as on prevailing business practices. Usually, the most important source of information from the merging parties is their business documents. Assuming that such documents were prepared in the ordinary course of business and not specifically for the merger investigation, they are usually highly credible and may provide important insights into issues such as market definition and possible competitive effects of the transaction.

The parties may also provide information that they have created specifically for enforcement agencies. This information obviously may be biased, but it should also be given careful consideration. In some cases the enforcement agency may want an officer of the company to take an oath attesting to full compliance. Enforcement agencies should also be prepared, if necessary, to use their subpoena powers where possible.

Since the information required is usually commercially sensitive, each party may be encouraged to make its submission separately. Although the parties may need to cooperate to provide some information (for example, relating to possible overlapping product lines, or to efficiency claims), the exchange of confidential information should be limited as much as possible. Information exchanged during merger negotiations that do not ultimately result in a consummated transaction may later facilitate collusion and thus violate the provisions of competition law relating to restrictive agreements.

**Third parties**

Industry contacts other than the merging firms—third parties—are also important sources of information. Buyers, for example, can provide information on market definition. Actual and potential competitors can help the investigator learn about entry conditions. (See the appendix at the end of this chapter for a sample list of questions used by officers of the Canadian Competition Bureau when contacting competitors and customers of the merging parties.)

On balance, third parties may be considered more objective than the merging parties, but the investigator should be aware of these parties' interests in the outcome of the investigation. For example, if competitors believe that a merger will significantly reduce competition, it is in their interest that the merger be approved. Conversely, if the merger will increase competition by creating a more efficient firm, competitors would prefer that the merger not take place. In these situations the information or opinion provided by the competitor may be biased, although the investigator should not automatically assume so. Still, objective information provided by competitors, such as sales volumes or costs of entry, is more reliable than subjective information, such as an opinion about the possible effect of the merger. However, buyers are more likely than competitors to take an interest in preserving competition and reaching efficient outcomes in the market. Their views about the effects of a given merger ordinarily carry greater weight with the competition authority.

Enforcement agencies may contact third parties in several ways. As with the merging parties, letters may be sent to market participants seeking their response to questions, or internal business documents may be sought. Such information may be provided voluntarily or by way of court order or subpoena. Telephone interviews may also be used in addition to, or in lieu of, letters or subpoenas. Also, it is not unusual for third parties to initiate contact with enforcement authorities. Any such complaints should receive careful attention from the investigator.
Authorities should make efforts to request only relevant information. Requests that are unnecessarily broad impose burdens on the party that must assemble and produce the information and on the competition agency that must review it. In particular, a merger investigation should not be used to look into other matters. The agency should be willing to discuss the request for information with the parties in advance so as to eliminate unnecessary burdens. The process of gathering and verifying information may be a continuous one, involving many interactions between the parties and the enforcement agency in the course of the investigation.

In more complex cases it may be necessary to consult industry or economic experts in addition to industry participants. Experts may be needed to fully explain the structural and behavioral characteristics of an industry, particularly one in which the agency has no previous experience. In addition, experts are often consulted when the failing-firm and efficiencies defenses are invoked.

If the competition agency has sufficient concerns to seek to prevent the merger, it should discuss these concerns with the merging parties before making a final decision. The agency should do so without disclosing confidential information or internal deliberative processes and invite a response. These discussions are almost always useful. The agency may have erred in its analysis—and, if this is so, it is far more efficient and fair to correct the error before formal proceedings have begun rather than after. Further, such discussions in advance of formal proceedings could, if the applicable laws and procedures permit, lead to a settlement without the need for formal proceedings or appeals.

**WHAT ARE EFFECTIVE REMEDIES FOR MERGERS?**

The merger control laws in most countries do not include punitive remedies, such as fines, for anticompetitive mergers. Instead, the goal is simply to remove the anticompetitive threat to the marketplace. The means for achieving this end can be separated into three categories: prevention of the merger in its entirety, or if the transaction has been consummated, full dissolution or breakup of the merged entity; partial divestiture of assets or operations sufficient to eliminate the anticompetitive effects, while permitting the underlying transaction to proceed; and orders regulating or modifying the conduct of the merged firm to prevent the feared anticompetitive effects. The first two remedies can be considered as structural, the third behavioral. Structural remedies are generally preferred. They are more effective in the long run and, equally important, do not require continuing oversight or regulation by the competition agency. It is strongly advised that structural remedies be implemented before consummation of the proposed merger. It is difficult and time consuming, and at times impossible, to undo a merger after it has occurred.

**Structural remedies**

If a merger is judged to be anticompetitive, its prevention is obviously an effective remedy, and often the most appropriate. But in some cases it may be possible to restructure the transaction to eliminate its anticompetitive aspects. For example, one or both of the merging firms may operate in many markets (product or geographic), but the merger may be anticompetitive in only a few. If assets could be divested in those few markets so that competition is maintained, the merger could be permitted. This partial divestiture remedy is becoming increasingly common in many countries, though it is not always easy to accomplish. Legal, institutional, and business frameworks conducive to such complex transactions must be present.

The first task of the enforcement agency when considering a partial divestiture is to identify a package of assets that can be divested to ensure sufficient competition in the affected mar-
markets. If the divested business is to operate as a separate, stand-alone competitor, the asset package must be viable and able to profitably operate as a going concern. Alternatively, assets could be sold to an entity already operating in the relevant industry. That firm could use the assets to enter new markets or to compete more effectively in its present markets. Viability as a stand-alone operation may be less important in that situation. If only a single asset is to be divested, such as a brand name, the purchasing firm must have additional resources—financial, managerial, production facilities, sales organization—to successfully use the asset. Thus there are three considerations in assembling an asset package for partial divestiture: the package must ensure adequate competition in the affected markets after divestiture, the package must be commercially viable, and the package must be of sufficient size and potential profitability to attract prospective purchasers.

As noted above, if a merger is to be stopped, it should be stopped before consummation if possible. The same is true of partial divestitures: the policy of “fix it first” is desirable for at least three reasons. First, if a partial divestiture proves to be impossible, the entire merger can still be blocked. Second, the merging parties have a strong incentive to complete the divestiture so that they can proceed with their merger. Third, the merger cannot have harmful anticompetitive effects before the divestiture is completed. In some cases, however, the merger may have been completed without the agency’s consent. Or, the parties may convince the agency that it is impossible to delay consummation until divestiture is completed and that they should be permitted to complete the merger and sell the assets afterward. The agency should agree to such an undertaking only if it has confidence that the sale can be accomplished quickly and effectively, and if other safeguards exist.

It is far preferable that a divestiture be completed before consummation of the underlying merger. Otherwise, an agency should use this remedy only when it is confident that a sale to an acceptable purchaser can be achieved quickly. The agency should adopt standardized procedures for divestitures, from which it rarely deviates. As agencies gain experience with partial divestitures, it is likely that they will employ this remedy more frequently than any other.

Safeguards. Principal among the safeguards that should be insisted upon if a merger is allowed to go forward before a divestiture is completed is an agreement by the parties to “hold separate” from the merged firm the assets to be divested. A hold-separate agreement will help to ensure that the value of the business to be divested is not eroded. It will also reduce the opportunity for coordinated conduct between the merged enterprise and the divested entity following the divestiture and will heighten the merged firm’s incentives to complete the sale quickly. Finally, it will ensure that the merger does not harm competition before divestiture is completed. The hold-separate agreement should require that the business to be divested operates apart from the rest of the enterprise, usually with different managers, and that the business is supplied with adequate resources including capital to maintain its value and competitiveness.

Other safeguards that are important when the underlying merger has been consummated include agreements on the timing of the divestiture and for a third party, or trustee, to assume responsibility for the sale if the parties are unsuccessful after a brief time (discussed further below). The agency may also require that the merged enterprise hold separate a particularly valuable part of its operations, but not a part slated to be sold to another party. This is known as a “crown jewel” provision. The enterprise will be able to take possession of the crown jewel only after the divestiture is completed, creating a strong incentive for the firm to divest quickly.
Procedures. It is important that effective and impartial procedures for carrying out the divestiture be devised. These procedures will of course be subject to prevailing business practices in each country. Common issues include: Who will conduct the negotiations and sale? What is the role of the competition agency? How will the price for the divested assets be determined? How much time will be allotted for completion of the sale? How can the divestiture agreement be enforced?

In principle one or both of the merging parties, depending on which is the owner of the assets to be divested, may conduct the sale. The parties are intimately familiar with the assets and could efficiently identify potential purchasers. Moreover, if completion of the underlying merger is made contingent on a successful partial divestiture, the parties have a strong incentive to work quickly. In some countries, however, the merging parties are given only a relatively short time to complete the sale (for example, six months), particularly if the merger has been consummated, after which an independent third party assumes the obligation. This offers another incentive to the merging parties to complete the sale as quickly as possible.

The competition agency has two principal interests in the purchaser: it must have the ability and intent to operate successfully in the relevant market and the divestiture itself should not be significantly anticompetitive. The agency should retain the right to veto any proposed purchaser or any other aspect of the sale that threatens to undermine these requirements. Otherwise, the agency should not interfere with a divestiture agreement arranged by the merging parties or by an independent third party. The seller is entitled to receive the highest possible price for its assets but should not be able to impose a minimum price. A price lower than the liquidation value of the assets should be avoided, however; otherwise the purchaser may liquidate the assets rather than operate them competitively. This problem can be avoided initially by selecting an asset package that is demonstrably viable.

The amount of time needed to successfully complete the divestiture depends to a great extent on prevailing business practices in each country. It is obviously important that the divestiture take place as quickly as possible to avoid a diminution in the competitiveness of the assets in the relevant market. In countries where the divestiture remedy is often used, 12 months is usually the longest divestiture period allowed. It may be as short as three to six months.

The ability of the competition agency to enforce a divestiture agreement is obviously important. Applicable laws and procedures should enable the agency to apply to the courts for sanctions or remedial orders if the parties do not observe their obligations. Absent such enforcement mechanisms, the divestiture process may break down at some point, especially if the underlying merger has been consummated, leaving the agency with no viable alternative for effective relief. For its part, the agency should monitor the divestiture process closely. It may have developed its own criteria for an acceptable purchaser, which it can share with the seller.

Behavioral remedies

The third type of relief in merger cases is behavioral—imposing orders or obligations on the merged entity to modify or limit its future conduct. Such orders might include obligations to supply a product or service to a certain class of customers for a period of time, or obligations to refrain from entering into certain types of contracts, such as requirements contracts, or, at the extreme, obligations not to raise prices by more than a specified amount for a period of time. Such orders are usually less satisfactory than structural relief. Most of them are excessively regulatory, especially those that purport to control prices or output in some way. They require continual oversight by the competition agency, preempting scarce resources that should be
devoted to more important matters. Also they may be rendered ineffective, irrelevant, or, at worst, competitively harmful over time as market conditions change.

Where the behavioral order is used, it should prescribe a discrete mode of conduct that can be easily monitored, and the obligation should be set for a specified, limited period of time. In Canada, for example, a merger was approved on the condition that the parties work toward the removal of tariffs that were limiting imports of the relevant product into Canada. The Canadian Competition Tribunal's order also held that if the tariffs were not removed within a fixed period of time, the parties would be required to divest an important manufacturing plant. The designated plant was held separately during the interim period. Following this order, tariffs were removed within the scheduled period, and these imported products established a presence within Canada.

A common type of behavioral remedy employed in several countries is a requirement that the merged enterprise license a relevant portion of its proprietary technology to other firms as a means of introducing new competition. In fact, such a remedy is more structural than behavioral: technology is a form of property—intellectual property—and licensing such property is a form of divestiture.

**What are the details of premerger notification?**

Most merger control laws require premerger notification, that is, notification of an intent to merge in advance of consummation. The purpose of such a requirement is obvious: to permit the authority to investigate the transaction and, if necessary, to prevent or amend it before it is consummated. Premerger notification laws vary among countries, reflecting different economic and political conditions. But many such laws have several aspects in common.

Not all mergers need be notified in advance. Such a requirement would add a significant and unnecessary compliance burden for the business community and an equally unfortunate burden for the competition agency, which would have to review the notifications. Experience has shown that usually only larger mergers pose significant risks to competition. Thus the law should set a minimum threshold size below which mergers need not be reported. The size threshold, or thresholds, may be expressed in terms of annual sales (turnover), total assets, or both. The size of the transaction (the value of the securities or assets to be acquired or merged) and the size of the parties (minimum size of either party) should be incorporated into the threshold. The threshold should be expressed in a way that permits, if possible, automatic adjustments for inflation (for example, x% minimum wages).

The law (or implementing regulations) should specify the information that must be supplied with the notification. In most countries the initial notification is not extensive. It should contain enough information to alert the competition agency to possible competitive problems. The agency will then gather additional information in order to make a more informed decision. The initial premerger filing usually contains the following information:

- Names and addresses of the firms involved in the transaction.
- Description of the transaction, for example, merger, acquisition of assets or shares, joint venture; the value of assets or shares acquired; and copies of any relevant documents relating to the transaction, such as the merger agreement.
- Timing of the transaction.
- Financial information on the merging firms, including sales or turnover and total assets, and copies of relevant annual or other financial reports.
- Details of the organizational structure of the merging firms and of affiliated firms,
and details on significant ownership interests.

- Description of the products and services supplied by each firm.

In some countries the following information is also required in the initial filing:

- A description of the relevant markets served by each firm and their shares in each.
- The reasons for the merger and its expected benefits.
- Certain annual reports and financial statements and internal documents analyzing the merger prepared for corporate decisionmakers.

After the initial filing the parties are required to wait for a set period of time before consummating the transaction. This waiting period is customarily not long, perhaps a month or so. During the initial waiting period, the agency has the power to require that the parties submit additional, specified information. The issuance of this second request extends the waiting period further, while the parties gather the requested information and the agency reviews it. The law may provide that the waiting period is suspended until the parties substantially comply with the second request, after which the period again begins to run. This scheme provides a strong incentive to the parties to gather the information quickly and to make a complete response. However, the agency should not have unlimited discretion to extend the waiting period by repeated or overly technical requests for information.

The notification rules should allow the agency and the parties some flexibility to modify procedures. They could agree to extend the waiting periods, for example. Or, the agency should have the power to shorten the waiting period once it has determined that it will not challenge the transaction. The law should grant the agency the power to adopt rules and regulations after giving the public adequate notice to implement the notification procedures and provide exemptions from the reporting requirements for transactions thought unlikely to present competitive concerns. Finally, the law should set adequate sanctions, usually in the form of fines, to deter and punish violations of the notification requirements.

**NOTES**

1. The purchase by one firm of less than all of the securities of another may be considered a merger if it permits the purchasing firm to significantly influence or control the acquired firm. If the securities of the acquired firm are held by many shareholders, owners of a relatively small share of its securities—perhaps as small as 10 or 20 percent—may be able to significantly influence or even control the actions of the firm. The extent of control must be determined for each transaction.

2. On the other hand, the easier it is for other firms in the market to reposition their own products to replace the close competition that had been offered by the acquired product, the less likely it is that the merger will allow the merged firm to raise prices.

3. The principal evidence that the judge relied upon in reaching this decision was the internal marketing documents of Coca-Cola, which expressed continuous concern about the competitive reactions of sellers of other carbonated soft drinks to possible actions by Coca-Cola, but no concern regarding (or even mention of) the reactions of manufacturers of milk, coffee, or other drinks.

4. This does not mean, however, that mergers below the size threshold are not subject to the merger control law. The competition authority should retain the power to challenge such mergers, breaking them up after consummation if necessary or preventing their consummation if it learns about them in advance rather than through premerger notification. Some countries' laws permit the parties to submit voluntary notifications to the competition authority. The rules and procedures of the notification law apply fully to these voluntarily submitted notifications.

5. In some countries the notification threshold is expressed in whole or in part in terms of a mini-
mum market share; for example, a merger that results in a market share in excess of 25 percent must be reported. The difficulty with such a test is that it is subjective: it requires the merging parties to define the relevant market for purposes of notification of the transaction. Market definition is a complex exercise. The parties might define the relevant market or markets in such a way that notification is not required. Their market definition could be wrong, however, and even if done in good faith, it could result in failure to notify a potentially anticompetitive merger.

**REFERENCES**


Appendix 4.1

Sample Competitor and Customer Interview Guides

Note: Not all questions will be appropriate for any given interview. This list is intended to be a comprehensive one from which relevant questions or issues can be selected to fit the circumstances of each interview.

Sample Competitor Interview

Part I. Basic Company Information

1. Address of the company’s head office and branch offices and location of manufacturing plants and distribution centers.

2. General description of the company’s overall business, including product range, total sales, and asset value.

3. Ownership structure of the company.

4. Position of the individual being talked to and length of service with the company. If the individual has any concerns about talking openly over the phone, offer a letter or suggest that the individual get authorization from a superior within the company.

5. Identify whether the company has any connection with the merging parties that could influence its answers.

Competitors will often be concerned about discussing sensitive business information over the phone with a stranger. Thus it will be important to relay the confidentiality safeguards written in the competition legislation.

Part II. Product Market

Actual Competition

6. Does the company sell, in any market, products that could be considered substitutes to those of the merging parties under examination with respect to:
   - The company’s view.
   - Physical similarities.
   - Similar end use.
   - Same customer base.
   - Similar relative price.
   - Similar absolute price.
   - Similarity in manufacture, distribution, and marketing.

7. Regarding these factors, list the other companies that currently manufacture substitute products.

Potential Competition

8. Does the company currently have any plans to sell, in any market, products that could be considered substitutes to those under review? If so, when will they be available for sale?

9. Could the company sell, in any market, products that could be considered substitutes to those under review with respect to:
   - Cost of adding the requisite capacity.
   - Availability of the product or inputs into its production.
   - Patents or other proprietary rights.
10. If it could, what price rise or other conditions would be required to make the commitment, and when would the products be available for sale?

Competitors will often be guarded in their responses to questions concerning strategic plans, especially over the phone. Other than providing them with a description of the confidentiality safeguards available in competition legislation, in writing if necessary, there is little that can be done to ensure accurate responses. In other situations overly ambitious responses may be proffered. Then detailed questioning that focuses on the barriers to entry can often result in a more realistic estimate of the likelihood of entry.

**PART III. GEOGRAPHIC MARKET**

*Actual competition*

11. How is the product in question usually transported, what are the costs, and what percentage of average shipment value do they represent?

12. What is the maximum distance that the product under review can be profitably shipped?

13. What is the maximum distance that the product under review is regularly shipped?

14. What is the average distance that the product under review is currently shipped?

15. Where are your competitors’ plants located?

16. What is the extent of the geographic market served by the parties’ plants?

17. What is the extent of the geographic market served by each plant that you operate?

18. What is the extent of the geographic market served by each plant that your competitors operate?

19. Which other companies and plants undertake nontransitory shipments into the geographic market(s) served by the parties’ plants?

Where competitors actually ship, profitability is the best indicator of the current geographic market. Care should be taken when dealing with shipments that, because of transport costs, are not profitable. Although such shipments may not continue and therefore may not be a postmerger factor, some companies are willing to absorb some losses to maintain a presence in a market. In such situations an understanding of the reasons why this is the case should be gained before making a determination whether these shipments are likely to be transitory in nature.

*Potential competition*

20. Are there any characteristics that limit the distance the product can be shipped, such as regulatory restrictions, perishability, or a low value-to-weight ratio?

21. Are there any local set-up costs associated with first-time shipments into a new geographic market?

22. What price increase or other condition would be required before you would be willing to ship significant and nontransitory quantities into the nominal market? The nominal market refers to the geographic market comprising actual competitors as defined by questions 12–20. This market should be expanded to include potential suppliers that would ship into the proximate market within one year in response to a significant price increase.

23. Have you had any past shipments into the nominal market?

24. Do you have any plans to begin shipments into the nominal market in the near future?

25. Do you have sufficient production capacity available to ship significant and nontransitory quantities of the product into the nominal market?

26. What volume of the product would your firm have to ship into the nominal market to have an effect on prices?

27. Where are (other) potential competitors’ plants located?

As with competitors’ estimates of the relevant product market, care must be taken
since answers may be either guarded or overly optimistic.

**PART IV. Market share and concentration**

28. In your view, which companies compete in the sale of the relevant product in the geographic market?

29. What are their respective shares (and on what basis—sales, units, capacity—are market shares estimated)?

30. Have these shares remained constant, or have certain companies increased their share over time?

31. What level of growth has the overall industry experienced during the recent past? What are your expectations for the future?

32. Do any of the smaller companies exert a disproportionate influence within the industry in terms of price, service innovation, and the like?

Although those contacted may be reluctant to estimate market shares because precise sales figures are unavailable, ask for their best estimate based on personal knowledge. This may be your only source of information on market shares upon which to corroborate or refute the parties' claims, and, if the disparity is large and other sources are unavailable, may lead you to piece together your own estimates based on individual sales figures.

**PART V. Substantial harm to competition**

33. With regard to previous price movements in this industry and also the price sensitivity of customers, what would be considered a significant real price increase?

34. To what extent, if any, could the merged entity raise prices by this level?

35. What would be the response of competitors currently supplying the market served by the merged entity to such a price rise?

36. How long could the merged entity sustain higher prices without losing so much market share as to make it unprofitable to maintain such a price increase?

37. Do customers possess any countervailing power; such as the ability to quickly switch to other suppliers or vertically integrate to provide their own internal supply?

38. Do orders tend to be large and infrequent?

39. What is the nature of supply arrangements between customers and suppliers?

40. Do customers divide their purchases among suppliers or insist on having secondary suppliers?

41. Do customers regularly monitor industry prices?

42. Can customers easily integrate into the business of supplying themselves with the product under review? Is there any history of this in the industry?

43. Is innovation in design, marketing, production, and distribution important in this industry? If so, are either of the parties to the merger known to be innovators?

44. Are either of the parties to the merger known to be particularly vigorous or effective competitors?

45. Has there been any indication in the past of anticompetitive acts, such as collusion or facilitating collusive behavior?

Price rise estimates will often vary significantly, with competitors who have a vested interest in thwarting their rivals' merger plans sometimes giving the highest estimates. When questioning in this area, it is important that respondents understand that their estimates are in real (inflation-adjusted) terms and are directly attributable to the merger.

**PART VI. Barriers to entry**

46. Describe the obstacles facing a de novo entrant into the market served by the parties to the merger with respect to:

- Capital costs of manufacturing and distribution.
• Tariff or regulatory barriers.
• Patents and other proprietary rights.
• Scale economy advantages.
• Access to scarce resources.
• Product differentiation.

47. What type of price rise would be needed to overcome these obstacles?
48. How long would it take to overcome these obstacles?
49. Describe the obstacles to entry facing an existing manufacturer that currently does not ship into the market served by the parties to the merger?
50. What type of price rise would be needed to overcome these obstacles?
51. How long would it take to overcome these obstacles?
52. Do either of the parties to the merger have a history of aggressive behavior in the face of new entry or in response to the actions of other incumbents?
53. How much excess capacity currently exists in the industry, and how much of it is accounted for by the parties to the merger?
54. What capital costs are associated with adding capacity, and what proportion of those are nonrecoverable in the event that the capacity is sold for other uses?

PART VII. EFFICIENCIES

55. Comment on the viability and magnitude of any savings in the cost of design, production, marketing, and distribution claimed by the parties as a result of the merger.
56. After the merger, will there be sufficient competitive pressure placed on the parties to ensure that they attain any claimed efficiency gains?

Competitors in the same industry as the parties to the merger will often be in a good position to comment on the viability of any efficiency gains that are claimed. But, given the reduction in competitive pressure that may accompany the merger, it is equally important to assess the likelihood that steps will be taken postmerger to attain them.

PART VIII. OTHER CONSIDERATIONS

57. Would you be willing to sign a statement and testify as a witness for the competition authority if need be?
58. Would you be a cooperative witness if you were subpoenaed by the competition authority?

These questions would generally only be asked in cases that have a good probability of resulting in a legal challenge before the courts or quasi-judicial competition authority. They do, however, tend to lead to more realistic answers, since the possibility exists that the respondent will be subject to public and expert scrutiny. Because they may also tend to reduce the willingness to cooperate that anonymity fosters, they should be asked at the end of an interview.

SAMPLE CUSTOMER INTERVIEW

PART I. GENERAL

1. Date of interview.
2. Name, position, and experience of interviewee.
3. Is the interviewee providing personal or corporate views?
4. Ownership, nature, and location of business activities. Length of time in the business. Major customers, competitors, and suppliers, if not already known.
5. Nature of the customer's relationship with the merging parties and industry being examined. Whom did the company buy from currently and in the past? Amount (dollars and volume) purchased. Importance of the product to the customer's total costs (percentage of total costs, if known). Other aspects of the relationship, service, credit, product quality, and so on.

Basic information should be obtained as a matter of practice. It is also important for assess-
ing the credibility and evidentiary weight of the more subjective information that is provided, such as ability to increase prices. The investigator should explain to customers that they are not legally compelled to answer any questions, and that any information provided will be used only for the competition authority’s purposes, subject to the confidentiality protections provided by the competition legislation.

**PART II. PRODUCT MARKET DEFINITION**

6. Describe the characteristics of the product or products purchased from or sold to the merging parties or industry under examination with respect to:
   - End-use applications.
   - Service considerations, such as delivery, warranties, postal service, and customized specifications.
   - Price points per unit.
   - Perishable or durable good.
   - Degree of product differentiation among suppliers.
   - Intermediate or final consumer good.
   - Standard contracts.
   - Other considerations such as promotional support and brand names.

7. Is the product available through nontraditional channels (such as leased products, secondhand or reconditioned goods, and gray marketers)? Can buyers easily resell the product to other customers (for example, is arbitrage possible)?

8. On what basis do you acquire the product—price, product quality or performance reputation, service considerations, or other factors (such as volume incentive programs)? Rank the importance of these factors in your buying decision.

9. What is the smallest price increase (or reduction in service) that the sellers of the product could implement and sustain over the course of one year that you would consider significant, that is, 2 percent, 5 percent, any increase beyond inflationary levels, 10 percent, 15 percent, and so on. (Henceforth, service refers to nonprice aspects of competition associated with the sale of the product. It does not include other aspects of competition, such as strategic behavior or innovation.)

10. Identify substitute products that you could switch to within the course of one year if sellers tried to sustain the significant price increase (or reduction in service) over that same year.

11. When prices for the product rose in the past (or service levels fell), did enough customers switch to the substitute product(s) identified such that the sellers of the product could not maintain the price increase (or reduction in the level of service)?

12. Are there any switching costs that you would have to bear in order to use the substitute products (such as costs to retool, repackage, break relationships, placate customers, or assume unacceptable product quality risks)?

13. Describe the price points and price trends of the substitute product. Have the price trends for the product sold by the merged entity or industry under examination and the substitute product moved in unison, or is there no significant price correlation between the product and its substitutes?

14. Would you begin production of the product internally or through an affiliate within one year in response to a significant price increase (or decrease in the level of service)? Discuss the practical investment, marketing, impact on downstream customer, and other issues associated with integrating upstream into the production of the product.

15. Are you aware of any producers of other products that could adapt their production processes within one year of a significant price increase (or reduction in the level of service) such that they could commence the production and marketing of the product? Would such entry have a constraining influence on prices (or the level of service) over a one-year time frame?
16. Has entry from related industries occurred in the past in response to a significant price increase (or reduction in the level of service)? Was such entry on a sufficient scale so that the sellers of the product could not sustain the price increase (or reduction in the level of service) over a one-year time frame?

17. Identify all of the firms that currently, or potentially within one year, could supply the product or the substitute products either internally or by adapting existing production facilities within one year in order to commence production and marketing.

PART III. GEOGRAPHIC MARKET

18. Identify the location of sellers of the relevant product that you are currently doing business with or have done business with in the past. What is the customer's practical notion of the geographic market?

19. How significant are transportation costs in the delivered price of the product to your location? Are there other reasons, for example, just-in-time delivery requirements or excessive storage costs, that dictate that suppliers must be in close proximity to their customers?

20. How do prices in increasingly distant areas compare with the price in your area? If sellers in your area imposed a significant price increase, would sellers in increasingly distant areas be able to ship to you and undercut the price increase? Has this ever happened in the past?

21. Are there any practical or other service reasons why you would not do business with a supplier from outside your region? Are there any reasons why a supplier from outside the region that is theoretically able to ship into your territory in response to a significant price increase would not do so (for example, it is at full capacity, may face retaliatory competition in other markets, knows that excess capacity in the market would be brought into play in response to new entry, faces local set-up or distribution costs, its product is perishable)?

22. What is the smallest geographic area in which sellers of the product could impose a significant price increase and maintain that price increase for one year without losing sales to suppliers of the product located in more distant geographic regions? (This question may in fact be a conclusion that the enforcement authority should develop.)

PART IV. MARKET SHARE AND CONCENTRATION

23. Estimate the distribution of market shares in the relevant market (and identify the basis for such estimates).

24. Cite any reasons why the combined market share of the merged entity and other participants in the relevant market may overstate or understate their respective competitive significance (for example, foreign competitors, sales made on infrequent large tenders, cost or strategic advantages held by the merged entity, and position in related markets).

25. Have the distribution of market shares and the share of industry sales held by the top four firms been stable, highly variable, increasing, decreasing, or favoring one or more firms to the detriment of others during the past three years?

Customers will rarely know the exact distribution of market shares, particularly if their notional understanding of the relevant market differs dramatically from the hypothetical monopolist approach. Customers can provide useful information, however, on standards used to measure market shares and the relative competitive weight the enforcement authority can attribute to its estimates.

PART V. OTHER FACTORS

Foreign competition

26. Cite any practical or observed experience with buying from a foreign competitor. Has there
been any new entry by foreign competitors in the past three years? When foreign competitors have entered, did they have an impact on prices or service? Did they sustain their entry? Did customers initiate their entry? What could cause foreign competitors to exit the market? How did incumbent competitors react to their entry? Were there any antidumping complaints?

27. Describe any practical limitations facing foreign competitors relative to:
- Tariffs, import quotas, voluntary export restraints, dumping complaints, licensing requirements, and other regulatory impediments to import competition.
- Distribution and marketing requirements for entry.
- Capacity constraints or absence of a sufficient profit incentive to warrant entry.
- Local preference, uncertain product quality, or post-sales servicing ability.
- Just-in-time or other delivery considerations.
- Currency fluctuations.
- Possible competitive retaliation by competitors in the relevant market or potential disruption of supply relations with customers that have cross-border operations.

28. How do prices for the relevant product of the closest foreign supplier compare with prices in your area? Is the price of the foreign supplier plus transportation costs, plus the tariff (if any), plus brokerage and any other associated shipping costs (for example, insurance) competitive with the existing price level of the product in your territory? Would the foreign supplier's delivered price become competitive if the merging parties or other participants imposed a significant price increase (or reduction in the level of service)?

29. How long would it take for foreign suppliers to ship its product into the relevant market on a large enough scale so that a price increase (or reduction in service) resulting from the merger could not be sustained? More than one year? More than two years?

30. If the foreign firm(s) entered the market, would this heighten competitive rivalry in that the foreign firm would have to offer lower-than-prevailing prices or better service, product quality, and so on in order to acquire business on a sufficient scale to warrant the cost of their entry? Or, would foreign firms enter to capitalize on higher prices and exit once market conditions became less favorable? Would it be relatively easy for the foreign firm to reenter the market if they did decide to exit?

Business failure

31. If the company being acquired were purchased by a different firm or if its assets were liquidated, would a greater degree of competition in the relevant market result than if the subject transaction took place?

32. If the merger did not take place, would the acquiring party remain in the market or cease to exist in its current form? Could it survive if it cut back on certain operations?

Realistically, it is unlikely that customers can contribute a great deal to this issue.

Acceptable substitutes

33. Describe any factors that would mitigate against increasing production of the substitute product or inducing enough customers to switch to the substitute product such that potential competition from acceptable substitutes could not constrain the exercise of market power over a two-year period.

Barriers to entry

See question 27 for barriers to international trade. For questions on barriers to sources of competition from potential product substitutes, see questions 12, 14, and 15. For questions on barriers to sources of competition from geographic areas outside the relevant geographic market, see question 21. In each case the investigator must make a determination that these sources of competition will materialize in the relevant
market on a scale that is sufficient to constrain a material price increase in less than two years.

34. Can the smaller firms in the market easily expand their sales, production, or both such that a material price increase in the market could not be sustained for more than two years? What has happened in the past when smaller firms have increased production or attempted to do so?

35. Has there been any new entry or exit in the relevant market within the past three years? What impact, if any, have these events had on price, service, and the level of competition generally?

36. Describe the characteristics of new entrants. Were they large- or small-scale entrants, did they survive, what industries and geographic areas did they come from, how long did it take them to get established, what was the source of their financing or ownership?

37. Is demand for the product increasing or decreasing? Is the rise in demand sufficient to warrant new entry? Would a material price increase induce entry? In either case would new entry raise the level of competitive rivalry in terms of prices or service?

**Effective competition remaining**

38. Which firms tend to be the most aggressive competitor in terms of price discounting, service, and innovative marketing, packaging, and so on.

39. Does any one firm dominate in terms of pricing, service, marketing, and so on in that when this firm implements a price change, the other firms in the market institute a similar change?

40. Have firms in the market been able to impose price increases each year, beyond levels that are cost (or inflation) justified? Have prices risen even though there is excess production capacity among suppliers? How have suppliers explained or attempted to justify such increases?

41. Describe any relevant, firm-specific facts, such as ownership, or product or customer orientation, or behavioral considerations, such as a history of price-following, traditional patterns of supplying only certain customers, that suggest that the level of competition in the relevant market will be materially lower as a result of the merger.

42. Describe what the merging parties will attain in terms of cost advantages, market position, sales force coverage, intellectual property, control over essential facilities, and so on that would suggest that the other competitors in the relevant market will not be as aggressive as in the past.

43. Describe how the level of competitive rivalry changed, if at all, as a result of previous mergers in the industry.

**Removal of a vigorous and effective competitor**

44. Is the firm being acquired considered a vigorous and effective competitor? Describe what will be lost in the market in terms of price competition, service, innovation, market certainty, specialized products, and so on.

**Change and innovation**

45. Is there a high degree of change and innovation in the market in terms of new products or production technologies, marketing and distribution channels, or changing consumer tastes, regulatory environment, downstream market, and so on.

46. What has been the most recent innovation in the market? When did it occur?

47. Describe the competitive state of the market: evolving, stable, or declining? Do suppliers recognize the ability of competitors to retaliate if one supplier introduces price discounts, increased levels of service, or other production or marketing innovations to try to maintain market stability?

48. Will the merger increase the level of change and innovation in the market and force other competitors to follow suit with similar innovations?
49. Will the merger remove from the market a particularly innovative competitor that is viewed as a competitive threat by the acquiring firm or other competitors?

**Market transparency**

50. Is information about competitive activity among suppliers easily and quickly made available to customers, other competitors, or both?

51. Are secret discounts off list prices common?

52. Do suppliers issue common price lists or employ common pricing formulas (for example, common base points for delivered prices)?

53. How often do you purchase the product or take delivery—or both? How is the product purchased: open tenders, only from qualified suppliers, formal contracts, and so on?

54. Describe the nature of supply contracts: length of term, meet the competition, right of first refusal, renewal provisions, pricing changes, and so on.

55. Cite examples of past procompetitive or anticompetitive conduct. Cite examples of explicit or implicit collusive behavior.

**Vertical mergers**

56. How much unintegrated capacity will remain upstream and downstream? How will this affect the level of competition at either stage? For example, if your supplier or a potential supplier is also your competitor in the downstream market, how will this influence your ability to compete?

57. Would the merger reduce the amount of unintegrated capacity upstream or downstream to the extent that potential entrants would have to enter both markets in order to provide entry on a scale that is large enough to constrain a material price increase? What additional costs or time delays are associated with two-stage entry?

58. Would unintegrated competitors in both the upstream and downstream markets have to vertically integrate in order to remain competitive with the merged entity or other vertically integrated competitors? Indicate whether this is likely to materialize within two years.

**Conglomerate mergers**

59. Would the acquiring firm have entered the market and raised the level of competition in the absence of the merger?

Customers realistically cannot contribute a great deal to this issue.

**PART VI. SUBSTANTIALLY**

60. Can the customer increase prices or pass on cost increases to their customers?

61. Will the merger result in a material price increase, a reduction in the level of service, or both that can be sustained over a two-year period? If yes, then:
   - What is the magnitude of the material price increase—2 percent, 5 percent, 10 percent, or more?
   - Describe how nonprice aspects of competition will be adversely affected.
   - Will the lessening of competition materialize uniformly throughout the market or will it have a greater or lesser impact in certain regions or on certain customers?

62. How will the customer respond to a material price increase:
   - Refuse to accept it.
   - Absorb the cost increase.
   - Produce the product internally.
   - Pass it on to its customers.
   - Make other adjustments so that its overall costs will not increase.

63. Would prices increase or the level of service diminish irrespective of the merger because of increasing demand, capacity shortfall, inflation or other cost increases (such as higher wages or taxes), or anticipated exit of a supplier?

64. If prices are anticipated to increase irrespective of the merger, will the merger raise the
magnitude, or accelerate the timing of such price increases?

65. Have the suppliers of the product passed on cost reductions in the past?

66. Have the suppliers of the product increased prices in the past, even though they had excess production capacity?

Simply asking customers if they are “concerned” usually does not generate very good information. Customers may not be concerned about mergers because they can pass on price increases, the product is a minor item in the grand scheme of things, they feel they can take care of themselves, they have good relations with their suppliers “who wouldn’t charge unjustified prices,” owe money to their suppliers, and so on. Conversely, customers that are concerned may have an ax to grind, dislike foreign ownership, owe money to their suppliers, compete with or supply the merged entity in another market, and so on.

PART VII. OTHER QUESTIONS

67. Would you be willing to sign a statement and testify as a witness for the competition authority?

68. Would you be a cooperative witness if you were subpoenaed by the competition authority?

Obviously, these questions call for some judgment on the investigator’s part. Most business people do not want to be seen as a complainant; therefore, only bring up the subpoena issue if the customer “wants to be forced” to cooperate.