Efficiencies/Dynamic Analysis/Integrated Analysis

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How Are the Agencies Doing?

- Hard to tell given most "tough" efficiency cases do not usually get filed
- Baby Food was not a "helpful" development
  - FTC should look closely at what has happened post-trial
  - *However*, the standards *should be* stringent (but not black letter) in a ***real*** 3-to-2 merger
- Other cases?
  - Tank ammo

How Are the Agencies Doing?

- But the importance of customer opinions in enforcement decisions is probably at least *indirectly* important in proper weighing of efficiencies in some investigations
  - For markets with sophisticated, representative **direct** customers, efficiencies are generally recognized (but <u>indirectly</u> through impact on customer opinions)
- The problem is in cases that do not have sophisticated direct customers
  - Oil, Branded Products, Supermarkets, *etc*.
- ***Need retrospectives focusing on efficiencies***

How Does FTC Actually Deal With Efficiencies

- Efficiencies can be important
  - In 2nd Request decision
  - In a "close" case
  - "Implicit" in Customer Opinions with sophisticated representative <u>direct</u> customers

- In effect, there is a sort of sliding scale in which the stronger the anticompetitive case the less weight efficiencies receive (but not weighing by magnitude of efficiencies *vs*. magnitude of anticompetitive effects)
  - In this weighing efficiencies are considered more generally than in Guidelines

How Does FTC Actually Deal With Efficiencies

- Merger Guidelines Efficiency criteria are generally used as a litigation-oriented check list
  - Is anyone on the matter looking at – but are there real efficiencies here?
  - And if there is and they find some – is anyone listening?
- One problem is lack of full testing of efficiency claims (parties often do not know what staff are thinking and why)
  - This is an area in which we need more transparency

Efficiencies Roundtable

- We learned a lot through Efficiencies Roundtable
- I think that we learned that:
  - Merger "Outcomes" are a mixed record, but to some extent not related to efficiencies
    - Leading reason for financial shortfalls is overpaying
    - Another important reason is unanticipated shortfalls in sales ("Revenue Dissynergies")
      - Customer Opinions
  - Other things equal, horizontal mergers are more likely to be successful
  - "Straightforward Cost Savings" are generally realized
  - Merger Planning and Implementation is Important
    - Implications for "Gun Jumping"
    - Implications for what agencies should expect to find in investigation

Where/How Do Efficiencies "Fit"?

- "Ideal Case"
  - Transaction driven by efficiencies

    Example:

    - Plant combinations will lead to higher capacity (e.g., combination of batch and continuous production processes)
    - Economics of production make reduction in capacity utilization not a viable theory
    - Efficiencies $\Rightarrow$ merger is procompetitive
- Most cases are not "ideal"
  - But efficiencies always belong at the beginning

Integrative Analysis

- Judgments about market definition, competitive effects, barriers, and efficiencies are generally not certain – in some cases far from certain
- Decision-making thus necessarily involves a compounding of probabilities
  - For example, if X, Y, & Z are independent,

    the probability that they are all "right" = P_x*P_y*P_z

Integrative Analysis

- Beyond compounding of probabilities, conclusions on market definition, competitive effects, barriers, and efficiencies are often interrelated
  - In practice, this is often not recognized – in particular once staff “decides” on market definition, that is treated as settled
  - However, the warts in the market definition or barriers evidence may be relevant to assessment of competitive effects
    - This was important in the Cruise Line Mergers – because empirical evidence was brought to bear that (for Staff and 3 Commissioners) rebutted *theory*

Integrative Analysis

- Interrelationship between market definition and competitive effects may be particularly important on a specific competitor basis
  - Minimum Viable Cartel analysis

- Obviously, as in our ideal case (and in Baby Food) the efficiencies are directly relevant to competitive effects analyses

What Efficiencies Should "Count"?

- "*Incremental Costs/Pass Through*" arguments have largely been sterile/fruitless and/or driven by litigation strategy
- Fixed costs
  (*See* http://www.ftc.gov/be/rt/presentationpanel4.pdf)
  - Are only fixed in "short" run
  - (Longer run) Fixed Costs clearly impact decisions on new product development, *etc.*
  - It has long been well known that many if not most companies use some version of "total" average cost (total or operations) in their decision making
    - This behavior is not irrational
    - May be consistent with long run profit maximization
    - Provides right managerial incentives

What Efficiencies Should "Count"?

- Rather than (simple) economic theory, treatment of costs in actual financial documents (if clear) should be the guide as to how cost changes will impact decision making
  - Subject to inquiry re: how cost effects of merger will be accounted for
- Internal cash flow is primary source of funds for most companies for investments in new products, technologies, *etc*.

- Merger Specificity?
  - How long do we/consumers wait?

How Should Efficiencies “Count”?

- More attention to where the extra cash flow goes/how cost savings impact decision making in companies’ financial analyses
  - In many markets suppliers make arguments **to their customers** on pricing based on profitability necessary to provide incentives for new innovations of importance to customers
- Past track record should be important, including w.r.t. managerial efficiencies
- Merger Specificity?

How Should Efficiencies "Count"?

- "Simons Analysis"
  - May look complex but it is simpler than the sorts of analyses many companies actually do these days
    - Scenario and Risk Analyses

- In any event, although the FTC and DOJ are clearly the experts in this area, their actual decision-making processes are too *ad hoc*
  - This is a problem that other agencies have confronted (*e.g.*, EPA) and can also be the antitrust agencies.

"Dynamic Competition"

- In the dot.com implosion there was a lot of consolidation that the agencies were probably too busy to deal with
  - A lot of 3-to-2 and 2-to-1 mergers
  - Many of these presented "true" dynamic competition issues
    - Short run competition impacted prices
    - But issue was how industry would consolidate and what would be effects
    - Apparent benefits to orderly consolidation through mergers
      - Preservation of people, IP, etc.
      - Potential benefits of sharing IP, choosing best features, *etc*.
      - Ability to fund survival
- Agencies are not too busy any more …
  - Monster/Hot Jobs
- Other industries …