Dynamic Competition and Big Tech Merger Cases

- **Big Tech mergers are increasingly under the microscope as authorities fear their effect on competition.**
- **Competition in these markets is dynamic as firms compete on innovation rather than price**
- **How is dynamic competition considered in merger cases and could the process be improved?**

Recent merger cases amongst "Big Tech" firms have highlighted the need for competition authorities to consider dynamic competition when determining whether the merger should be allowed. SPC Network was recently asked by the British Institute for International and Comparative Law (BIICL) to examine how the Competition and Markets Authority in the UK took account of dynamic competition in its assessment of the Microsoft/Activision and Meta/Giphy cases and propose how a formal analytical framework could better assess dynamic competition. This edition of Hexagon provides a summary of that report.

For many years, some competition economics academics and practitioners have argued that competition authorities do not take sufficient account of dynamic competition when assessing merger cases, instead relying on neoclassical economic theory and static competition. Under dynamic competition firms use innovation to introduce new products, processes and services and compete for future rents, whilst under static competition products are generally close substitutes and firms compete for current rents.

In the report commissioned by BIICL, SPC Network reviews two merger cases in the UK (Meta/Giphy and Microsoft/Activision), which were both rejected by the Competition and Markets Authority (CMA), and examines how, if at all, dynamic competition was considered in their analysis. This report does not consider whether the CMA came to the right conclusion or not, only the process they followed when dynamic competition could be significant.

Defining Static and Dynamic Markets

Market definition is traditionally based on the Hypothetical Monopolist Test (HMT), which examines potential supply and demand side substitution by similar products. However, in many markets we can see generational shifts in products and services brought about by innovation, such as the shift from feature phones to smart phones. These shifts often see old suppliers replaced by new ones, for example when Apple's iPhone replaced RIM's Blackberry, showing that dynamic competition often comes from outside the market. Therefore, authorities often need more qualitative techniques than the HMT to develop an understanding of the competitive arena.

Static market definition also tends to concentrate on vertical relationships between focal products and their upstream suppliers and downstream customers and horizontal relationships with direct competitors. However, this method of defining markets is increasingly outdated as firms and products become part of wide ecosystems, consisting of many types of relationships including complementors and co-creators.

In both cases under review, the CMA seeks to avoid the static means of defining markets and instead uses a more qualitative approach to try to understand the various relationships that exist in the market. Despite this, however, they end up with what are arguably static market definitions of products that currently exist, and do not take account of any potential future developments.

This leads the CMA to examine two traditional theories of harm in the markets: horizontal effects and vertical effects.

The Competition Appeal Tribunal's comments on horizontal effects help to analyse dynamic competition.

Horizontal effects are found only in Meta/Giphy, where both firms are found to be competitors in the display advertising market. Giphy was developing an advertising product called "Paid Alignment" under which advertisers could have their products featured in GIFs. The CMA considered Paid Alignment as potential dynamic competition that would be removed as a result of the merger leading to a Substantial Lessening of Competition (SLC).

The Competition Appeal Tribunal (CAT), which heard an appeal against the decision brought by Meta, considered the question of dynamic competition and set out four indicators that may assist the CMA in identifying genuinely dynamic competition as opposed to "duds". These were:

a) The motives and thinking of the merging firms.
b) The market value attached to the dynamic element.
c) Contestability of the market, pointing out that a contestable market has low barriers to entry and exit.
d) The manner in which the dynamic element can be monetised.

Importantly, and in contrast to many of the academic contributions to this debate, the CMA and the CAT considered dynamic competition as something the merger could substantially lessen, rather than something coming from outside the market that could reduce the competitive effect of the merger.

Vertical Effects

The CMA found vertical effects were present in both cases. This was because Giphy and Activision both had strong positions in the searchable GIF and gaming markets respectively and the merger would have allowed the merged entity to refuse to supply downstream rivals with access to these important products.

In both cases the discussion on vertical effects does not include dynamic competition but only considers foreclosure of existing products. However, when considering countervailing factors, the CMA does examine whether the merger could result in efficiency gains or higher barriers to entry and expansion in the future. It does not consider whether foreseeable developments could counter any static SLC arising from vertical effects. The CAT also only applies its analysis to horizontal effects.

Conclusion on Recent Cases

We draw three conclusions about the use of dynamic competition analysis in merger cases:

a) The CMA takes account of dynamic competition to some degree but appears to do so in an ad hoc manner rather than employing an holistic framework. For example, the inclusion of dynamic competition when assessing horizontal, but not vertical, effects.

b) Dynamic competition is only considered as something that could be lost as a result of the merger rather than something that could overcome any SLC if new technologies were available to potential rivals.

c) The CMA relies for information on the Parties, other firms involved and the knowledge of its panel members rather than being able to call on independent experts to provide the panel with a neutral but informed view of likely market developments.

We propose a five-stage process for the structured assessment of dynamic competition.

In the light of these conclusions, we propose a five-stage process for incorporating dynamic competition analysis into future merger analysis, which we present as five questions to be analysed:

a) ***Do technical and economic conditions mean that the market is likely to be subject to dynamic competition?*** We propose a further set of questions is considered in answering this first question which we have based on our comparison of static and dynamic competition set out in the report. We also propose that the panel should have access to independent experts to help their assessment along the lines of the panel of digital experts recently appointed by the CMA.

b) ***What is the scope of the relevant market?*** We suggest that the CMA adopts a systems thinking approach to develop a "map" of the competitive arena which would allow it to identify the area of concern and how that interlinks with the overall market system.

c) ***If a static SLC is not found, could there be a dynamic SLC?*** This is broadly in line with the approach proposed by the CAT and designed to ensure future competition is not negatively affected by the merger.

d) ***If a static SLC is found, could dynamic competition be an effective counter?*** This is the inverse of the previous question with the purpose of assessing whether foreseeable developments could facilitate entry by new rivals with dynamically competitive products. Again, a panel of experts could provide independent advice.

e) ***Do coordination benefits from integration outweigh an SLC?*** Innovation may require a closer relationship between firms in the market than one based on contracts to overcome dynamic transaction costs. A merger may, therefore, allow the merged entity to adopt a new organisation design that can deliver enhanced innovation benefits to consumers that are sufficient to outweigh any loss caused by the merger. We believe that it is for the Parties to make such a case and for the CMA to assess that case, perhaps with independent expert advice.

The full report is available on our website here.

SPC Network