Victorian Commonwealth Executive Forum: Get Started Today, Tomorrow Starts Now

Mergers and Competition in a Global Environment

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Introduction

Globalisation has had an enormous impact on business, consumers, governments and regulatory agencies, such as the Australian Competition and Consumer Commission (the Commission), alike. The pace of change has been, and continues to be, rapid. Technological innovation, falling transport costs and international liberalistation of trade have led to the development of the 'borderless marketplace'.

It is increasingly necessary for business and regulatory bodies to adapt and modify their traditional activities to new forms and modes of doing business so as not to be left behind. For business, the failure to do so may mean loss of profits, for agencies such as the Commission it is the potential for business to run riot, with consumers suffering as a result.

In some areas, such as mergers, this means that while the Commission continues to apply the same law, it must apply it to the ever changing global market. As a result, decisions are likely to be very different to what they would have been some years ago. In other areas the Commission must develop new strategies to deal with 'innovative' breaches of the Trade Practices Act (the Act).

Globalisation has been greatly facilitated by the growth and development of the internet and e-commerce. E-commerce has the potential to provide immense benefits for both consumers and businesses. For consumers, it provides the opportunity for improved convenience, choice, range and price of transactions. For businesses e-commerce offers access to a global market with low start-up and operating costs and efficient marketing and distribution mediums.

However, just as e-commerce provides opportunities for competitive and ethical traders, it also provides opportunities for scam operators and business seeking to cut corners. Accordingly, the Commission is closely scrutinising new arrangements to ensure that they are not in breach of the Act.

Mergers and Acquisitions in the Global Environment

Merger policy makes a major contribution to developing and maintaining a competitive and efficient Australia, able to compete in global markets. It is not some necessary evil that businesses have to endure, but instead it makes an important contribution to the ability of Australian businesses to compete. As Australia has reduced the protection of tariffs that many industries once enjoyed, these industries

have recognised the need to improve their efficiency. However, if industries exposed to foreign competition are unable to be supplied with inputs at competitive prices, their ability to compete in world markets may be severely hampered.

It is incorrect to see merger policy as a hindrance to business efficiency. The merger provisions of the Act do not prevent the overwhelming majority of merger proposals from going ahead. In the three years to June 30 2000, the Australian Competition and Consumer Commission (ACCC) opposed twenty-five of the more than 500 merger proposals it examined. Those which are opposed naturally receive the greatest amount of attention. Some of those are of course borderline and critics may argue that in particular cases the ACCC has been in error in its decision. Of course criticism of merger decisions sometimes comes from a range of directions. Large firms wishing to merge may sometimes complain that the ACCC has opposed a merger while at other times criticism has come from consumer and small business interests that the ACCC has approved a merger.

The Commission's Merger Guidelines

Section 50 of the Act prohibits acquisitions that would or are likely to substantially lessen competition in a substantial market in Australia, in an Australian State or Territory.

As a guide for industry, the Merger Guidelines set out the process for, and issues relevant to, the Commission's administration of the merger provisions. The guidelines do not bind the Commission, but provide parties with an indication of what the Commission considers when investigating mergers and importantly indicate to industry what the Commission is looking for in a submission outlining a proposed acquisition.

The Guidelines provide a five stage process for the Commission's assessment of the substantial lessening of competition. The steps are:

- Market definition. In establishing the market boundaries, the Commission seeks to include all those sources of closely substitutable products, to which consumers would turn in the event that the merged firm attempted to exercise market power. A market involves four dimensions namely: product, geographic, functional and temporal.
- Market concentration ratios are assessed. If the market concentration ratio falls outside the Commission's thresholds, the Commission will determine that a substantial lessening of competition is unlikely. The Commission considers the post-merger combined market share of the four largest firms (CR4) and will examine the matter further if the merged firm's market share is over 75 per cent and the merged firm will supply at least 15 per cent of the relevant market. Alternatively, if the merged firm will supply 40 per cent or more of the market, the Commission will want to give the merger further consideration.
- Potential or real import competition is considered. When considering the impact of globalisation and internationalisation of markets, this is an important factor. If import competition is an effective check on the exercise of domestic market power, it is unlikely that the Commission will intervene in a merger.

The Commission's Merger Guidelines have adopted an indicative position of not opposing mergers where a sustained and competitive level of imports has been at 10 percent or more of the market.
However, even though the Commission has set this as an indicative level, it is not the historical share of imports that is significant, but their potential to constrain the price and output decisions of the merged entity. In its assessment of import competition, the Commission will establish whether or not imports provide or are likely to provide a competitive discipline on a merged firm.

- Barriers to entry to the relevant market. If the market is not subject to significant barriers to new entry, incumbent firms are likely to be constrained by the threat of potential entry, to behave in a manner consistent with competitive market outcomes. A concentrated market is often an indication that there are high barriers to entry.
- Other factors which are outlined by the Act (section 50(3)) include whether the merged firm will face countervailing power in the market, whether the merger will result in the removal of a vigorous and effective competitor, or whether the merger is pro-competitive, not anti-competitive.

In applying its guidelines, the Commission recognises that many Australian firms operate in a global environment. There is, however, a distinction to be made between operating in a global environment where offshore investment and market access issues are a focus. The Commission, when considering globalisation issues is required to focus on the global competitive conditions applying to Australian markets. Domestic mergers of Australian firms where there is a clear and identifiable constraint from offshore have not been opposed by the Commission.

The Merger Guidelines also highlight that increased exposure to global markets is placing pressure on domestic firms to reduce costs, improve quality and service and innovate in order to become more competitive. Mergers may be one means of achieving such efficiencies. While efficiencies generally arise as a question of public benefit, which falls for consideration under authorisation, they are relevant in a section 50 context to the extent that they impact on the level of competition in a market.

Globalisation

In recent times there has been a spectacular increase in the extent of international merger activity, in one sector after another. Recent global mergers such as Exxon/Mobil, British American Tobacco/Rothmans and Alcoa/Reynolds generate competition issues in many countries.

However, for the most part, these mergers are not anti competitive and pose no major challenge to the global economy's major competitiveness. Indeed, in many cases, they enhance competitiveness and improve economic efficiency by creating more efficient arrangements for international business transactions.

The ACCC recognises that many of these mergers are driven by the need to improve efficiency as a consequence of technological change, deregulation and trade liberalisation. For example, many global telecommunications mergers are linked to deregulation of markets in most countries and the removal of barriers to international

transactions.

Nevertheless, it is very important that we be vigilant about these matters.

However, some international mergers may damage competition in some markets but not in others.
The Trade Practices Act applies to the domestic impact of offshore mergers and in two recent instances the ACCC has taken action to prevent the anti-competitive effects in Australia of an international merger. It is not necessarily the case that the merger is blocked. A recent example was the attempt by the British American tobacco company (trading in Australia as W.D. and H.O. Wills) to take over Rothmans. While in some countries the merger did not generate competition issues, in Australia it was clear that it would. There are only three companies - WD & HO Wills, Rothmans and Philip Morris - and imports are fewer than 1%. The Commission considered that a merger of two of three big players would reduce competition. It opposed the merger. Following this, British American Tobacco and Rothmans decided to release 17% of the total brands of cigarettes on the market and they were acquired by Imperial Tobacco, a major international tobacco organisation which has now entered, aided by an initial 17% market share and the introduction of its own well established brands into Australia. Some coincidental changes in tax law will also boost imports. As a result, there remains three strong credible players in the Australian market and the original merger between British American tobacco and Rothmans has been able to go ahead in Australia as well as in other parts of the world.

Another interesting solution has occurred in a couple of cases where the Commission had initial concerns. When BHP, Australia's major steel company, wanted to take over New Zealand Steel, the Commission believed that there could be some anti competitive effects in certain parts of the steel market, even though international trade would take care of many problems. However, when the Commission objected a practical solution was found. The Government agreed to reduce tariffs on an accelerated basis in relation to those parts of the market where there could have been an anti competitive effect. Accordingly, it is my provisional view that many of the problems for competition created by global mergers can be met by appropriate action in domestic markets.

In other instances, such as the proposed acquisition of the Schweppes soft drink brands by Coca Cola, the anti-competitive detriment from the acquisition, which would have given the merged entity in excess of 70 percent of the Australian soft drink market, was not able to be removed and the acquisition has not proceeded.

While the ACCC recognises that global competition is occurring in many markets, the fact that companies may earn significant profits from overseas operations does not in itself make the markets in which they operate global. There are many markets which are clearly global. Most commodities such as minerals and agricultural products are traded on global markets. Prices in those markets respond to global factors. However, the fact that, say, a ready mixed concrete has concrete plants in numerous countries does not make ready mixed concrete a global market.

The ACCC always considers the impact of global factors on competition in Australian markets. It has not rejected a merger where imports have maintained, over the

medium term, a market share in excess of ten percent, even in circumstances where the merger has led to a domestic production monopoly.

It is sometimes argued by business in Australia that, in a global environment, domestic firms need to develop some 'critical mass' to be able to compete with large foreign multinational firms. At its extreme this argument becomes the so called 'national champion' argument whereby its proponents claim that small economies such as Australia can support at best one large firm in a market which then competes vigorously with its large foreign competitors. Consequently some proponents of these arguments have claimed that the merger provisions of s50 of the Act prevent this apparently desirable objective.

While not dismissing these arguments out of hand, there are a number of problems with this line of reasoning. First, there is no evidence that, simply by merging with a competitor, a company's ability to compete internationally is enhanced. Size is not necessarily the determining factor in whether or not a firm will achieve overseas success. Second, it has been argued on numerous occasions in many countries that national rivalry rather than national dominance is more likely to generate innovative and efficient firms more able to compete in international markets. Third, there is the reasonable fear that a national champion may use its domestic market dominance to increase the domestic price to import parity and subsidise its export price. Such an outcome is not in the interest of local consumers.

It is also important to recognise that the merger provisions of the Act do not necessarily prevent firms from achieving this critical mass. Even in circumstances where a merger leads to a substantial lessening of competition, it is possible to have that merger authorised on public benefit grounds.

E-Commerce

Globalisation has effected almost every area of the Commission. E-Commerce, in particular, is raising a large number of issues within the Commission. The Commission recognises the potential benefits of e-commerce for both business and consumers. For consumers, it provides the opportunity for improved convenience, choice, range and price of transactions. For businesses e-commerce offers access to a global market with low start-up and operating costs and efficient marketing and distribution mediums. As I mentioned above, the Commission is closely scrutinising this area to ensure that anti-competitive or unscrupulous conduct does not retard the growth of e-commerce and the potential benefits.

What I would like to do now is outline the competition and consumer protection issues that are arising out of the development of and the growth in e-commerce applications on the Internet.

Competition Issues

The Internet provides a mechanism for new types of industry alliances and structures to arise, such as procurement 'ehubs' which provide centralised exchanges for buying and selling business inputs. Such arrangements have the potential to deliver pro-competitive outcomes, to encourage new entry and to enhance efficiencies. However,

it is also possible that such arrangements could increase industry concentration and market power.

Business to Business Procurement Ehubs

One of the emerging applications of the Internet is the development of 'Business to Business' Procurement Ehubs. This is an electronic communications service, or 'ehub', through which users/participants can acquire business supplies. The advantages of these schemes include lower transaction costs and potential access to a wider range of buyers and sellers.