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PERSPECTIVES

THE TYRANNY OF MARKET SHARES: INCORPORATING SURVEY-BASED EVIDENCE INTO MERGER ANALYSIS

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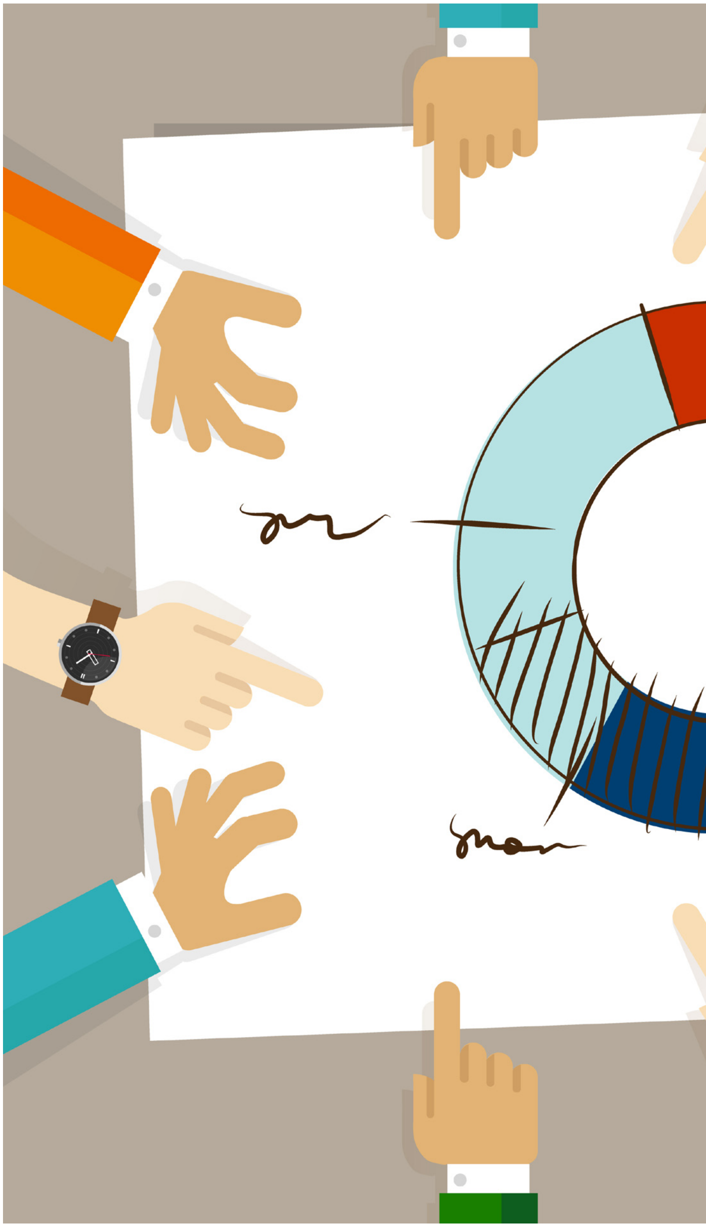
In merger reviews, regulators such as the Department of Justice (DOJ) and the Federal Trade Commission (FTC) in the US, or the Directorate-General for Competition (DG Comp) of the European Commission, frequently lean heavily on public or internal measures of revenue or unit shares when evaluating potential competitive effects. The regulators use these traditional measures of market share not only in the consideration of market definition and potential market power, but also to understand how much competitive discipline each party to a merger places on the other, and hence, whether a merger might remove competitive constraints from the market and lead to price increases.

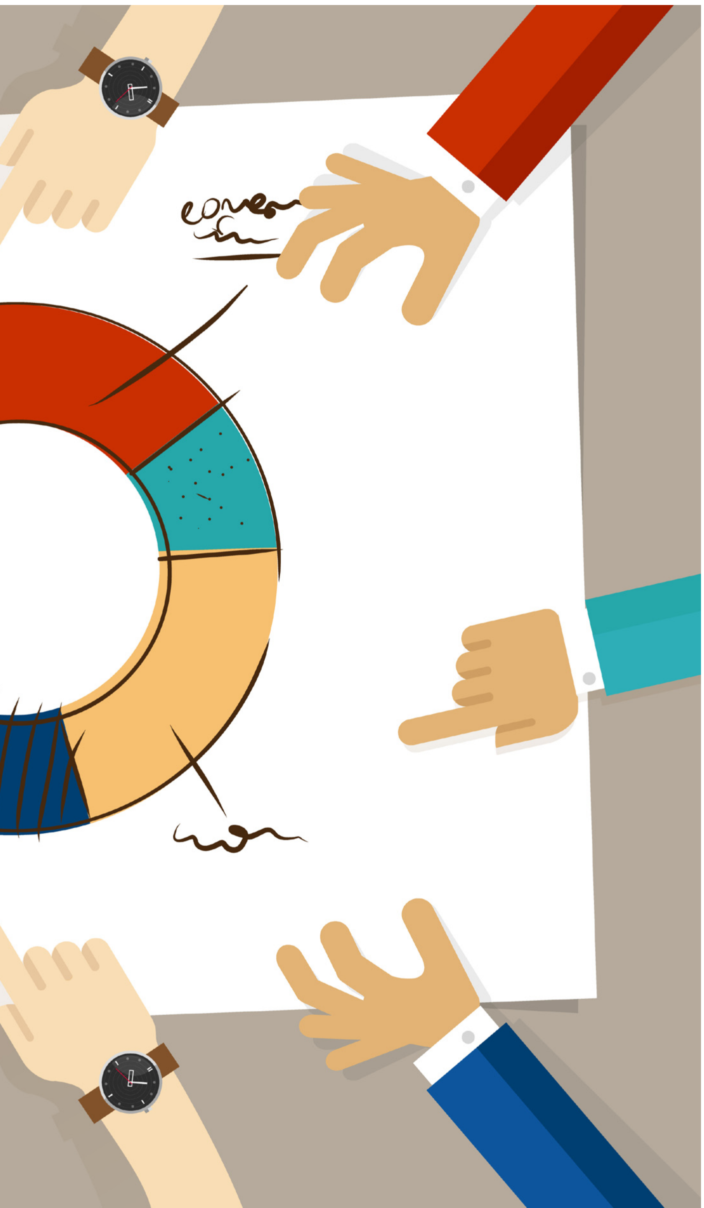
However, in some instances traditional share measures may reflect overly broad or overly narrow market definitions, or may simply be a poor reflection of the current extent of competition. Traditionally tracked industry reports may be insufficient or insufficiently detailed to accurately define an antitrust market, measure market shares, or determine each firm's next best substitute. In these instances, the regulators' view of market definition or of potential competitive effects of a proposed merger can be clouded, rather than clarified, by a reliance on traditional industry reports.

Parties and regulators have begun to recognise the need to expand the view of competition by looking beyond traditionally tracked market shares and focusing more deliberately on the consumers' and businesses' underlying purchasing processes. For example, in order to try to account for consumers purchasing from both online and brick-and-mortar retailers, as part of the review of the 2016 Fnac/Darty merger, the French Competition Authority and the parties each extended the traditional retail market share analysis to allocate online sales to local geographic markets.

This example suggests that a careful analysis of the purchasing process and current competitive options can be an important part of an empirical analysis to determine the extent of competition and the future options available for a given customer post-merger. Courts have accepted rigorous and reliable survey methodologies in antitrust litigation (e.g., *Walmart et al. v. Visa et al*. and the Microsoft California class action case) to provide deeper insight into the competitive dynamics of a given market. Similarly, survey techniques in merger analyses, as in the review of recent media and telecom acquisitions (e.g., the DirecTV/AT&T merger), can provide regulators and parties with more accurate measures of diversion ratios and a more sophisticated understanding of competitive constraints before and after a proposed merger.

In this article, we first discuss some of the ways that traditional market share analysis can mask, rather than reveal, true competition. We then briefly describe how consumer surveys can be used to better understand purchase decisions, and so lead





to a deeper understanding of post-merger market dynamics.

Assessment of potential competitive effects and traditional market share measures

To understand the competitive effects of a merger, parties and regulators generally consider market shares before and after the merger; diversion ratios between the merging parties before the merger; and the efficiencies that may be generated by the merger. The stated goal of antitrust analyses in these circumstances is in part to determine whether one can reasonably expect the anticipated benefits of the merger (e.g., operational efficiencies or synergies) to be shared with the customers, or whether eliminating a competitor will allow the merged entity to raise prices or withhold the benefits of cost savings.

However, markets can be difficult to delineate precisely. For example, when examining the potential competitive effects of a merger, traditionally defined product or geographic markets may not be bounded in a manner that accurately reflects the intensity or closeness of competition of the merging parties. Defining geographic service or catchment areas based on the physical location of supplier facilities provides, at best, only a rough indication of competition for customers within that geography.

Similarly, product and service groupings may be inadequate, as business documents and thirdparty reports may overstate or understate the substitutability among competitor products and services. For example, differentiating supplier attributes may mean that there are different competitive option sets for large corporate purchasing functions, which may prioritise deep production capacity, compared with smaller businesses, which may prioritise price. Thus, a merger that suggests only a small increase in total market concentration based on traditional measures of market share may actually mask the merger's competitive effects on a particular customer segment.

Market share calculations that focus on traditional competitor sets also may fail to capture the effects of new entrants, and particularly the explosive growth of online competition, which is redefining the competitive landscape in many industries. Ignoring the unique dynamics characterising online competition may concentrate the analysis on only a portion of transactions whose characteristics (e.g., geographical location) may not be representative of competitive factors overall. Apportionment of online sales into local markets, or consideration of the increasing presence of online entrants into bidding markets, can be a critical, if challenging, undertaking when attempting to understand the potential competitive effects of a merger, as was the case with the Fnac/Darty merger.

For these and other reasons, generally tracked measures of revenue or unit shares can sometimes be misleading, particularly if care is not taken to properly define the relevant market. Consider an industry with five players, in which A and B account for 30 percent of revenue in a particular product category, C accounts for 10 percent, and D and E each account for 15 percent. In this scenario, analyses relying on reported shares of sales from public sources may initially consider a merger of firms A and B to be problematic, but an acquisition of firm C by firm A to be fine. However, there may be particular customer sub-segments that view A and C to be closer competitors than A and B. Shares based on industry reports or generally tracked statistics

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may not capture these dynamics, but a closer look at the purchase decision process could.

The use of survey methodologies to identify the drivers of purchase decisions

One problem is that reported shares typically reflect the results of the purchase decision process, but have little to say about the *reasons* for a purchase decision. In other words, these analyses reduce a purchase to a yes-no decision, without looking at questions such as 'Why?' and 'To what extent?' In this regard, such analyses neglect the complexity of the purchase decision process itself, whether for individual consumers or for businesses.

Purchasers make their decisions based on how well a product or a service meets their specific needs. While 'best price' may certainly be among those needs, other factors include quality, availability, experience, level of service, comfort, and ease of doing business, to name a few. Understanding the reasons behind purchase decisions may be critical to determining an accurate definition of the market, but also importantly to understanding the potential competitive effects.

These types of factors affect the degree to which consumers find one product or service substitutable for another. In 2010, DOJ and FTC acknowledged the importance of substitutability in their update to the 1997 Horizontal Merger Guidelines by introducing the concept of diverted sales, or diversion ratios, as a measure of closeness of competition. They proposed that the degree to which one product or service can be substituted for another is an indicator of upward pricing pressure (or UPP), and hence, of competition.

Given that the bounds of the market as defined may or may not reflect the intensity of competition, these Guidelines emphasise that "[d]iagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration". Intriguingly, the regulators stopped short of prescribing alternative methodologies, leaving it up to the merging parties to make their cases as best they can.

Survey methodologies can be used to fill the gap by providing a better way to predict future consumer preferences, consumer behaviour and market outcomes following a proposed merger. Asking a representative sample of consumers to indicate their first and second choices among a set of competing products or services can enable qualified experts to estimate actual diversion based on revealed preferences, while taking into account the myriad factors underlying purchase decisions. One can also use surveys that let respondents make choices similar to those in the real world. Such surveys would help merger applicants and reviewers better understand 'why' end customers buy certain products or services, and 'to what extent' they would respond if prices or quality, availability, experience, etc., changed for packaged goods.

In consumer products markets, studies that evaluate consumer choices using experimental designs (or A/B tests), or more sophisticated choice-based methods such as conjoint surveys, can be used to model but-for sales if prices for one of the merging parties were to rise. Similarly, surveys of business-to-business customers in bidding markets can be conducted to more accurately determine the competitive choice set for recent contracts. Diversion ratios can be estimated from these types of data and considered directly, integrated into UPP measures, or integrated into market simulation models. In this way, regulators can be presented with a more nuanced and accurate measure of the potential competitive effects from a merger.

Overcoming the tyranny of market shares

An appropriate survey methodology, properly designed and executed, can go beyond traditional consideration of revenue and unit shares to provide more accurate insights into the complexities of consumer preferences and demand. If traditional reports of shares of industry sales overstate or understate the relative extent of competition, a survey can provide a more reliable determination of the market and a more accurate assessment of post-merger effects.

The use of survey results is already a well-established practice in intellectual property litigation to develop a more refined understanding of consumer choice. Rigorous, scientifically-sound consumer surveys have been used in trademark infringement matters for decades, and more recently have also begun to be used in cases involving patents (to quantify damages), false advertising (to evaluate consumer harm), collusive behaviour (to assess the impact on consumer demand), and employment-related class actions (to fill evidentiary gaps). Recent merger reviews suggest that it may well be time to apply the same level of insight into competitive dynamics in the merger review process. CD

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