

Efficiencies/**Dynamic Analysis**/Integrated Analysis

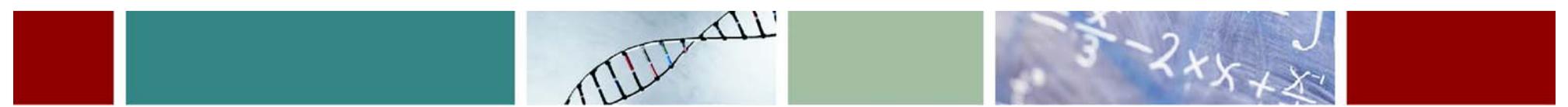
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How Are the Agencies Doing?

- 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 indirectly 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 direct 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”

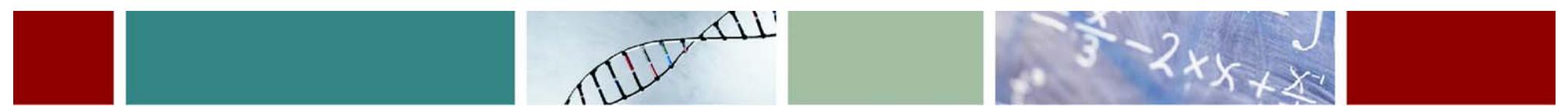
- Transaction driven by efficiencies

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

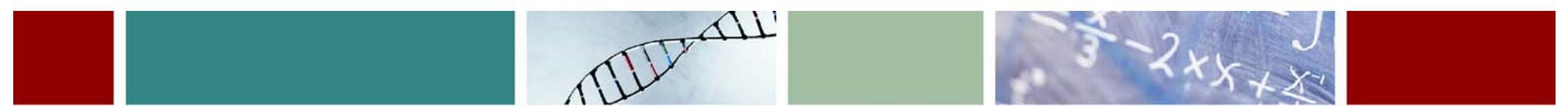
■ Most cases are not “ideal”

- But efficiencies **always** belong at the beginning



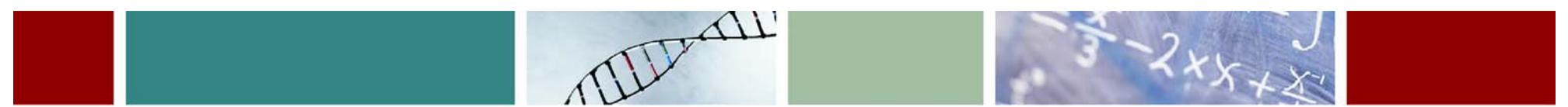
Integrative Analysis

- **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**



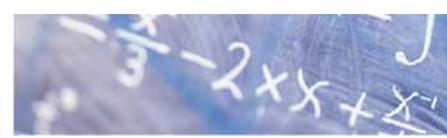
What Efficiencies Should “Count”?

- **“*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



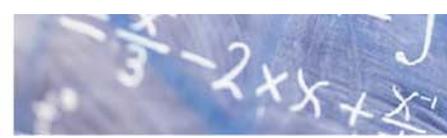
What Efficiencies Should “Count”?

- 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 ...**