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Merger Control – the Role of Economics in Applying the Law

Merger control was included in the Finn- ish competition law on October 1, 1998. From this date on, the law covers both behavioral and structural elements of markets. Mergers are now subject to control of the Finnish Competition Authority and the Competition Council. According to the Competition Act, a merger may be prohibited if it creates or strengthens a dominant position as a result of which competition would be significantly impeded in the Finnish market or a substantial part of it.

The objective of this article is to answer three questions. The first concerns the reason for control of mergers. We next go to address specific problems that the competition authority and enterprises will face as competition related issues of a merger or acquisition are assessed. The third topic we discuss is how the motives of enterprises affect the work of the authorities. The article is organized according to the three broad issues above.

Mergers are controlled due to the potential inefficiencies they bring about with the emergence of or increase in market power. With market power, the markets do not allocate the resources of an economy in an optimal way, this results in a loss of welfare to the society. Since the competition authority cannot directly observe the degree of market power, it applies an indirect test. This calls for the evaluation of factors that affect market power. We discuss these factors and present empirical evidence on the arguments. Particular attention is paid on barriers to entry, which is usually the most important single factor in sustaining market power.

Mergers and acquisitions have for the recent times been driven by the objective of concentrating business operations in the core competencies of enterprises. These are the areas of a business in which the enterprise has been successful and where it owns skills that its competitors cannot easily imitate. We argue that this affects considerably the assessment of mergers. The effect of these motives is a high number of horizontal and vertical mergers and acquisitions – at the expense of conglomerate ones. Furthermore, acknowledgement of these motives is great importance to the competition authority. Mergers motivated by core competencies will usually increase market power but at the same time lead to true efficiencies. Since the competition authority decides whether to block a merger based on the net effect of these two forces, it is expected that the assessment of mergers becomes even more difficult than at the time when such motives were not so clearly defined at the enterprise level.

Future plays a major role in the assessment of mergers. We discuss how this affects the assessment of mergers. One difficulty that is encountered is that the competition authorities try to infer from the current market structure and from additional market information the likely development of the market. Thus, the assessment is partly structural on its nature. Another difficulty is the asymmetry between the informational positions of the competition authority and enterprises. Due to this, the firms are given the burden of proof in what comes to showing, for instance, the efficiency effects of mergers. Yet another difficulty is to show, in the case of the so-called failing firm situation, that the acquired company will most probably exit the market if the merger is not challenged and that no alternative third party exists for the proposed transaction.