## Contents

1. Introduction ................................................................. 2
2. The Indian Scenario regarding merger .............................. 3
3. Reasons for merger & amalgamation ................................. 4
4. Motivation of horizontal merger ..................................... 6
5. Adverse features ............................................................ 6
   - Coordinated effects .................................................. 6
   - Unilateral effects .................................................... 7
6. Some key expressions ..................................................... 8
   - Relevant market definition ...................................... 8
   - Product market definition ....................................... 9
   - Geographic market definition .................................. 9
   - Appreciable adverse effect ..................................... 10
   - Concentration & market share ................................ 10
   - Calculation of market share .................................... 12
7. Criteria to be within the purview of the Act ..................... 13
8. Procedure of Investigation ............................................. 14
9. Inquiry introduction combination by the Commission ........... 15
10. Pre notification ............................................................ 22
11. Conclusion ................................................................. 22
Academic Exercise

HORIZONTAL MERGER GUIDELINES

Introduction

Competition in the market is the most crucial aspect in terms of growth of productivity and optimum allocation of resources. Competition also creates expansion of employment opportunities, higher GDP growth, better standard of living and a dramatic rise in the availability and choice of goods and services for the consumer. But some enterprises resort to anticompetitive practices for personal gain that result in unfair competition. Unfair competition means adoption of practices such as collusive price fixing, deliberate reduction in output in order to increase prices, creation of barriers to entry, tie-up sale, predatory pricing and discriminatory pricing. Such practices if not arrested make the market inefficient and affect social welfare. Merger and amalgamation sometimes create market power which may be abused. Merger is considered to be safe if the merger entity was not the market leader and the market was not conducive to collusion. A merger may have anti-competitive effects in two ways: either the competitors of the merged firm have no capacity to react to a possible reduction in output arising from the merger or competitors do have the capacity to do so, but do not use it because a collusive behaviour is sustainable.

To address these issues there is a requirement for a competition law. The competition law is an increasingly common element of public economic policy. In India, the Monopolies and Restrictive Trade Practices Act was enacted in 1969; it underwent a number of amendments most notably in 1984 and 1991. It was felt that MRTP Act had become obsolete in certain respects in terms of international economic development and there was a need to shift the focus ‘from curbing monopolies to promoting competition’. A high level committee was set up by the Government to study the issue. After considering the report a Competition Bill was introduced in the Parliament in 2002. The Competition Act became a law in January 2003.

The highlighted main provisions related to the four components of Competition Act, 2002 are anti-competitive agreement, abuse of dominance, combination regulation and competition advocacy. The companies always use merger, a type of
combination, as a business strategy to grow and consolidate and to eliminate competition. In this guideline we will concentrate on the merger. Unlike cartel merger is not presumed to be illegal according to the Act. It helps weak firms to sustain in market; it increases efficiencies and help being internationally competent. But sometimes merger may pose a threat to the competition in the market. This happens when merger raises a possibility of abuse of market power. When merger gains some market power it can raise price above the anti-competitive level or can reduce the size of production. These would certainly make consumer worse off. So there should be some regulatory authority to monitor the merger.

The Indian scene

In India, the Companies Act, 1956 and the Monopolies and Restrictive Trade Practices Act, 1969 (before the 1991 amendments) are the statutes, which regulate mergers. In the Companies Act, a procedure has been laid down, in terms of which a merger can be effected. Sanction of the High Court is an essential prerequisite for the effectiveness of mergers. The other statute-regulating merger was the MRTP Act, 1969. After the 1991 amendments, the statute does not regulate mergers*. The regulatory provisions in the MRTP Act were removed through 1991 amendments, with a view to giving effect to the new industrial policy of liberalization and deregulation. In spite of the 1991 amendments to the MRTP Act there continues to be a concern that merger can have an adverse effect on public interest, such as reduction in the number of players, market concentration, discouragement of new entrants, dictation of prices by the large merged firms. On account of the 1991 amendment to the MRTP pre-merger approval requirement was removed. However, MRTP still had power under provisions relating to restrictive trade practices (RTP) and monopolistic trade practices (MTP) to take action against merger that were anti-competitive. The HLL employees’ union in the HLL-TOMCO merger case used this reasoning. Merger of TOMCO with HLL results in major market share for HLL, which can also eventually lead to elimination of some TOMCO product and limiting choice of consumers. Such situation can lead to higher prices of available product. A committee of Former Chief Justice of Delhi High Court and company

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* Since 1991, the number of mergers has accelerated. But even now, most of mergers are friendly fusions.
representative was supervising the effects of merger on free availability of competing products to consumers. Committee examines complaints of consumers about non-availability of brands. However, Supreme Court ruled that the 1991-amendments to MRTPA did not empower the Central government to pre-emptively stop a merger, because it is likely to affect competition. Thus, 1991-amendments removed ex-ante power of MRTPA to block merger deals. This vacuum has been plugged by the Competition Act, 2002, which gives ex-ante power to the Competition Commission to block certain combinations if found to adversely affect competition but the combination should cross the threshold limit stipulated by the Act to be regulated by the Commission.

**Definition:**

According to the Oxford Dictionary “merger” means “combining of two companies into one”. Merger is a fusion between two or more enterprises, whereby the identity of one or more is lost and the result is a single enterprise. In merger the assets and liabilities of the companies get vested in another company, the company that is merged losing its identity and its shareholders becoming shareholders of the other company.

Merger can be categorized under three types----- **horizontal, vertical** and **conglomerate.** In this Guideline we are only concentrating on horizontal merger. Horizontal mergers normally involve the joining together of two or more companies, which are producing essentially the similar products or rendering the similar services which compete directly with each other (for example, sugar and artificial sweeteners).

**Reasons for Merger & Amalgamation:**

There are multitudes of reasons why Mergers take place:

1. Synergy in operating economics:
   Combined efforts produce better results than two separate undertakings because of saving in operating costs.

2. Taxation advantage:
   A profitable company can buy a loss maker to target’s tax write-offs

3. Other advantages:
Growth, diversification, operating efficiencies, procurement of supplies, financial assets because of larger size of merger

A merger is said to be **Horizontal** if the parties involved undertake directly competing activities. Horizontal mergers produce two consequences that do not arise in either vertical or conglomerate mergers. They reduce the number of firms competing in the relevant market and eventually result in market concentration. This structural change raises two potential competitive issues. **Firstly**, they weaken the strength of overall competition constraints currently exist in the relevant market. If two potential competitors of the relevant market merge then there may rise a situation of abuse of dominance. This combined entity then may have command over price and price may rise too significantly relative to pre-merger level or they can also limit the output. A merger that has this characteristic is said to give rise to a situation of **single firm dominance**. This competitive effect is also known as the **unilateral effect** of merger. Here the decisive factors of the intensity of this effect are degree of substitutability between the products of merging parties and those supplied by the other producers. If customers find the product of a merging party very close substitute to the product of another merging one then merger can easily increase price. Unilateral effects are therefore likely to occur primarily in **differentiated product market**. Therefore the conducive factors for the unilateral effect are high market share, high level of competition between merging parties and lack of alternatives for customers.

**Secondly**, by eliminating effectiveness of competition merger can also change the shape and nature of competition. Merger may lead to coordination friendly environment. It is more favourable for sustainable tacit collusion. Once merger takes place competition in the market is largely eliminated. The firms that have been coordinating even before merger gain some collective market power after merger takes place. This market power can involve increasing prices, limiting output or dividing up the market. A merger which has these characteristics is said to give rise to **collective dominance** or alternatively to give rise to **coordinated effects**.

In contrast to the unilateral effects, this coordinated effect more likely to emerge in **homogeneous market**.
Motivation of Horizontal Merger

The major factors that motivate mergers are: To achieve optimum size of business, to remove certain key factors and other bottlenecks of input supplies, improve the profitability, serve the customer better, achieve economies of scale and size, acquire assets at lower market price, bring separate enterprise under single control, grow without any gestation period, and nurse a sick unit and tax advantages by acquiring a running concern.

Adverse Features:

Merger of two companies in the same field may involve reduction in the number of competing firms in an industry and tend to dilute competition in the market. They generally contribute directly to the concentration of economic power and are likely to lead the merger entities to a dominant position of market power. It may result in lesser substitutes in the market, which would affect consumers’ welfare. Yet another adverse feature may surface, if a large undertaking after merger because of resulting dominance becomes complacent and suffers from deterioration over the years in its performance. These adverse features may or may not be outweighed by the positive features such as economies of scale; utilization of idle funds, nursing a sick unit. That is why competition law seeks to enforce strict regulation.

• Coordinated Effects of Merger:

A merger may diminish competition by enabling the firms selling in the relevant market to engage in coordinated interaction that harms consumers. Coordinated interaction is comprised action by a group of firms that are profitable for each of them only as a result of the accommodating reactions of others. This behaviour includes tacit or explicit collusions. A merger may also make coordination easier, more stable or more effective for firms that were already coordinating before the merger either by making the coordination more robust or by permitting firms to coordinate on even higher prices. Coordination may take various forms. In some markets, the most likely coordination may involve keeping prices above the competition level. In other markets, coordination may aim at limiting production or the amount of new capacity brought to the market. Firms
may also coordinate by dividing the market, for instance geographic area or other customer characteristics, or by allocating contracts in bidding markets. Coordination is more likely to emerge in markets where it is relatively simple to reach a common understanding on the terms of condition.

The Commission should examine if it would be possible to reach terms of coordination and if it is likely to be sustainable. Evidence of past coordination is important if the relevant market characteristics have not changed appreciably or are not likely to do so in the near future. So factors conducive to coordination are:

(i) Similar structure of enterprises,
(ii) Availability of key information about rivals,
(iii) A relatively stable market,
(iv) No countervailing power present in the market in terms of powerful buyers,
(v) No ‘mavericks’
(vi) The presence of barriers to entry.

• **Unilateral Effects of Merger:**

A merger may diminish competition even if it does not lead to likelihood of successful coordinated interaction, because merging firms may find it profitable to alter their behaviour unilaterally following the acquisition by elevating price and suppressing output. Unilateral competitive effects can arise in a variety of different settings. In some markets the products are differentiated, so that products sold by different participants in the market are not perfect substitutes for one another. Moreover, different products in the market may vary in the degree of their substitutability for one another. A merger between firms in a market for differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales loss due to the price rise merely will be diverted to the product of the merger partner and, depending on relative margins; capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable pre-merger. The price rise will be greater the closer substitutes are the products of the merging firms, i.e., the more the buyers of one product consider the other product to be their next choice.
**Some Key Expressions:**

Mergers may result in anti-competitive practices in the relevant market. If merger causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

Now we will analyze some of the terms frequently used in Competition Act. The economics in these terms should be understood to get right sense of the competition issue.

**Relevant Market Definitions:**

This part ensures that the Commission evaluates the likely anti-competitive effect of a merger within the market that could be subject to the exercise of economic power. Accordingly the Commission seeks to define a market for the product or service of each merging firm. The main purpose of market definition is to identify in a systematic way the immediate competitive constraints facing the merged entity. The relevant market contains all substitute products and regions, which provide significant competitive constraints on the products and region of interest. In recognition of this the underlying approach to define a relevant market is now common across most competition jurisdictions. This test is known variously as the “Hypothetical monopolist test”, SSNIP (Small but Significant and Nontransitory Increase in Price) test” or the “5-10% test”.

The test originated in the US Horizontal merger Guidelines issued jointly by the Department of Justice and the Federal Trade Commission. **“Hypothetical monopolist test”** finds whether a hypothetical monopolist of concerned product would be able to increase price profitably (e.g.5 to 10 per cent). This is the case when other substitute products are not creating sufficient constraints to the product of our interest and so it can profitably raise price. If this condition is satisfied for a product in a market then it is considered to be a relevant market for the aforesaid product. But if it is not, because a sufficiently large number of customers would switch to some other substitute products, then we have to include the substitute product with the focal product (i.e. product under investigation) and repeat the same test. As before, we will ask if it would be profitable to sustain 5-10% above competitive levels. If so, the test is complete. The relevant market is
the focal product and its closest substitute. Defining the relevant market in this way it can be ensured that all products that pose significant competitive constraints are taken into consideration. According to the Act relevant market means “the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets”.

A market definition should normally contain two dimensions: a product and geographic area. It is often practical to define the relevant product market first and only then to define the relevant geographic market.

**Product Market Definitions:**

In Act, “relevant product market” means “a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use. The product market considers which products provide effective competitive constraints on those products produced by the parties under investigation. For example, if the pricing of Pepsi provides effective competitive constraints on the pricing of Coca-cola, then the relevant product will include both Pepsi and Coca cola.

**Geographic Market Definitions:**

The Act defines relevant geographic market as “a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from the conditions prevailing in the neighbouring areas”. The relevant geographic market is defined with reference to the competitive constraints that firms located in one region pose for those firms located in the same region as the firm or firms under investigation. Thus, if another product constrains Thus a relevant market might be the market for steel in India. The product market in this case is “steel” while the geographic market is India. A relevant market cannot just have a product dimension or just have a geographic dimension: it must be a collection of products in a given area.

In general, there is not a single methodology for determining the relevant geographic market definition. At least one needs to identify the number, size, and
locations of firms that compete with the merging parties. The availability of particular data for these tasks varies greatly from deal to deal, as do the institutional details of the market, including different national regulations, legal barriers to trade, language differences, and other factors that impede entry or expansion of output. A variety of approaches have been proved to be useful. **Elzinga-Hogarty tests, price correlations, Granger Casualty and Cointegration** is some approaches to geographic market definition. **Elzinga-Hogarty tests** relies on two simple threshold tests of concentration of imports and exports for a given product definition. The first test is called LIFO (‘Little In From Outside’) and the second is called LOFI (‘Little Out From Inside’). LIFO measures the importance of imports and LOFI, on the other hand, measures export.

**Appreciable Adverse Effect:**

In assessing if an activity has an appreciable anti-competitive effect; the Commission will consider the facts and circumstances for each individual cases. The Commission would investigate the nature of action, the relevant market share of the business, the nature and structure of the market or industry etc. It is recognized that there are difference between industries and the nature of competition, so there should not be any rigid definition of the term. In some cases, although an arrangement may seem to be anti-competitive as it involves collaboration of powerful companies, the particular arrangement may in reality have net economic benefits and hence will not be found anti-competitive. The Commission can announce a threshold aggregate market share of the merger parties (like 25% or so) in the relevant markets. If the agreement exceeds that margin then it is considered to have appreciable adverse effect. However, it must be emphasized that this market share threshold is indicative. The determination in a particular case will depend on its facts and circumstances. There may be an appreciable adverse effect even when share of the market is below that stipulated one and vice versa.

**Concentration and Market Shares**

Market concentration is a function of the number of firms in a market and their respective market shares. More experienced jurisdictions have developed an economic tool to measure the concentration and to indicate which mergers may have possible anti-
competitive effects. The test initially adopted was the four-firm concentration ratio test, also known as 4CR. 4CR is the sum of the shares of the four largest firms in the relevant market. Australia and Canada for example calculate a 4CR for their merger reviews. But it does not provide any information on the relative size of the firms and number of the firms. However, over the years the Herfindahl-Hirschman Index ("HHI") has been seen to be a more accurate tool for measuring market concentration. The HHI is calculated by summing the squares of the individual market shares of all the participants. Unlike the four-firm concentration ratio, the HHI reflects both the distribution of the market shares of the top four firms and the composition of the market outside the top four firms. It also gives proportionately greater weight to the market shares of the larger firms, in accord with their relative importance in competitive interactions.

The Federal Trade Commission of US divides the spectrum of market concentration as measured by the HHI into three regions that can be broadly characterized as unconcentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800), and highly concentrated (HHI above 1800). For example, a market with four firms with market shares of 30, 30, 20 and 20 percent will have HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2600$). The HHI ranges from 10,000 (in case of a pure monopoly) to a number approaching zero (in the case of atomistic market). Although it is desirable to include all firms in the calculation, lack of information about small firms is not critical because such firms do not affect HHI significantly.

Market concentration is a useful indicator of the likely potential competitive effect of a merger. Like many countries’ competition commission we can also calculate ranges of HHI, which would indicate the level of concentration and likely adverse effects.

- For example in **US**, post merger HHI below **1000** is not considered to have adverse competitive effects resulting from merger. In **European Union (EU)** the Commission is unlikely to identify horizontal competition concerns in a market with a post-merger HHI below 1000. Such markets normally do not require extensive analysis.
**In US**, post-merger HHI between **1000 and 1800** in a market is regarded to be moderately concentrated. Mergers producing an increase in the HHI of less than **100** points in moderately concentrated markets post merger are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 100 points in moderately concentrated markets post merger potentially raise significant competition concerns. **In EU** this post-merger HHI range is **1000-2000** and threshold of price rise post-merger is **250**.

- Post-merger HHI above **1800** is regarded to be highly concentrated in **US**. Mergers producing an increase in the HHI of less than **50 points**, even in highly concentrated market post-merger, are unlikely to have adverse competitive effects and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns. Where the post-merger HHI crosses 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise. **In EU**, a merger with post-merger HHI above **2000** and post merger increase in HHI of more than **150** is considered to identify horizontal competition concerns.

However this HHI measure is only indicative. Commission should investigate the nature and structure of market, characteristics of players to get deeper understanding of market concentration.

**Calculation of Market Shares**

The definition of the relevant market in both its product and geographic dimensions allow identifying the suppliers and the customers/ consumers active on that market. On that basis, a total market size and market shares for each supplier can be calculated on the basis of their sales of the relevant products on the relevant area. In practice, the total market size and market shares are often available from market sources, i.e. companies’ estimates, studies commissioned to industry consultants and/ or trade
associations. When this is not the case, or also when available estimates are not reliable, the Commission will usually ask each supplier in the relevant market to provide its own sales in order to calculate total market size and market shares.

If sales are usually the reference to calculate market shares, there are other indications that can offer useful information such as, in particular, capacity, the number of players in bidding markets. As a rule of thumb, both volume sales and value sales provide useful information. In cases of differentiated products, sales in value and their associated market share will usually be considered to better reflect the relative position and strength of each supplier.

In MRTP ACT, after 1991 amendment no combination regulation was there. Now in Competition Act, 2002 combinations, which fall beyond stipulated threshold limit, are regulated.

Section 5(C) of the Act outlaws any merger or amalgamation of enterprise, which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such combination, shall be void.

**Criteria to be within the purview of the Act:**

The Commission will take care of the competition issue caused by the merger only if the size of merger falls within the purview of the Act.

According to Act “any merger or amalgamation in which ------

(i) The enterprise remaining after merger or the enterprise created as a result of the amalgamation, as the case may be, have -----

(A) Either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees, three thousand crores; or

(B) in India or outside India , in aggregate, the assets of the value of more than five hundred million US dollars or turnover more than fifteen hundred million US dollars; or
(ii) The group, to which the enterprise remaining after the merger or the enterprise created as a result of the amalgamation, would belong after the merger or the amalgamation, as the case may be, have or would have, -

(A) Either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or

(B) In India or outside India, the assets of the value of more than two billion US dollars or turnover more than six billion US dollars.”

Procedure for Investigation of Merger

In the Competition Act there is a provision for any person or enterprise, who or which proposes to enter into a merger to give a notice to the Commission addressing the all details of the merger, within seven days of approval of proposal or execution of any agreement or the document for acquisition relating to merger by the board of directors of the merger entities. But this notification is not mandatory but voluntary unlike in many other jurisdictions. Now if Commission doubts that this proposed merger is likely to cause, or has caused an appreciable adverse effect on competition in the relevant market in India it will issue a notice to the combination asking their response in favour of combination within thirty days of the receipt of notice. The response from combination should include the reasons why the investigation of the Commission about the effect of merger should not be conducted. If the Commission presumes that the combination has, or is likely to have, an appreciable adverse effect on competition then, it can order the combination to publish the details of their combination within ten working days from this direction, to inform the public and persons affected or likely to be affected by the said combination. But Commission can only direct the combination about the public declaration within seven working days from the date of receipt of the earlier mentioned response from the combination. When combination publishes the details any person or member of the public, affected or likely to be affected by the said combination, can file his written objections, if the Commission invites, before the Commission within fifteen working days from the date on which the details are published. Once the specified period is over the Commission may, within fifteen working days demands for other additional information from the parties to the combination. The information shall be
furnished by the combination within fifteen days from the expiry of the above-mentioned period.

If the Commission is of opinion that any combination does not, or is not likely to have an appreciable adverse effect on competition then it would approve the merger. But if the Commission concludes that the combination has, or is likely to have appreciable adverse effect then it shall direct the combination not to take place. Where the Commission is of the opinion that the adverse effect caused or likely to be caused by the combination can be eliminated by the suitable modification, it may propose appropriate modification to the combination. If the parties accept the modification then it has to perform the modification within the stipulated period. If the parties to the combination do not accept the proposed modification they may come up with their amended version of proposed modification. If the Commission is satisfied with the amendment then it would approve the combination. Otherwise Commission would allow the parties further period of thirty working days within which they have to accept the modification proposed by the Commission. If the parties do not follow the modification then the combination shall be deemed to have an appreciable adverse effect and the Commission will deal it according to the provisions of this Act.

If the Commission does not issue any direction or pass an order within the ninety working days from the date of publication of details of combination, the combination shall be deemed to have been approved by the Commission.

**Inquiry into Combination by the Commission:**

To determine whether a combination has or likely to have appreciable adverse effect on competition in the relevant market the Commission should analyse all or any of the following factors, namely:-

**(a) Actual and potential level of competition through imports in the market:**

There is a probability that there is no such significant competition in the relevant market for domestic production after merging of firms. Then we have to take import market into consideration. If there is potential import market or tariff policy is favourable for imports of that product (which is produced by merger firms) then imports are playing
important role as competitive constraints. In that case merger may not be reducing effective competition. So details of any barriers to entry to importing, including access to distribution facilities, transport cost and customs restriction and details of price of imports vis-à-vis domestic price in the relevant market should be considered as crucial factors to conclude about import market.

(b) Extent of barriers to entry into the market:

When entering a market is sufficiently easy a merger is unlikely to pose any significant anti-competitive risk. For entry to be considered to be sufficient competitive constraints on the merging parties, it must be shown to be likely, timely and sufficient to deter any potential anti-competitive effect of merger. When entry barriers are high, price increases by merging firms would not be significantly constrained by entry. Barriers to entry can take various forms. Sometimes regulatory barriers limit the number of market participants by, for example, restricting the number of licenses. They also cover tariff and non-tariff trade barriers. The incumbent firms also enjoy technical advantages, natural resources, innovation and R&D or intellectual property rights. But for any entrant it is difficult to acquire these and compete successfully. The incumbent firms also take advantage of established position, reputation, experience which new firms lack. Factors such as consumer loyalty to a particular brand, the closeness of relationships between suppliers and consumers, the importance of advertising or other advantages relating to reputation will be taken into account. Moreover entry is more likely to be profitable in a market that is going to be experience high growth in the future than in a market that is mature or expected to decline.

The Commission should examine whether entry is sufficiently swift and sustained to deter the exercise of market power. Entry should be of sufficient magnitude to defeat anti competitive effects of the mergers.

(c) Level of combination in the market;

The Commission should consider the present situation about the combination in the market and the proposals regarding the combination.
(d) Degree of countervailing power in the market;

The competitive pressure on a supplier is not only exercised by producers but can also come from its customers. Even firms with very high market shares may not be in a position, post-merger, to significantly impede effective competition, in particular by acting independently of their customers, if the latter possesses countervailing buyer power. Countervailing buyer power should be understood as the bargaining strength that the buyer has vis-à-vis a seller in commercial negotiations due to its size, its commercial significance to the seller and its ability to switch to alternative suppliers. The Commission should consider to what extent customers will be in position to counter the increasing market power that a merger would otherwise be likely to create. One source of countervailing buyer power would be if a customer promptly could change to alternative sources of supply if the merger increases its price or quality of the product deteriorates. It is more likely that large and sophisticated customers will possess this countervailing buyer power than smaller one. So the target group of the product should also be considered.

(e) Likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;

If there is no entry barrier and entry is timely, sufficient and expansion of capacity is not that costly then it is less likely for the merged firms to raise price. ‘Significantly and sustainable increase prices’ can be measured by SSNIP or Hypothetical monopolist test. Commission also has to consider how potential the closest substitutes of the product exist in the market. Price elasticity of that product in the relevant market, brand loyalty of the consumers and past history of consumers’ behaviour in the relevant markets are also the determining factors of this analysis.

(f) Extent of effective competition likely to sustain in a market;

A merger may significantly impede effective competition in a market since important competitive constraints can be removed between two sellers who merge. For example, if prior to the merger one of the merging firms had raised its price, it would have lost some of its market to the other merging firm. The merger removes this
particular constraint. Non-merging firms in the same market can also benefit from the reduction of competitive pressure those results from merger, since the merging firms’ price increase may switch some demand to the rival firms, which in turn, may find it profitable to increase prices. Such expected reactions by competitors may be relevant factor influencing the merged entity’s incentives to increase prices. This could lead to significant price rises in the relevant market.

(g) Extent to which substitutes are available or are likely to be available in the market;

Closer substitutes impede merger firms to gain a market power on the same good. If no more substitutes are likely to be available merging firms will raise prices significantly. Incentive to raise prices is more likely to be constrained when rival firms produce closer substitutes to the products of the merging firms than when they offer less close substitutes. Therefore it is less likely that a merger would impede effective competition through creation of a dominant position, when there is a high degree of substitutability between the product of merging firms and those supplied by rival products. When data are available, the degree of substitutability may be evaluated through customer preference surveys, analyzing of purchasing patterns, estimation of cross price elasticities of the products involved. Evidence of past customer switching patterns and reaction to price changes may provide important information in this respect.

(h) Market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;

The larger its market share, the more likely for a firm to possess market power. The larger the increase in the sales based on which to enjoy higher margins after a price increase, the more likely it is that the merging firms will find such a rise in price profitable despite the accompanying reduction in output.

(i) Likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
When market conditions are such that rival firms have enough capacity and find it profitable to expand output sufficiently, the Commission is unlikely to find that the merger will create or strengthen a dominant position or otherwise significantly impede effective competition. Therefore Commission has to check capacity constraints, and the cost of expansion of capacity.

(j) **Nature and extent of vertical integration in the market;**

If one or both parties of merger are found to be vertically integrated with some other undertakings then it may give rise to the competition concern. Vertical mergers involve firms in a buyer-seller relationship -- a manufacturer merging with a supplier of component products, or a manufacturer merging with a distributor of its products. A vertical merger can harm competition by making it difficult for competitors to gain access to an important component product or to an important channel of distribution. This is called a "vertical foreclosure" or "bottleneck" problem. So if the firms merging together are also found to be vertically integrated then competition concern would be more. It may concentrate the market power in both ways i.e. by horizontal as well as vertical integration.

(k) **Possibility of a failing business;**

When one party in the merger has been making loses then it is claimed that this merger is not effecting the competition. For, in the absence of merger the loss making firm would go out of the business. But this can not be a sufficient condition to legitimize the merger. The comparison between the likely nature of competition following the exit of the failing firm and likely nature of competition if merger is permitted is required. If there is no other alternative purchaser of failing firm, then productive assets of failing firm would surely exit the market causing anticompetitive effect. In this situation, the merger is likely to have pro-competitive effect. If the other firm would buy the asset after the firm has failed, then the failing firm defence of a merger is not valid. So the failing firm defense carries most weight when it can be shown that the merger enables productive assets to continue in productive use. If other firm will buy the assets after a firm has failed, then the failing firm defence of a merger is not valid. Only if productive
assets would otherwise leave the market does the failing firm argument provide a legitimate defence. In order to succeed on the failing firm defence, a party must establish that it is unable to meet its financial obligation, unable to successfully re-organize itself, there is no other alternative and that the assets of the failing firm would sink but for the merger.

The European Commission considers the three criteria to analyze ‘failing firm defence’. First, the allegedly failing firm would in the near future be forced out of the market because of financial difficulties if not taken over by another undertaking. Second, there is no less anti-competitive alternative purchase than the notified merger. Third, in the absence of a merger, the assets of the failing firm would inevitably exit the market.

(l) Nature and extent of innovation;

In market where innovation is an important competitive force, a merger may increase the firms’ ability and incentive to bring new innovations to the market and so competitive pressure on rivals to innovate in that market. Alternatively, a merger between two important innovators may significantly impede effective competition. Impact of merger on R & D depends on the technological similarities that exist between the companies involved in a particular merger, and on the similarities between the markets they are active in. When two companies focus on the same technological areas, it should lead to a rationalization of the R&D process [after the merger or acquisition]. However, those companies that operate in complementary areas of technology have a higher probability of achieving long-range synergies and economies in their R&D as a direct result of their merger.

(m) Relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;

Commission should also recognize that merger has some advantages also. It can add some contribution to the society as well. A merger enables a merged entity to rationalize cost of production by operating at an increasing scale. An enterprise that is otherwise very vulnerable to the open market may become insulate to the emerging international competition after merger. An infant industry always has incentive to merge
with big companies to ensure its existence. Combination sometimes creates new employment opportunity due to its greater capital and extension of production areas. Moreover, if merger is taking place in a new field which has not gained sufficient importance and does not have impressive investment then that case must have some edge over.

**(n) Whether the benefits of the combination outweigh the adverse impact of the combination, if any;**

Mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction. Efficiencies generated through merger can enhance the merged firm’s ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective (e.g. high cost) competitors to become one effective (e.g. lower cost) competitor. In a *coordinated interaction* context marginal cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. In a *unilateral effects* context marginal cost reductions may reduce the merged firm’s incentive to elevate price. Efficiencies also may result in benefits in the form of new or improved products or services, for instance gains in the sphere of R&D and innovation. So the Commission has to conclude on the basis of sufficient evidence that the efficiencies generated by merger are likely to enhance the ability and incentive of merged entity to behave pro-competitively for the benefit of consumers, thereby counteracting the adverse effects on competition, which the merger might otherwise have. The greater the potential adverse competitive effect of a merger---- as indicated by the increase in post merger HHI, timeliness, likelihood, sufficiency of entry---the greater must be efficiencies in order to clearing the merger. But surely sufficient efficiencies do not justify a merger to monopoly or near–monopoly.
Pre-notification:

One important issue is the requirement for prior notification. There are two possibilities:

1. Approval or disapproval may be obtained before going ahead with the merger.
2. No notification of permission is required and that the threat of action in case of a violation should generally enforce legal behaviour.

In the Competition Act, 2002 pre-notification is not necessary. Prior-notification is likely to lead to delays and unjustified bureaucratic interventions. Both the US and the EU laws require prior approval for mergers above certain thresholds though UK law does not require this. India’s Competition Commission has taken more liberal steps in this respect and the stipulated threshold level is also relatively large. It would surely encourage India’s corporate development. Relative to the size of major international companies, Indian firms are still small. The Commission’s merger regulation is quite favourable for the firms to grow big in the time of globalization.

Conclusion

Global experience has shown that only a few mergers notified receive disapproval. The act gives limited time period to the Commission to look into the matter. The Commission has to pass an order within ninety working days from the date of publication of details of proposed merger. Further, the Commission can call for inquiry if such merger has, or is likely to have, an appreciable adverse effect but within the stipulated time limit. This provision of limited time ensures that there should not be any kind of negligence, unbridled scrutiny into mergers, administrative delay. This saves the opportunity cost of time, capital, and efficiency. The Commission should always keep into the mind it is there to promote and sustain competition, protect the interest of consumers and as well ensure freedom of trade. There is no need to create a stranglehold over such combinations. It should encourage the companies to grow big, to reach an international standard, utilizing economies of scale but without adversely affecting the economy to an appreciable amounts.
Horizontal Merger Guidelines†

For

Competition Commission of India (CCI)

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This project report/dissertation has been prepared by the author as an intern under the Internship Programme of the Competition Commission of India for academic purposes only. The views expressed in the report are personal to the intern and do not necessarily reflect the view of the Commission or any of its staff or personnel and do not bind the Commission in any manner. This report is the intellectual property of the Competition Commission of India and the same or any part thereof may not be used in any manner whatsoever, without express permission of the Competition Commission of India in writing.
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