European Competition Law Summit

The Effects of Horizontal Mergers onProduct and Process innovation

Taking Stock of the Recent Academic Debate

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HORIZONTAL MERGERS ARE LIKELY TO IMPACT INNOVATION OUTCOMES

- Focus on innovation effects is to be welcomed
- Horizontal mergers are bound to have an impact on the incentive and ability to innovate of the merging firms
- Both product and process innovation will be impacted
- Economic analysis can help to assess the sign and magnitude of the effect on innovation of horizontal mergers

KEY QUESTIONS

- Do horizontal mergers reduce the merging parties' incentives to invest in process and/or product innovation?
- Do they *always* reduce such incentives? Or, in other words, is there justification for the adoption of a structural presumption?
- Could horizontal mergers affect the merging parties' ability to engage in process and/or product innovation?
- How should competition authorities and courts balance the potential anticompetitive and procompetitive effects of horizontal mergers on innovation?

DO HORIZONTAL MERGERS REDUCE THE MERGING PARTIES' INCENTIVES TO INVEST IN PROCESS AND/OR PRODUCT INNOVATION?

- Horizontal mergers **may reduce** the merging parties' incentives to invest in process and/or product innovation

  – E.g. Under certain assumptions about the structure of the market and R&D costs, when the investment decision of a merging party impacts negatively the profitability of the other merging party's investment, a merger will reduce the merging parties' incentives to invest

    – Federico et al. (2017): (a) the resulting innovations are bound to compete in the same downstream market and (b) the merged entity prefers not to concentrate its investment in one of the research facilities

  – E.g. Motta & Tarantino (2017): horizontal merger may reduce process innovation because it results in lower output, which reduces the incentives to cut costs

DO THEY ALWAYS REDUCE SUCH INCENTIVES? OR, IN OTHER WORDS, IS THERE JUSTIFICATION FOR THE ADOPTION OF A STRUCTURAL PRESUMPTION?

- **No**, horizontal mergers **may increase** the merging parties' incentives to invest in process and/or product innovation

  – Under certain assumptions about the structure of the market and R&D costs, when the investment decision of a merging party impacts positively the profitability of the other merging party's investment, a merger may increase the merging parties' incentives to invest

    – Denicolò and Polo (2018): (a) merging parties' invest in general purpose technologies generating positive spillovers or (b) when their innovations compete but the merged entity prefers to concentrate its investment in one of the research facilities only

    – Jullien and Lefouili (2018): merging parties' R&D programs are too similar from a social viewpoint.

COULD HORIZONTAL MERGERS AFFECT THE MERGING PARTIES' ABILITY TO ENGAGE IN PROCESS AND/OR PRODUCT INNOVATION?

- **Yes**

- ***R&D synergies***:
  - Complementary skills, etc.

- ***Financial synergies***:
  - Firm with unfettered access to capital markets subsidizes the R& projects of financially constrained start ups
  - Mergers may facilitate investment by lifting credit constraints
    - Relationship between cash flows and investment is well documented
    - Accepted in state aid cases

HOW SHOULD COMPETITION AUTHORITIES AND COURTS BALANCE THE EFFECTS OF HORIZONTAL MERGERS ON INNOVATION?

- Competition authorities should investigate the impact of mergers on innovation with an open mind because mergers may reduce or promote innovation depending on the circumstances

- The assessment of the impact of the horizontal merger on the innovation ***incentives*** of the merging parties should correspond to the competition authority in charge of the case. The competition authority must demonstrate that the ***net incentive effect*** of the merger is negative to discharge its burden of proof

- The assessment of the impact of the horizontal merger on the innovation ***ability*** of the merging parties should correspond to the merging parties and will be subject to the conditions of any other ***efficiency defense***

WHAT ABOUT QUALITY?

- More or less the same:
  - Horizontal mergers may reduce the merging parties' incentives to invest quality; e.g. when an increase in quality by one of them reduces the profitability of an investment in quality by the other
  - However, mergers may increase reduce the merging parties' incentives to increase product variety; e.g. when competition leads to too little product variety …
  - And they may also increase the merging parties' ability to invest in quality and product variety

THANK YOU!

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