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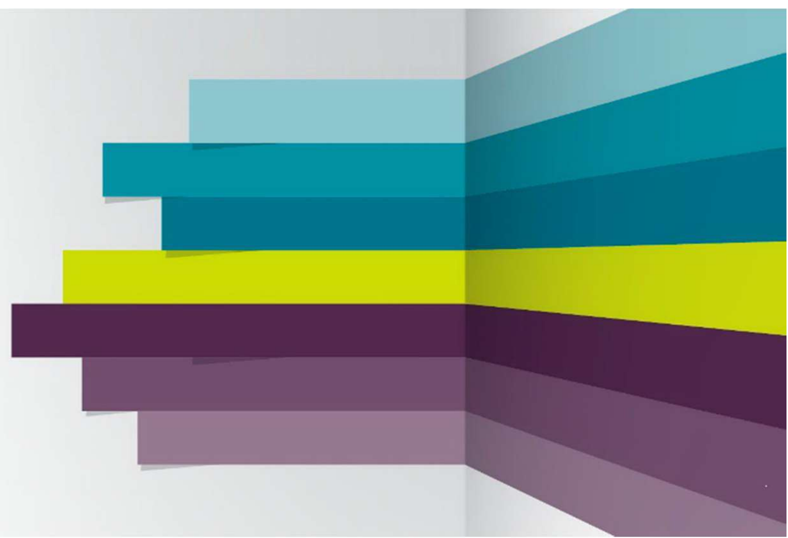
Competition Counsel Day 2019



# Innovation, technology and deal-making

## Technology and disruptive business models

Antitrust analysis in the 'pure-play' technology space has gained a lot of airtime in recent years, as regulators grapple with issues like the effect of 'platforms' on competition, the use of data as a competitive parameter and so-called network effects.

But the disruptive effects of technology are equally evident in more 'traditional' markets. There are a number of industries where disruptive, technology-driven businesses have shaken up competition e.g. taxi services (Uber and Lyft), takeaway services (Deliveroo, UberEATS and Amazon Restaurants), TV and film content (Netflix, Hulu and Amazon) and groceries markets (Ocado and Amazon). Many markets are now more susceptible to rapid new entry, disruptive business models and heightened competition, as incumbents 'up their game' to take advantage of technological innovation.

## Making the case for clearance

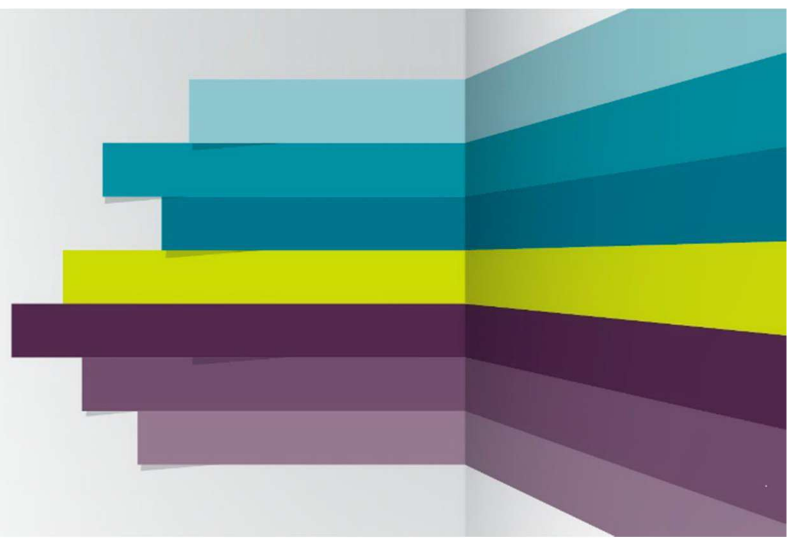
While disruptive entry from digital innovators is a relatively recent phenomenon, it is possible to draw some tentative conclusions as to how companies might use innovative entry to support the case for merger clearance.

Regulators have taken disruptive entry into account not only after it has taken place and had a demonstrative effect on competition, but also at earlier stages in its development, including:

- where it has not yet taken place, but is sufficiently likely on the short-term horizon to be taken into account (e.g. *Sirius* / *XM* in the US); and

- where it has occurred relatively recently, but is already challenging incumbent business models (e.g. *Just Eat* / *Hungryhouse* in the UK).

The key issue is evidencing these effects as the regulators have in some cases rejected arguments as to the constraining effect of disruptive entrants (e.g. *Steris* / *Synergy* in the US). Generally speaking, proving that successful entry will take place in the short-term future is a high hurdle to cross and will require compelling evidence.



The cases in which disruptive entry has been taken into account share certain features:

- **Recent entry by innovative business models accepted as evidence of effective future constraints on mergers of incumbent players.** For example, in *Just Eat / Hungryhouse* (UK), the CMA cleared a merger between the two top players with over 80% of supply on the basis that the market was 'rapidly changing' due to new innovative players (e.g. Deliveroo, UberEATS and Amazon Restaurants). Similarly, the US DoJ noted when clearing *Expedia / Orbitz* that customers could benefit from new innovative competitors such as Google's Hotel and Flights finder and TripAdvisor's Instant Booking feature.

- **Innovative entrants with strong branding and technological expertise are more likely to be accepted as exerting a competitive constraint.** For example, in *Just Eat / Hungryhouse*, the CMA referred to the strong branding and technological and logistics expertise of Deliveroo, UberEATS and Amazon Restaurants. Similarly, the EU noted in *Priceline / Momondo* that, despite being a recent entrant, Google's expertise in search made it well placed to exert a material constraint on the established players.

- **The merger is seen as providing a counterweight to a strong no.1 player benefitting from network effects.** For example, in *Digital Property Group / Zoopla* (UK), the market leading Rightmove had around 50% of the property portals market. The CMA found that the market was subject to strong network effects, meaning that absent the merger it was unlikely that Rightmove would face a strong competitor in the foreseeable future.[1] The merger was cleared on the basis that the merged entity would provide a stronger constraint on Rightmove than the two competitors could do individually.

- **Disruptive innovation can fundamentally change the parameters of competition.** For example, in *Sirius / XM* (US), the parties were generally considered as the only significant operators in the satellite radio market. However, the DoJ considered the merger was unlikely to lessen competition, partly because of the technological change that was anticipated in the music streaming area. Whilst the market had not changed rapidly at the time of the decision (2008), the

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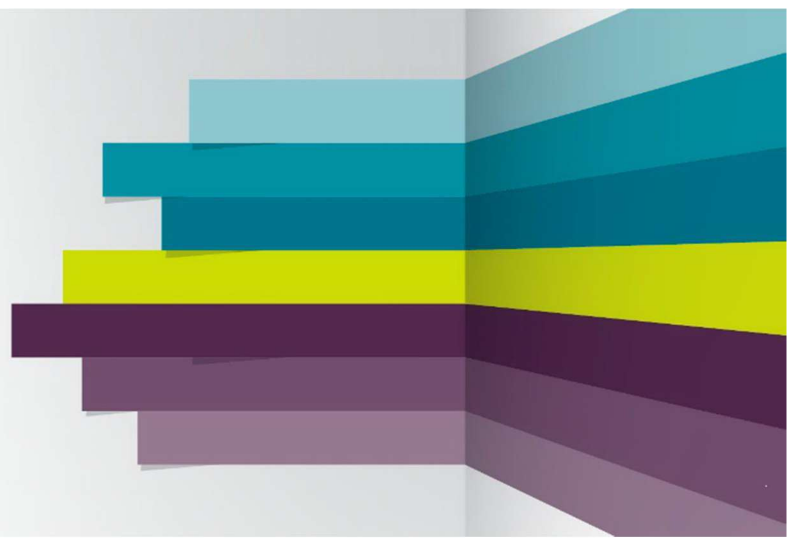
[1] Regulators are increasingly focusing on the risk of some marketplaces tipping towards monopoly where one company is able to pull away from its competitors through network effects. This tendency often arises in respect of online platforms since they often act as intermediaries between two different sides of a market. Where a platform in a given market starts to gain a lead on one side of the market, then this can often lead to the other side of the market following. Eventually, that platform may reach a 'tipping point' where it inevitably services the majority of demand on both sides of the market and can pull away from its rivals.



DoJ pointed to the anticipated introduction of mobile internet services and other platforms as evidence that the merger would be unlikely to result in long-term harm to consumers.

## Key takeaways

Entry or potential entry of innovative companies using new technology and disruptive business models can strongly support the case for merger control clearance.

To assess the strength of arguments around the constraint posed by (actual or potential) entrants, the regulators will typically look at factors such as:

- The strength of competitive threats, including those from outside the 'core' group of incumbents.
- Whether recent entrants may, because of their distinct business proposition, become a stronger competitive threat in the near future. This will include whether new entrants already have a strong brand or significant technological expertise e.g. from complementary markets.
- Whether a merger between smaller competitors could enhance competition with a leading firm that is already benefitting from 'tipping' in its favour.
- Whether recent or potential near-term entrants are likely to change the nature of competition in the relevant market e.g. because they are offering something fundamentally different to incumbents.
- In the context of a specific deal – the rationale of that deal in light of all dimensions to competition, including the need to compete more effectively against innovative entrants.

Companies contemplating deals that may seek to rely on these kinds of market development will need to provide compelling evidence on the constraint posed by disruptive entrants.

Internal documents are a key source for regulators when assessing both deal rationale and the wider competitive landscape. While companies cannot control the content of either a potential target's pre-existing documents or the views of third parties like industry reporters, they should therefore look to ensure that their own documents (whether related to general strategy or specific deals) record all aspects and dimensions of competition in their markets.