Economic Issue of the Day

Philippine Institute for Development Studies
Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas

Vol. XVI No. 1 (December 2016)

Mergers and acquisitions: Do they hinder competition?

Mergers and acquisitions are business activities that affect the market environment and consumer welfare. According to the Philippine Competition Act, a merger occurs when: (1) two or more entities, previously independent of each other, merge into a new entity and cease to be distinct or (2) an existing entity absorbs another entity, with the result that the latter ceases to be distinct.

Companies choose to merge with other entities for varying strategic reasons, such as the improvement of their business capacities. A company might find it crucial to enhance its growth or performance and make itself more competitive by gaining established businesses and capitalizing on the native skilled workforce or technologies (Schlachter and Hildebrandt n.d.). Others, meanwhile, seek mergers and acquisitions to diversify their products and services or to survive during times of economic crisis.

This *Economic Issue of the Day* explains the basic concepts of mergers and acquisitions and tackles their advantages and disadvantages to the economy and consumer welfare. It also discusses the rules and regulations for mergers and acquisitions under the new Philippine Competition Act.

Types of mergers

As with the reasons why they are undertaken, the *types* of mergers and acquisitions also vary. Some merger activities are *vertical* in nature, such as when a company buys another company within their supply chain to streamline production costs. Other activities, meanwhile, are *horizontal* in nature, which companies usually do to reduce competition. Such activities happen when a company buys a smaller company with similar operations or similar products and services to reduce competition.

Mergers and acquisitions are also typified based on the changes they introduce to the nature of the merging companies' business operations. Some enable companies to integrate *product extensions* into their traditional output by acquiring products and services complementary to their own (e.g., a hardware company buying a software company). Others help companies acquire *market estensions* or access to markets that are different from what the acquiring companies are used to.

Good or bad?

Mergers do not necessarily harm competition and may actually contribute to improved consumer welfare. Moreover, they enable firms to reduce costs and become more efficient. Efficiencies that arise from a merger may enhance rivalry, creating incentives for firms to reduce price and deliver new and better-quality products and services. Firms that perform well in this aspect attract customers and take business away from their competitors.

However, some mergers may create stagnation instead of competition and reduce consumer welfare. This happens when mergers are undertaken to create or enhance the merged firm's ability or incentives to exercise market power—either unilaterally or through coordination with rivals. Unilateral effects can arise in a horizontal merger where the merger involves two competing firms and removes the rivalry between them, allowing the merged firm to profitably raise prices. Vertical mergers may also result in harmful anticompetitive practices when the merged firm is able to unfairly refuse to deal with rival firms to limit competition. Coordinated effects may also arise in both horizontal and vertical mergers when firms operating in the same market recognize that they are mutually interdependent and that they can reach a more profitable outcome if they coordinate (Competition Commission and the Office of Fair Trading 2010). Adverse results from these activities include price increases above competitive levels for a significant period of time, reduction in the quality of goods and services, or stagnation of innovation.

Ultimately, it is critical for policymakers to enable and encourage competition in the markets and allow new players to enter and participate. A more liberal business environment can be good for the poor and helpful to enhance the efforts to fight and reduce poverty (Quimbo 2016).

Rules and regulations for mergers and acquisitions

While some companies see mergers and acquisitions as necessary corporate decisions to increase business efficiency and to diversify their portfolios, or to shape features of the markets in their favor, they must abide by fair competition laws and regulations.

The Philippine Competition Act of 2015 provides the guidelines on competition-related activities, including mergers and acquisitions, in the country. According to its implementing rules and regulations (IRR) released in June 2016, the law regulates three types of competition-related behavior by private entities: (1) anticompetitive agreements, (2) abuse of market-dominant position, and (3) mergers and acquisitions that may substantially prevent, restrict, or lessen competition.

The Philippine Competition Commission (PCC) is in-charge of evaluating the legality of mergers and acquisitions. The law requires companies attempting to merge with or acquire other business outfits to notify the PCC and seek its approval regarding the legality of the features of their proposed transaction.

However, not all companies are required to notify the PCC. For instance, the Commission will only require notification from participating entities in a proposed merger or acquisition should the income of their ultimate parent entity directly or indirectly exceeds PHP 1 billion. The same figure is the threshold for other features of a proposed transaction, including its value, and the aggregate assets and gross revenue of the acquiring entities inside or outside of the Philippines.

There is also a regulation for corporations attempting to gain control of a company and increase their shares of the profit. An acquisition projected to give an acquiring corporation more than 35 percent of the voting share or to enable it to receive more than 35 percent of the profits of the noncorporate entity is also required to notify the PCC.

The IRR also details the penalties for those who will fail to notify the PCC or will be found guilty of preventing, restricting, or lessening competition in the relevant market or in the market for goods and services (Clifford Chance 2015). Parties guilty of entering in anticompetitive agreements, of abusing their dominant position, or of engaging in prohibited mergers or acquisitions can be penalized up to PHP 100 million on the first offense, and up to PHP 250 million on the second (Clifford Chance 2015). Depending on the severity of the case, PCC can also impose penalties that range from administrative sanctions to imprisonment from two to seven years (Clifford Chance 2015).

How to review a merger

Merger reviews require thorough analysis, comparison, and investigation to establish if a transaction can potentially cause unfavorable effect on consumer welfare. They must evaluate (1) the relevant market, (2) the likelihood that the transaction will result in substantial changes in market structure, and (3) the probable impact on public's interests or consumer welfare.

As stated in Rule 4, Section 1 of the IRR, some key factors that may be considered when evaluating the effect of a merger or acquisition on competition include (1) the structure of the relevant market, (2) market position of the entities concerned, (3) number of actual and potential competitors, (4) alternatives available to suppliers and users and access to markets, and (5) other barriers to entry.

Upon submission of the notification form, the PCC has 15 days to check if all documentary requirements have been met before launching the review of the proposed merger or acquisition, which takes 30 days. In cases where the parties need to submit other documents or supply new information, the PCC may launch the comprehensive and detailed analysis.

Conclusion

The Philippine Competition Act is the primary law of the country for promoting fair market competition. One of the highlights of this law is to regulate or prevent anticompetitive mergers and acquisitions. Following its mandate, the PCC investigates anticompetitive agreements and abuses of dominant position in the market, as well as conducts inquiries and reviews mergers and acquisitions to determine if these will significantly reduce competition. Whether mergers and acquisitions are good or bad depends on the extent to which they are likely to create substantial changes in the market structure that could lessen competition and the probable impact on consumer welfare of the proposed transaction. ✽

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The *Economic Issue of the Day* is one of a series of PIDS efforts to help in enlightening the public and other interested parties on the concepts behind certain economic issues. This dissemination outlet aims to define and explain, in simple and easy-to-understand terms, basic concepts as they relate to current and everyday economics-related matters.

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