

BETTER TOGETHER: THE PROCOMPETITIVE EFFECTS OF MERGERS IN TECH

October 1, 2021

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Executive Summary

The British government is consulting on whether to lower the burden of proof needed by the Competition and Markets Authority (CMA) to block mergers and acquisitions involving large tech companies that have been deemed as having strategic market status (SMS) in some activity. This is likely to include companies like Google and Facebook, but the scope may grow over time.

Under the current regime, the CMA uses a two-step process. At Phase 1, the CMA assesses whether or not a deal has a 'realistic prospect of a substantial lessening of competition'. If so, the merger is referred to Phase 2, where it is assessed in depth by an independent panel, and remedied or blocked if it is deemed to carry a greater than 50 per cent chance of substantially lessening competition.

The reforms proposed by the government would stop any deal involving a SMS firm that creates a 'realistic prospect' of reducing competition. This has been defined by courts as being a 'greater than fanciful' chance.

In practice, this could amount to a de facto ban on acquisitions by Big Tech firms in the UK, and any others designated as having strategic market status.

Mergers and acquisitions are normally good or neutral for competition, and there is little evidence that the bulk of SMS firms' mergers have harmed competition.

Although the static benefits of mergers are widely acknowledged, the dynamic benefits are less well-understood. We highlight four key ways in which mergers and acquisitions can enhance competition by increasing dynamic efficiency:

Acquisition is a key route to exit for entrepreneurs

- Startup formation and venture capital investment is extremely sensitive to the availability of exits, the vast majority of which are through acquisition as opposed to listing on a stock market. In the US, more than half (58%) of startup founders expect to be acquired at some point.
- According to data provider Beauhurst, only nine equity-backed startups exited through IPO in 2019. By contrast, eight British equity-backed startups were acquired last year by Microsoft, Google, Facebook, Amazon, and Apple alone.

- Cross-country studies find that restrictions on takeovers can have strong negative effects on VC activity. Countries that pass pro-takeover laws see a 40-50% growth in VC activity compared to others.
- Nine out of ten UK VCs believe that the ability to be acquired is 'very important' to the health of Britain's startup ecosystem. Half of those surveyed said they would 'significantly reduce' the amount they invested if the ability to exit through M&A was restricted.

Acquisitions enable a 'market for corporate control'

- M&A allows companies with specific skills, such as navigating regulatory processes or scaling products, to acquire startups and unlock value that would otherwise not be realised in the absence of a takeover.

Acquisitions can reduce transaction costs between complementary products

- M&A can encourage the development of complementary products that might not be able to find a market without the ability to be bought and integrated by an incumbent.
- In the presence of network effects or high switching costs, takeovers can be a way to allow incremental improvements to be developed and added to incumbent products that would not be sufficiently attractive to compete users away from the product by themselves.

Acquisitions can support inter-platform competition

- Competition in digital markets often takes place between digital platforms that have a strong position in one market and move into another market, sometimes using their advantage in the original market to gain a foothold in the new one. This often involves them moving into markets that are currently dominated by another digital platform, increasing competition faced by these companies.
- Acquisitions can accelerate this kind of inter-platform competition. Instead of starting from scratch, platforms can use mergers to gain a foothold in the new market, and do so more rapidly and perhaps more effectively than if they had to develop the product in-house.
- There are many examples of this kind of behaviour: Google's acquisition of Android increased competition faced by Apple's iPhone; Apple's acquisition of Beats by Dre increased competition faced by Spotify; Walmart's acquisition of Jet increased competition faced by Amazon in e-commerce; myriad acquisitions by Google, Amazon, and Microsoft in cloud computing have strengthened the competition each of those face from each other.

The UK risks becoming a global outlier

- There is a serious risk that the US and EU do not follow suit on merger regulation. Although the EU's Digital Markets Act is highly restrictive in some ways, it does not propose any changes to the EU's standards of merger control besides changes to

notification thresholds.

- It is also unlikely that the US will follow suit. Although a bill has been brought forward in Congress, it may struggle to pass without bipartisan support. In the last Congress, between 2019 and 2020, only 2% of the 16,601 pieces of legislation that were introduced were ultimately passed into law.

The Government's theories of harm caused by tech mergers are under-evidenced, hard to action, and do not require a change in the burden of proof to be effectively incorporated into the CMA's merger review process.

The Government should instead consider a more moderate approach that retains the balance of probabilities approach, but that attempts to drive competition by supporting startups and entrepreneurs, and gives the CMA the tools it needs to do the best job it can within the existing burden of proof.

- To support startups, the government should: streamline venture capital tax breaks such as EIS and SEIS, lift the EMI caps to £100M and 500 employees to make it easier for scale-ups to attract world-class talent, and implement reforms to the pensions charge cap to unlock more of the £1tn capital in Defined Contribution pension schemes for investment in startups.
- The CMA should be better equipped to challenge deals that are potentially anti-competitive with lower and mandatory notification thresholds for SMS firms, alongside additional resourcing to bring the cases it believes may threaten competition.
- Most importantly, any new SMS mergers regime should be limited to the activities given SMS designation, not the firms as a whole, to avoid limiting the use of M&A to increase inter-platform competition.

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