

Editorial

Capabilities Checklist for Mergers with Nascent Competitors

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Calls to block mergers involving ‘nascent competitors’ are at historical heights. The momentum comes on the backdrop of two emerging strands in economics literature. First, some studies claim that many mergers do not produce efficiencies.¹ Second, some works document risks of ‘killer acquisitions’ in sectors like pharmaceuticals and digital.

The idea of adapting merger policy to safeguard nascent competitor involves a *dynamic* concern distinct from the usual theory of protecting potential competitors. In competition economics, potential competitors are established firms that do not currently compete in the acquirer’s (antitrust) market, but that are prospectively able and willing to enter in response to a price increase.

The term ‘nascent competitor’ by contrast appears to describe a *new* firm that could be a significant competitive constraint in the acquirer’s (antitrust) market in the future.² If both potential and nascent competitors are a source of *dynamic* competition, the main difference is that the former are established firms, and the latter are new firms.

This very fact requires to treat nascent competitors ‘as a distinct analytical category’ as Scott Hemphill and Tim Wu write.³ Hemphill and Wu lay out three general criteria that must be met to warrant illegality of the merger. A nascent firm must (i) be an innovator, (ii) have future potency, and (iii) be a threat to the incumbent. In turn, Hemphill and Wu advocate a revision of the merger guidelines to take nascent competitors into account, and

a stricter approach to single firm conduct under Section 2 of the Sherman Act.⁴

Is this convincing? Yes. At a high level, Hemphill and Wu correctly call attention to capabilities in the identification of a nascent competitor that constitutes a dynamic competition constraint. Is this sufficient? Unfortunately, not. As Wu recognized elsewhere, unless antitrust reform proposals ‘specify what, exactly, they mean, in concrete, legal detail’, their will remain ineffective.⁵

We add that reforms could even be dangerous. Inasmuch as nascent enterprises that would be status quo disrupters (i.e. ‘overturn the existing order’ . . . to quote Schumpeter) are likely to be rare, then interventions based on the proposed criteria ought to be very infrequent . . . and even then, they would need to be based on compelling evidence by uncommonly qualified experts and backed up by supportive documentary evidence and commentary in the business records of both the acquirer and the target.

But there is hope. The business and management literature on capabilities supplies guidance towards the identification of nascent competitors. Many works in the literature hint that a test should elicit (i) proof of technological viability, (ii) proof of business model viability, and (iii) strong indications that cash flow and/or venture capital and private equity and or IPO funds are likely available to give the target a prospect of outlandish competitive successes.

From there, a capabilities checklist can be derived. The checklist conditions intervention on proof that at least six conditions are likely to be met:

1. The acquiring firm has monopoly power.
2. The nascent firm’s technology has passed proof of concept.
3. The nascent firm has a proven business model to monetize the technology.

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1 Nancy L. Rose and Jonathan Sallet ‘The Dichotomous of Efficiencies in Horizontal Mergers’ (2020) 168 *University of Pennsylvania Law Review* 1941.

2 Hemphill and Wu define a nascent competitor as a firm whose prospective innovation represents a serious threat to the incumbent. C. Scott Hemphill and Tim Wu, ‘Nascent Competitors’ (2020) 168 *University of Pennsylvania Law Review* 1879.

3 *Ibid.*, 1881.

4 An acquisition of a nascent competitor by a monopolist may injure competition if the effect is to enhance the market power that would otherwise be dissipated.

5 <https://onezero.medium.com/the-utah-statement-reviving-antimonopoly-traditions-for-the-era-of-big-tech-e6be198012d7>.

4. The nascent firm has an existing entrepreneurial leadership and strong dynamic capabilities to carry it forward for at least 5–10 years . . . or has a credible succession plan in place.
5. Documents from target and acquiring firm indicate that the technology will be disruptive to core revenue streams of the acquiring firm, and that the target has a viable business model for value capture.
6. The technology of the nascent firm is not competition enhancing (complementary) to the acquiring firm.

The above capabilities checklist purports to establish whether a ‘nascent competitor’ can go the distance by standing alone or by being purchased/supported by another firm. If this is the case, the nascent competitor can be treated as a source of dynamic competition that merger agencies must protect.

Now, the above checklist is an example. It is an invitation to agencies and courts to improve the law by developing operational principles along the same lines.

More important, perhaps, the checklist calls attention to issues of method. Identification of ‘nascent competitor’ requires an adaptation of the tools used in merger analysis. Merger agencies must ‘look under the hood’ of the target and the acquirer. Capabilities audits that focus merger analysis on the resources and assets of the business organization are a step forward. Such analyses are very distinct from the assessments that merger agencies conduct when they evaluate potential competition by looking at pre and post entry prices, production cost and capacity constraints (or lack thereof). Absent the strengthening of capabilities evaluations in the enforcement agencies, trying to identify actionable mergers involving nascent competitors risks remaining a fool’s errand.

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