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A Deeper Dive Into Merger Remedies

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Merger remedies are a crucial component of antitrust enforcement. In fiscal 2015, 77 percent of the Federal Trade Commission's merger enforcement challenges involved orders to remedy the competitive concern.[1] When properly constructed, remedies eliminate the anti-competitive aspects of a proposed transaction while allowing the remainder of the transaction to proceed. Of course, this is a "win-win" for both the merging parties and the antitrust agencies only if the proposed remedy works as intended.

Steven A. Tenn

Retrospective analyses, such as the FTC's recent remedy study[2] (released on Feb. 3, 2017, and summarized here), are a crucial step toward validating whether merger remedies succeed in maintaining the premerger level of competition.

The FTC study concludes that merger remedies generally have been successful, with "failures" representing only 17 percent of the 50 remedy orders considered in their case-study analysis. Interpreting this finding requires an understanding of the methodology used in the FTC's study, and the benefits and limitations of the employed approach relative to possible alternatives. In this article, I consider how the FTC undertook its remedy study, and compare it to an alternative approach that is widely employed in economics literature.

Study Analysis

In its case-study analysis, the FTC judged whether a given remedy was successful based on interviews with the merging parties, buyers of divested assets, other competitors, and customers. This assessment was augmented by an analysis of market share data. The report does not provide details on how FTC staff combined this qualitative and quantitative information to arrive at an overall assessment of a given remedy's success. While success is judged based on whether the premerger level of competition was maintained, it would have been helpful if more information was provided on how the assessments were made. For example, it is unclear how market share data was used. Is success based, in part, on whether the premerger market share for the divested assets was maintained? Or, could a limited decline in market share still be considered a success? With additional information on the study's methodology, such questions could be clarified.

For horizontal mergers with a structural remedy, the study compares the pre- and post-divestiture periods to determine if the remedy maintained competition, under the assumption that the difference between the two periods captures the effect of the employed divestiture. Of course, other market forces may be changing over time that potentially impact the competitive significance of the buyer of divested assets. For example, some remedies may have "failed" due to unrelated demand or cost changes. A comparison of "success" and "failure" rates between divested and nondivested assets would have been useful in interpreting whether the observed failure rates for the divested assets were high or low relative to what would have likely occurred in the "but-for" world.

Multiple approaches can potentially be used to conduct a merger remedy retrospective. By considering a largely qualitative assessment of whether a given remedy was successful, the FTC was able to consider a wide range of merger remedies from many different orders. The study was extremely broad, covering all applicable merger orders over the period 2006-2012.

Alternative Approach

A complementary approach would be to conduct follow-up studies that sacrifice breadth in favor of a deeper analysis of a few specific orders. Since competition may impact a wide range of outcomes, such as price, quantity, quality and product availability, a more detailed analysis could potentially reveal effects (or lack thereof) that might not be apparent when conducting a higher-level, largely qualitative assessment.

An example of such an analysis is a retrospective study I co-authored with FTC economist John Yun that analyzed divestitures from Johnson & Johnson's 2006 acquisition of Pfizer's consumer health division.[3] By relying on retail scanner data collected by ACNielsen, we were able to compare the pre- and post-merger performance of the six divested brands.[4] We considered several outcome variables, including price, quantity and a measure of retail distribution. By collecting detailed information for the impacted markets of this specific merger, we were able to consider a wide range of competitive dimensions that could potentially have been affected.

Our retrospective study found a few instances where the divested brand experienced a major post-divestiture sales change. Further investigation, however, indicated that these changes were likely unrelated to the divestiture itself. For example, diarrhea remedy Kaopectate experienced decreased sales post-divestiture. Further investigation revealed that Kaopectate had discontinued its line of pills (Kaopectate is primarily sold in liquid form). While this product discontinuation began prior to the merger (and divestiture), this process took a long time to complete and did not finish until after the divestiture. This example highlights the importance of considering alternative explanations for why a brand's pre- and post-divestiture performance may differ. This can be accomplished through additional empirical analyses, in conjunction with qualitative assessments such as the industry interviews taken by the FTC in its remedy study.

Since the ACNielsen retail scanner data reported sales for both the merging parties and competing manufacturers, we were able to compare the performance of the divested brands relative to a control group. This approach is widely employed in the economics literature, and allowed us to control for contemporaneous changes that may have impacted market outcomes post-merger but which were unrelated to the merger (or divestiture) itself.

We found substantial heterogeneity across the control group brands. For example, while some control group brands increased sales (or price or retail distribution) between the pre- and post-merger time periods, other brands in the control group experienced a decrease. While common, such variation within the control group makes it difficult to estimate precisely the effect of the divestiture. Even if a divested brand under- or overperformed relative to the average counterpart change for the control group, it would be inappropriate to infer that the divestiture had a significant impact if similar differences also arose for a significant fraction of the control group. This highlights the difficulty of conducting retrospective studies to determine the success of antitrust enforcement. While the effect of a merger or divestiture can be identified if it is sufficiently large, compared to the counterpart change for the control group, it is often difficult to distinguish smaller effects from “random” variation unrelated to the transaction.[5]

Conclusion

The FTC study is an important contribution in assessing whether merger remedies have generally been successful. Alternative approaches that look more deeply at particular remedies, such as the J&J/Pfizer divesture retrospective, have the potential for providing additional insights. These two approaches are complementary, with both expanding our understanding of the real-world performance of merger remedies.

—By Steven A. Tenn, Charles River Associates

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[1] Fiscal year 2015 covered the period Oct. 1, 2014, through Sept. 30, 2015. HSR annual reports are available at https://www.ftc.gov/policy/reports/policy-reports/annual-competition-reports.

[2] Available at https://www.ftc.gov/reports/ftcs-merger-remedies-2006-2012-report-bureaus-competition-economics.

[3] Steven Tenn and John M. Yun (2011), “The success of divestitures in merger enforcement: Evidence from the J&J-Pfizer transaction,” International Journal of Industrial Organization 29, 273-282.

[4] Four brands were included in the merger order, while two additional brands were divested in anticipation of possible anti-competitive concerns. The merger order is available at https://www.ftc.gov/enforcement/cases-proceedings/0610220/johnson-johnson-pfizer-inc-matter.

[5] For further discussion, see Steven Tenn (2011), “The Price Effects of Hospital Mergers: A Case Study of the Sutter-Summit Transaction,” International Journal of the Economics of Business 18, 65-82.
