Statement of the Federal Trade Commission

Presented by
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Before the

Committee on the Judiciary
United States Senate

Concerning

Mergers and Corporate Consolidation in the New Economy

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Mr. Chairman and Members of the Committee, I am pleased to present the Statement of the Federal Trade Commission on Mergers and Corporate Consolidation in the New Economy. The subject is one immediately familiar to us because the Commission, along with the Antitrust Division of the Department of Justice, has a statutory responsibility to review the competitive implications of almost every large merger that is proposed.

Recently, merger review has been an extremely daunting and challenging task. The number of mergers reported to the antitrust agencies under the Hart-Scott-Rodino (○HSR○) Act has increased dramatically from 1,529 filings in fiscal year 1991 to an estimated 4,500 in fiscal year 1998. It has been predicted that the market value of merger transactions this year could exceed $2 trillion, compared to $600 billion for the peak year (1989) during the merger wave of the 1980's. Although antitrust requires a highly case-specific analysis, over the course of reviewing almost 20,000 transactions in the last seven years, we have been able to gain valuable insight into the forces that drive mergers. HSR regulations require merging companies to provide certain studies, analyses and reports that evaluate the proposed transaction. In many cases, the companies supplement those documents with ○white papers○ prepared for the antitrust agencies that offer their reasons for a particular transaction. These documents, as well as other evidence gathered in our investigations, reveal a number of factors that underlie the growth in mergers and acquisitions. This statement will touch on some of the economic forces and corporate motivations underpinning this merger phenomenon, what it means for the competitiveness of the U.S. economy, and the appropriate governmental response.

I. Market Conditions and Corporate Responses

Why has the pace of consolidations increased so dramatically in the last few years? Are mergers today different in character from those of a decade ago? We believe it is fair to say that the current merger wave is significantly different from the ○junk bond○-fueled mergers of the 1980's. Some of those mergers involved the acquisition of unrelated businesses that were targeted for their break-up value or designed to generate cash for corporate raiders. Today§s mergers are more likely to be motivated by fundamental developments in the rapidly changing economy and reflect more traditional corporate goals of efficiency and competitiveness. Among the more prominent factors are the following:

Globalization of competition. Many of the largest and most important product markets for American consumers have become much more global in scope -- automobiles, computers, pharmaceuticals, and commercial aircraft, to name just a few. A merger may enhance a firm§s ability to compete in foreign markets by providing rapid access to an established distribution system, knowledge of local markets, economies of scale, and complementary products.

Deregulation. Many mergers are taking place in industries undergoing or anticipating deregulation. In the 1980's, the Commission reviewed a substantial number of mergers in the natural gas industry, which was then undergoing deregulation. Now, deregulatory changes are taking place in electricity, telecommunications, and banking and financial services. Deregulation often engenders structural change and more competition. Mergers may enable firms to acquire quickly the assets and other capabilities needed to expand into new product or geographic markets. Deregulation also facilitates market entry across traditional industry lines. For example, banks seek to provide other financial services, and other firms seek to serve markets traditionally served by banks. Firms increasingly seek to provide a bundle of services that cross industry lines as regulatory constraints are lowered. We see that happening in several deregulating industries such as financial services, telecommunications, and public utilities. Consequently, we can expect to see a number of cross-industry mergers.

Industry downsizing and consolidation. While this probably was a more important factor several years ago, a number of mergers continue to be associated with industry downsizing and consolidation. That is particularly true in some defense industries. With lower procurement levels and fewer new projects on the horizon, companies have sought to rationalize or reduce capacity through merger.

Downsizing and consolidation also are significant forces in the health care industry. Changes in health care practices, such as shorter hospital stays, may result in excess capacity in some hospitals. A merger may enable two hospitals to eliminate unneeded capacity and operate more efficiently. Structural changes also are occurring in health care as firms seek not only to become more efficient but to meet broader public policy goals, such as increasing the cost effectiveness of health care, increasing the quality of care, and providing diversity of choice. This, too, can lead to mergers that cross traditional industry lines.

Technological change. Economic progress is often driven by innovation and technological change, and mergers may be a response to that change or contribute to it. In a fast-moving, technology-driven economy, a merger may enable a firm to acquire quickly the technology or other capabilities to enter a new market or to be a stronger competitor. The communications industry is a good example. Other mergers may be driven by a desire to consolidate research and development resources to produce a greater research capability. Some pharmaceutical mergers fit that mold.

Strategic mergers. Many mergers, perhaps more than in some years past, involve direct competitors and appear to be motivated by ○strategic○ considerations. Firms are increasingly concerned about being number one or a strong number two in their markets, or perhaps even dominant. That drive can lead to mergers intended to boost market share, eliminate competitors, or acquire an important supplier of inputs needed by competitors. In these types of mergers we may be concerned that a firm has acquired a dominant position. In addition, a concentrated market can make it easier to collude. These mergers also require close scrutiny.

Financial market conditions. Low interest rates and low inflation have produced a favorable climate for investment, and that is reflected in the booming stock market. One result of the above-described emphasis on strategic combinations is that relatively fewer mergers today are financed with cash or debt, as compared to the 1980's. Today, more companies are financing mergers through exchanges of stock. To the extent that a company§s improved performance is reflected in higher stock values, its managers may be more willing to acquire another corporation or be acquired by another corporation through the exchange of stock.

II. How Does The Merger Wave Affect Consumers and the U.S. Economy?

Some mergers can harm competition. The harm to competition, in turn, can harm consumers in many ways -- higher prices, restricted supply of products, lower quality goods and services, less variety from which to choose, and less innovation for the future. In addition, less competition may dampen the incentives to be efficient, and economic performance will suffer. A fundamental goal of the Clayton Act, including its Hart-Scott-Rodino provisions, therefore, is to prevent harm to competition by stopping anticompetitive mergers before they take place. The Commission§s efforts to achieve this goal during the current merger wave explains why the Commission now devotes over two-thirds of its competition mission resources to merger enforcement, compared to about fifty percent a few years ago. We believe those resources are well spent and produce significant dividends in protecting American consumers from competitive abuses and keeping the U.S. economy strong and competitive.

But current resources are inadequate to the task. Despite a three-fold increase in merger activity since 1991, the total workyears budgeted for the Commission§s competition mission have remained essentially flat. We have tried to keep pace by being more efficient and working longer hours, and by shifting resources from non-merger enforcement. We are now stretched to the limit. Merger analysis has become increasingly sophisticated and fact-intensive to ensure that we understand the competitive implications of each transaction. We must examine the possible anticompetitive consequences as well as the potential efficiencies and procompetitive benefits of the transaction. This analysis produces better decisions, but it also is more resource-intensive. Consequently, more resources are needed for both the FTC and the Antitrust Division to do our job of ensuring a competitive American economy.

Although we have found that the majority of mergers do not appear to harm competition, we are able to make that determination only after reviewing the facts of each transaction. We must be able to do that quickly and accurately. We believe we have been quite successful under the circumstances. For example, of the 3,702 transactions filed under HSR in fiscal year 1997, roughly 70% were reviewed very quickly and allowed to proceed before the end of the statutory 30-day waiting period; that is, they were granted ○early termination.○ Approximately 14% of the transactions raised enough issues to proceed beyond the initial review stage and were assigned to either the Commission or the Antitrust Division for further substantive review. In the past year, 4.5% raised questions serious enough to warrant a request for additional information (○second request○) from either the Commission or the Antitrust Division. These are the most intensive investigations and require major resources. Almost half of those transactions resulted in enforcement action or abandonment due to antitrust concerns. In fiscal 1997, the Commission and the Antitrust Division challenged a total of 52 mergers through court or administrative actions and settlement proceedings, and an additional seven transactions were abandoned before formal enforcement action was announced. Over the past three fiscal years (1995-1997), Commission action has resulted in an average of 32 transactions per year either challenged or abandoned. Although the number of problematic mergers is small in relation to the total, the consequences of anticompetitive mergers can be enormous. For example, enforcement action in one case alone -- the proposed merger of Staples and Office Depot -- saved consumers an estimated $1.1 billion over five years.

III. The Antitrust Agencies§ Response

Given the tremendous numbers of recent mergers, it is appropriate to ask whether the antitrust agencies are doing enough to prevent anticompetitive mergers. We believe the level of enforcement has been appropriate. To the extent the mergers not challenged are procompetitive, consumers benefit and companies can be more competitive in both domestic and international marketplaces. We should be concerned about the relatively small but important number of mergers that pose a serious threat to competition and to consumers. We believe we have been successful in distinguishing between the mergers that should be allowed to proceed, and those that raise significant concerns. We review transactions efficiently, we promptly give the green light to those that clearly are not anticompetitive, and we challenge those that present a serious threat to competition and consumers. Furthermore, we place great emphasis on implementing an effective remedy when we find reason to believe that a merger will be anticompetitive.

Forward-looking analysis. The dynamics of the new economy make it especially important that merger analysis be rigorous and forward-looking. In fact, the Commission held a series of public hearings in 1995-96 to address precisely whether antitrust analysis should be modified in light of competitive conditions in the new high-tech, global marketplace. Some of the issues considered were whether antitrust analysis recognized the international nature of competition, merger review in industries that were downsizing, the standards for strategic alliances and joint ventures, and evaluation of cost-savings or efficiency claims.

The hearings produced a comprehensive report and a general consensus that antitrust policy is on the right course. This consensus reflects the basic fact that the antitrust laws have been and continue to be sufficiently flexible to accommodate new economic learning and a changing business environment. Court decisions and the agencies§ guidelines demonstrate that our interpretation and application of those laws have changed with the times. Merger analysis has moved from strict reliance on structure-based presumptions that focused largely on market share data to a sophisticated analysis that takes account of the dynamic nature of competition in the real world. The analysis recognizes that competition in many markets is global. Thus, antitrust analysis takes account of competition from imports, and it recognizes the need for U.S. firms to be competitive in world markets.

As we undertake this analysis, we find there is little inconsistency or conflict between the goal of the antitrust laws to protect U.S. consumers and competition in domestic markets, on the one hand, and the imperatives of global competition on the other. Competition in world markets and competition at home go hand in hand -- one benefits the other. Likewise, efforts to increase efficiency and competitiveness transcend national boundaries. A merger that produces a stronger competitor in a global market could very well have procompetitive benefits in the United States, and those efficiencies will be taken into account. Further, if a merger does create a competitive problem in a domestic market, antitrust remedies are targeted to the specific competitive problem; we make every effort not to interfere with the remainder of the transaction. A Commission order may require a partial divestiture, or licensing of technology, and the remainder of the merger is allowed to proceed. In most cases it is not necessary to block a merger entirely.

Thus, the Commission§s enforcement decisions recognize that the principles of merger analysis must be applied with sharp attention to the dynamics of competition in the new economy. It is important to take a careful look at how firms compete in the marketplace, and how a merger might affect that competition. The following are some examples of our analytic focus:

- *Identifying new markets and new methods of competition.* It is important to recognize new markets and new forms of competition, and identify what firms act as a competitive constraint on others. For example, in the proposed merger of Staples and Office Depot, many people thought that the relevant market for antitrust analysis would consist of all stores that sell office supplies. However, Staples and Office Depot had created a new market segment called office supply ○superstores○ that provided a bundle of products and services unavailable from other retailers. Extensive evidence, much of it from the companies§ own documents and from their pricing behavior, showed that other retailers were not a competitive constraint on the pricing of Staples and Office Depot. The district court agreed that office supply superstores constituted a separate market for purposes of antitrust analysis. Because the merging companies were the two largest of only three firms in that market, the court found that the merger would be anticompetitive and granted the Commission§s motion to enjoin the transaction.

- *Innovation competition.* Our examination of innovation markets is another example of paying close attention to the dynamics of new competition. Research and development -- innovation -- is the lifeblood of our economy. It produces new products and services, and it can greatly affect the competitive landscape of markets in the future. In fact, it is a way that firms compete for future market position.

Some mergers can enhance R&D efforts by combining complementary talents or technologies. Some of those mergers can enable a firm to gain market entry with a new product and interject new competition. Other mergers, however, can restrict R&D efforts and lessen competition. A recent example is the merger of Ciba-Geigy and Sandoz, two pharmaceutical giants based in Switzerland but with far-reaching global operations. Both companies were developing gene therapy treatments for various forms of cancer and other serious illnesses. These research efforts held significant promise for new treatments within the next few years. But, Ciba-Geigy and Sandoz were the only two firms with the bundle of patent rights and technology needed to develop products in this promising new area.

The Commission§s concern with the Ciba-Geigy merger was that it would enable Ciba-Geigy to gain monopoly control over competing patents and other important technologies and, therefore, the power to preclude development and commercialization of these new products by other companies. The Commission therefore challenged the merger but allowed it to proceed with the condition that Ciba-Geigy license certain intellectual property to other firms so that the race to develop and commercialize these important new products could continue.

- *Evolving forms of business organization.* We may observe a variety of complex business relationships as firms enter into new markets. Many of these affiliations bring together businesses from different industries and nations. Firms may find the need to enter into strategic alliances with competitors, suppliers, or customers, or combinations of those entities. Examples include joint ventures and holding companies, which we already see in the financial sector as banks and insurance companies seek to affiliate. It will be important to sort through those relationships to determine their competitive significance.

- *Mergers in deregulating markets.* It is not unusual to see an increase in merger activity in deregulating markets as firms seek out new opportunities. In most cases, that is healthy for competition. However, we must also watch for mergers that may enable firms to retain market power they enjoyed under their prior sheltered existence. Such mergers obviously can frustrate the goals of

> deregulation and deprive consumers of the benefits of competition. Current concerns about the state of competition in certain sectors of the airline industry are a vivid reminder of the importance of close antitrust scrutiny as industries restructure under deregulation. More rigorous application of antitrust principles to airline mergers in the 1980's could have prevented the levels of market concentration we now see in certain airline hubs across the country.

Deregulating markets can be affected in several different ways through mergers. One, of course, is through a merger with a direct competitor. That was the case in the airline industry, and we would expect to see a number of horizontal mergers to occur in industries now undergoing or anticipating deregulation, such as electricity, telecommunications, and banking and financial services. We are prepared to review those mergers to the extent they are within our jurisdiction.

The goals of deregulation also can be frustrated by mergers that result in the elimination of a potential future competitor -- a firm that is not yet in the market but is poised to enter and provide new competition. An example is a merger the Commission challenged in 1995, involving the proposed acquisition of a likely entrant into the natural gas pipeline market in the Salt Lake City area. The natural gas industry had undergone substantial deregulation and was offering new competitive opportunities for consumers. The potential entrant already was having a positive effect on the market through its efforts to line up customers before constructing new pipeline facilities. Enforcement action preventing the acquisition preserved the benefits of deregulation for industrial customers in the Salt Lake City area.

It is also important to take a close look at the strategic implications of vertical mergers in the new market environment. While many, if not most, vertical mergers are likely to be efficiency-enhancing, such as by joining complementary assets, some vertical mergers can be anticompetitive. For example, by acquiring the supplier of a critical input for which there are few or no alternatives, a firm may be able to raise the input costs of its rivals or foreclose entry. Two recent examples serve to illustrate this point.

The first is the merger of Time Warner and Turner Broadcasting. Both companies were major producers of video programming for distribution on cable television. In addition, Time Warner was a major operator of cable television systems, as was TCI, which held a significant interest in Turner Broadcasting. At the time, deregulation of the telecommunications industry promised to interject new competition for cable television, as telephone companies and others sought to use new technology to deliver video programming through alternative channels. The merger, however, threatened to give the combined entity control over competition and entry conditions in both the video programming and cable distribution markets. As a result, the Commission issued a consent order that prohibits Time Warner from discriminating against rivals at either level of the market.

Another recent example is the proposed merger of PacifiCorp and The Energy Group. PacifiCorp is a significant generator of electric power in the western United States. It sought to acquire certain coal mines that were the only source of fuel for several generating plants owned by competitors. By controlling a critical supply of coal, PacifiCorp could raise its rivals§ costs and effectively boost the wholesale price of electricity during certain periods. Had that acquisition taken place, the goals of electric power deregulation in California could have been frustrated and consumers would have faced higher prices.

- *Focus on high technology.* The importance of high technology in the American economy cannot be overstated. High technology markets are marked by creativity, rapid change, and growth. It is precisely these characteristics that may allow anti-competitive behavior to have a more significant impact on a market. We recognize that many mergers may be beneficial to the advancement and commercialization of technology, but some mergers can be harmful. The rapid pace of technological change can appear to obviate competitive concerns because any market power will be short-lived, but that is not always the case. Entry into some high-technology markets can be difficult, and it can be made more difficult by incumbents with market power. It is important to maintain a climate that is conducive to innovation and competition. That requires a carefully balanced approach. Accordingly, the Commission devotes substantial resources to understanding and evaluating issues in this area.

A recent example is the enforcement action involving Digital Equipment Corporation§s sale of microprocessor assets to Intel. The microprocessor at issue was Digital§s Alpha chip, regarded by many as the fastest microprocessor in the world. It is the closest present substitute for Intel§s Pentium chip for computers running the Windows NT operating system. Intel today is the dominant producer of microprocessors, and Digital is one of the few other innovation competitors in the design and development of high-performance microprocessors. The transaction would have given Intel sole control over the production of the Alpha chip and enabled Intel to block this competitive alternative to Intel§s Pentium. As a result of the Commission§s investigation, Digital agreed to a consent order that will require it to license Alpha technology to certain Commission-approved producers of microprocessors or semiconductor products. The order will ensure the continued availability of the Alpha chip as a competitive alternative.

Another example is a case involving software used to automate the design of integrated circuits, or ○microchips.○ The software, called ○routing○ software, is used to map out the connections between the millions of miniature electronic components within a microchip. The acquiring company, Cadence Design Systems, was the leading supplier of a complementary product that microchip designers used in conjunction with routing software. The evidence indicated that Cadence§s acquisition of the routing software would give it an incentive to foreclose competition from competing developers of routing software, which needed to interface with Cadence§s product. The Commission§s consent order requires Cadence to allow other software developers to participate in Cadence software design programs on a non-discriminatory basis, to ensure compatibility of their products.

Finally, as an illustration of the fact that technological change cannot always be counted on to resolve competitive problems, there are continuing concerns about the state of competition in cable television markets. Our investigations show that alternative technologies for delivering video programming have not yet had a significant restraining effect on cable television rates. Since most local cable markets are franchised monopolies, antitrust has limited application in preventing higher prices. However, some communities authorize multiple franchises to serve their consumers, thereby permitting competition. Mergers in those situations are something we can address, and we have. Most recently, Commission action preserved competition between cable systems in two cities in New Jersey.

- *Recognition of efficiencies.* It also is important to recognize and give proper weight to the potential efficiency effects of mergers. With dynamic competition in a global setting, efficient firms will be in the best position to compete. One result of the Commission§s 1995-96 hearings on competition policy in the new high-tech, global marketplace was a revision of the joint DOJ/FTC 1992 Horizontal Merger Guidelines to explain in greater detail how the agencies will analyze merger-generated efficiencies in assessing the overall competitive effects of a merger. The question of merger efficiencies need not be reached unless it appears that the merger may pose a serious threat to competition. When merger efficiencies are relevant, the Commission gives serious consideration to valid, substantiated claims of merger-specific efficiencies.

- *A balanced approach.* Another important principle is that the agencies use a balanced, carefully focused approach, and we do. First, of course, the agencies must direct their enforcement resources at mergers that pose a serious threat to competition and to consumers. Two cases illustrating the importance of strong antitrust enforcement have already been mentioned: the proposed mergers of Ciba-Geigy/Sandoz, and Staples/Office Depot. In the first, enforcement action preserved competition in the race to develop life-saving treatments for cancer and other diseases. In the second, enforcement action saved consumers from paying substantially higher prices as a result of the merger -- an estimated $1.1 billion over five years.

These cases demonstrate some of the many benefits of carefully focused merger enforcement: direct savings for consumers, business customers, and taxpayers; preservation of rivalry in innovation of products -- some life-saving -- for the future; and maintenance of open markets by preserving competitive opportunities for new firms. Importantly, the Commission devotes a major portion of its investigative resources to six high-priority economic sectors that affect millions of consumers and taxpayers: information and technology, health care, pharmaceuticals, defense, energy, and consumer goods and services. Increasingly, we leverage our resources by cooperating closely with state antitrust enforcers. They have been very supportive of Commission enforcement actions, as in the *Staples* case.

The other part of the equation is that antitrust should not intervene when it is not necessary. An example is the merger of Boeing and McDonnell Douglas. Although the merger would give Boeing control over 60 percent of the market for commercial airliners and leave only one major competitor, the evidence from the Commission§s extensive investigation showed that McDonnell Douglas was no longer a significant competitive force in the market, and there was little likelihood that it would regain that status. Thus, although market concentration data suggested that a merger of Boeing and McDonnell Douglas would raise competitive concerns, a careful review of the evidence indicated that the merger would not significantly lessen competition.

- *Minimizing burdens.* The Commission also recognizes that it is important to minimize burdens on business as we conduct this essential review. Since the majority of mergers do not raise anticompetitive concerns, they should be reviewed quickly and allowed to proceed. We have taken several recent steps to reduce burdens. Last year, we adopted five new rules to exempt certain mergers from the Hart-Scott-Rodino reporting and waiting period requirements. Our experience showed that those kinds of transactions were very unlikely to raise competitive concerns. The new HSR exemptions reduced the reporting requirement by about seven to ten percent and resulted in a significant saving of filing fees and other reporting costs for companies engaging in those transactions, as well as a saving of resources for the antitrust agencies in processing and reviewing those filings. While adoption of additional exemptions may be possible, we must proceed cautiously. The fact-specific nature of merger analysis makes it very difficult to determine beforehand which transactions are not likely to raise competitive concerns.

The agencies also have worked on process improvements -- ways to make merger review faster and more efficient. We have expedited the process, called ○clearance,○ through which we decide which agency will review a particular merger. The agencies have also adopted a more streamlined joint model request for additional information, and we implemented a ○quick look○ investigative process that permits an investigation to be terminated if certain threshold information indicates that the merger is not likely to be anticompetitive.

- *Continued evaluation of antitrust standards.* Plainly, the antitrust agencies must continue to be forward-looking in their antitrust analysis, and must do so with efficiency and sophistication. In that regard, another observation from our review of marketplace behavior is that companies increasingly are entering into strategic alliances and joint ventures that are something less than a complete merger. That phenomenon is occurring in a number in industries, including high-tech markets, and a number of joint ventures are international. These ventures may involve, for example, joint research and development, joint manufacturing, marketing agreements, or joint distribution arrangements. While we would expect many of those ventures to be procompetitive, certain concerns inevitably arise whenever competitors collaborate. The need for further study of this issue is another outgrowth of the Commission§s global competition hearings. As a result of those hearings, the Commission formed a task force to study the competitive implications of joint ventures and other forms of competitor collaboration, with the goal of providing additional antitrust guidance to firms and practitioners. That task force has completed its hearings and is in the process of preparing recommendations to the Commission. We, of course, are collaborating with the Antitrust Division in that effort.

- *Adequate resources.* Finally, it is important to ensure that agency resources are adequate to accomplish both parts of our job -- to conduct a timely review of transactions to distinguish ones that are not anticompetitive, and to challenge those that are. The American public and American businesses are entitled to prompt and effective antitrust enforcement. We are doing that job, but with too few resources. As noted before, the workyears budgeted for the maintaining competition mission have been essentially flat since 1991. Mr. Klein§s testimony indicates that the Antitrust Division is facing similar constraints. We are making every effort to keep pace with the surge of merger activity, but our resources currently are stretched to the limit.

IV. Conclusion

In summary, we appreciate this Committee§s attention to the dramatically increasing level of merger activity that has enveloped our country over the past several years, and the opportunity to share with you our views of important issues pertaining to recent mergers and consolidations. We believe that many of these mergers are the result of fundamental economic changes in both our economy and world markets, and that they are, for the most part, beneficial to the economy and to consumers. At the same time, it is critically important to review each of these transactions to ensure that competition, and consumers, will not be harmed. The Federal Trade Commission embraces that challenge and the important responsibility to protect American consumers.