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Law alert

EU competition law

Converge or conglomerate

Competition law implications for the TMT sector

Will competition law affect convergence? Convergence in the Technology, Media and Entertainment, and Telecommunications (TMT) sector is at the forefront of C-suite strategic thinking, and three questions should be considered:

1. When industries converge, what is your advantage?
2. What gives you greater market power — partnering or owning?
3. What role can transactions play in strengthening strategy?

The buzzword in the TMT business community is convergence. In contrast — especially in the context of recent developments and the common view of equity analysts over the past 20 years — conglomerates may appear to be in disfavor. Yet recent competition authority decisions related to convergence mergers have brought out concerns about conglomerates.

This article will define the terms convergence, as used in the TMT sector, and conglomerate, as used by the competition authorities. Next, we'll examine the three questions above and, given the competition regulatory landscape, what implications they have for the TMT sector.

Convergence and conglomerate — context

When it comes to convergence, TMT companies are relentlessly driving disruption, even as that same force ceaselessly reshapes them. Their market boundaries continually dissolve, reform and dissolve again. Content distributors are transforming into content producers, and vice versa; service providers are becoming tech companies; and technology companies are driving dramatic change in virtually every sector of the economy as enablers or new competitors to incumbent players. Competition escalates everywhere, and new entrants move from the far horizon to existential threat, seemingly overnight. Meanwhile, the range of digital disruption and convergence suffuses business with unprecedented complexity, while digitally empowered customers demand more and more — and they want everything now.

The prospect of full vertical integration is drawing closer. Many players are extending their value-chain position to take advantage of new monetization opportunities. Thus, there is an increasingly symbiotic relationship between content and connectivity. Alliances unlock new vertical opportunities, but partnerships have failed to deliver in the past. Partnerships speed entry into new ecosystems, but their long-term effectiveness is questionable. At the same time, non-TMT businesses are playing a growing role in TMT subsectors. Both private equity (PE) and players from other industry sectors are increasing their exposure to TMT.

Conglomerate mergers are mergers between firms that are in a relationship that is neither purely horizontal (as competitors in the same relevant market) nor vertical (as supplier and customer). In practice, the competition focus is on mergers between companies that are active in closely related markets (e.g., mergers involving suppliers of complementary products or of products that belong to a range generally purchased by the same set of customers for the same end use).

The main concern for conglomerate mergers is foreclosure. The combination of products in related markets may allow the merged entity the ability to leverage a strong market position from one market to another by means of tying, bundling or other exclusionary practices. Tying and bundling are common practices that often have no anticompetitive consequences. Companies engage in tying and bundling to provide their customers with better products or offerings in cost-effective ways. Nevertheless, in certain circumstances these practices may lead to a reduction in rivals' ability (either actual or potential) to compete. This may reduce the competitive pressure on the merged entity, allowing it to increase prices.

In Q1 2018, the European Commission (EC) considered conglomerate effects of a transformative deal in the optical industry that resulted in the creation of the only large integrated supplier able to provide opticians with corrective lenses, prescription frames and sunglasses. The EC considered the extent that bundling or tying could occur — namely, the selling of a "complete job" of frames and lenses to customers. It looked at foreclosures, in particular — whether the merged parties' actions could weaken the ability or incentive for rivals to compete. While some commentators argued that the parties' branded products were a "must-have" for opticians, the EC concluded otherwise. In particular, it considered that since the parties' combined market share would not exceed 20%, there were no "must-have" brands, and about half of all opticians' stores did not stock the parties' products. There would be no foreclosure, so no conglomerate effects.

> "Recent competition decisions identify that authorities will analyze convergence transactions to determine if there are conglomerate effects. If one of the merging parties holds significant market power in at least one market, there could be conglomerate concerns."
>
> **Kiran Desai**
> Partner, EU Competition Law Leader

1. When industries converge, what is your advantage?

A major focus for business in relation to convergence is data — specifically, access to data that has value or, as more commonly seen, has volume. The potential of big data analytics is beginning to come into focus. We see that content distributors are collaborating with content providers to gain access to consumer data (especially over-the-top-related data) and strengthen their presence in the value chain.

Market trends are driving the need for investments and business model changes, especially for information service providers. In the context of convergence, this could include focusing on the technology aspects of data analytics, with businesses combining technologies to improve services and develop new propositions. Alternatively, the focus could be on the data itself, such as increasing the value of combined data sets. Some businesses are shifting their focus to customers — adopting a customer-oriented mindset. Other companies are dealing with market trends by focusing more on regulation and helping their clients navigate the new requirements.

The EU Competition Commissioner, Margrethe Vestager, has switched on a searchlight when it comes to data — she is watching. Prompted, some say, by a particular merger in 2014, she has been vocal about the role of data in competition cases. Speaking about transactions for which merger control procedures apply (namely joint ventures and mergers and acquisitions), she said in a 2018 interview, "When we do a merger procedure, we would look into what role will data play. Maybe it's nothing because the data the two businesses merge is something that you can easily copy, or you can buy or you can create it yourself. But maybe they merge sets of data that will work as a unique source for innovation and a barrier to entry for other businesses in this market. The first situation would give us no concern, the last situation may give us concern."

The conclusion one may draw about convergence and data is that there may well be advantage from the proposed transaction. However, if that transaction is subject to review by the competition authorities — if data is a key aspect of it and if at least one party has market power in at least one market — then concerns over conglomerate issues may lead to intervention by the authority.

2. What gives you greater market power — partnering or owning?

As potential future business models multiply and evolve, complexity, convergence, and the need for scale and speed to market are all accelerating one another. That is why one of the clearest data points to emerge from recent research by our organization is the rapid growth of strategic alliances and partnerships across all three TMT sectors. For example, partnerships soared at a 35% compound annual growth rate in TMT, from 2014 through 2017, to an aggregate 527 deals.

Interpreting the data, we have seen a qualitative change in the nature of TMT partnerships. "Many past partnerships were looser affiliations," says Clarence Mitchell, Global Strategy Leader for TMT. "Alliances today in TMT are frequently more significant and tightly integrated. Partners are sharing data, jointly developing products and offerings, and actively building ecosystems and platforms. There is more real operational

integration between partners."

Competition law defines a strategic alliance as either a cooperation agreement or a corporate (or corporate-like) joint venture (JV). The key distinction is that a JV has the resources, financial and otherwise, needed to be active and will be active in a manner that is the same or very similar to a stand-alone player in the same market. Determining which side a strategic alliance falls on can be very complex, and it can have fundamental consequences. If it is a JV, then typically it will need to be notified to one or more competition authorities, depending on the size and geographic distribution of the parent companies' revenues. The JV cannot be implemented before such consent is obtained.

Owning another business — namely, M&A activity — is readily identifiable as an act that typically needs to be notified to one or more competition authorities, depending on the size and geographic distribution of the purchaser and the target companies' revenues.

Whether a JV or an M&A transaction, this likely means a convergence transaction will be reviewed by a competition authority. Any market power held in one market, as identified above, might lead to a conclusion that there are conglomerate effects, resulting in the transaction being blocked or divestments being necessary. A partnering relationship might be a preferable route if preliminary analysis indicates market power is held by at least one of the parties in at least one of the relevant markets. While partnering relationships are not immune from competition law, companies can be more flexible and dynamic while also being compliant with competition law.

3. What role can transactions play in strengthening strategy?

Convergence deals encompass two types of growth-seeking M&As that TMT companies have pursued from time to time. These have reached critical mass in recent years, however, to become a core component of the growth agenda developed in executive suites and boardrooms across the sector. They are:

- **Future-growth convergence**

  These are acquisitions of small, often private, typically venture-backed startups to strategically position for anticipated future high-growth markets. Targets typically possess strategic technology elements, potentially disruptive digital business models, extremely hard-to-find talent or some combination of the three.

- **Immediate-growth convergence**

  These are larger-scale acquisitions to achieve more immediate growth by targeting adjacent industries. Targets typically are incumbent operating businesses that can extend from, or leverage the use of, the buyer's core business or infrastructure — complementing the buyer's existing revenue model.

> "There's hardly a company left that doesn't think technology is going to be core to their ability to succeed in the marketplace."
>
> **Clarence Mitchell**
> Partner, Global Strategy Leader for TMT

Examples of future-growth convergence deals are numerous, as mega-cap industry leaders across TMT invest in emerging players focused on the Internet of Things (IoT), artificial intelligence (AI), analytics, blockchain solutions, advanced advertising technologies, emerging video content developers and many others. For immediate-growth deals, think content creation and distribution mergers, pay-TV and wireless hookups, telecom and internet combinations, software and social media linkages, or even automaker and digital mapping or telematics combinations.

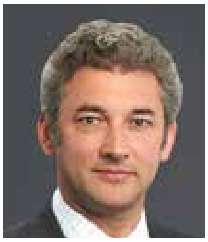
If the strategy is to acquire the target and leverage a strong market position held by either party, then conglomerate effects might apply, remedies may be demanded by the competition authorities and the company's goals frustrated.

Implications for the TMT sector

While the above points have focused on substantive issues, procedure is a significant issue that can materially slow down a transaction timetable and could even prevent the deal from happening. This is most typically experienced when divestments or other remedies must be addressed. One way of shortening the formal merger control timetable is by identifying and addressing issues almost immediately after inception. An appropriate level of preliminary analysis at a deal's first inception, using a combination of business analysis, competition law analysis and economic input, will help prevent strategic paths from later having to be abandoned due to regulatory interference.

If one of the converging parties holds market power, undertaking a preliminary competition analysis is vital, especially if a major reason for the convergence is to obtain access to data. If market power is held, pursuing a partnering approach may be preferential to avoid regulatory interference.

Contacts



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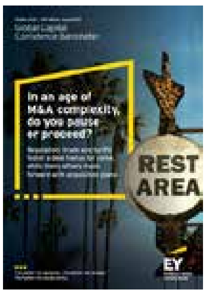

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