European Commission

The Economic Effects of Minority Stakes

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Giulio Federico
Chief Economist Team, DG Competition

Outline

Brief review of possible economic effects

Lessons from recent case studies

Taxonomy of cases

Theory of Harm	Silent Stake	"Material influence"
Horizontal unilateral effects	✓	✓
Coordinated effects	✓	
Input foreclosure	(✓)	✓
Customer foreclosure		✓

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Theories of harm - Horizontal

Unilateral effects

- Logic of Upward Pricing Pressure (UPP) extends naturally to cases with silent minority stakes
- “Material influence” can be incorporated into theory of harm and also into adjusted concentration indicators
- Mismatch between influence and financial interest can exacerbate anti-competitive effects (“free-riding” on other shareholders)

Coordinated effects

- Presence of silent stake affects incentives to coordinate
- Effects work via (lower) deviation incentives and via (lower) punishment payoffs
- Economic literature relatively complex but indicates that coordination easier under some conditions (e.g. intense price competition absent coordination; “maverick” acquires a stake; tough deterrent strategies feasible; information exchange)

Theories of harm – Vertical

- **Backward integration**
  - *Downstream firm holds a partial stake in upstream firm*
  - Input foreclosure concerns worsened if there is material influence, since loss of upstream profits “shared” with other shareholders (whilst downstream gain the same)
  - Even with passive stakes, it may soften downstream competition (since higher sales by downstream rivals benefit acquiring firm via its stake in upstream provider)
- **Forward Integration**
  - *Upstream firm holds a partial stake in downstream firm*
  - This mitigates input foreclosure, but may worsen customer foreclosure (through same “free-riding” argument)

Glencore / Xstrata (2012)

- Glencore owned 34% stake in Xstrata prior to Transaction (down from higher levels), but Commission found that Glencore did not control Xstrata
- Evidence indicates that the minority stake affected competition between the parties
  - Firms not seen as (fully) independent competitors
  - Xstrata relied on Glencore as "trader of last resort" (e.g. for zinc metal in Europe)
- Competition concerns present independently of characterization of stake
- Remedy: Termination of long-term off-take with a key competitor (Nyrstar)
  - Removes the overlap
  - Overall concentration effects depend on treatment of stake
- Current Regulation allowed for effects-based assessment of the structural links between Glencore and Xstrata in this case, because there was change in control

Ryanair / Aer Lingus (UK Competition Commission 2013)

- Ryanair holds a 30% non-controlling stake in Aer Lingus
- Two bids for full control prohibited by the European Commission (in 2007 and 2013)
- UK CC Provisional Findings (May 2013) indicate that the stake may lead to a SLC via a number of mechanisms, e.g.:
  - Reduced ability by AL to merge with another airline
  - Reduced ability by AL to raise capital (since Ryanair can block special resolutions)
  - Influence on AL´s ability to manage its LHR slots (via de facto veto power conferred by the stake)
- These mechanisms are based on forms of influence that fall short of control, and rest on Ryanair's economic incentives to make Aer Lingus a less effective competitor

Munksjö / Ahlstrom (2013)

- Proposed Transaction combines Munksjö and some assets of Ahlstrom in "NewCo", leading to significant overlaps in two specialty paper markets
- Ahlstrom retains a 15% stake in NewCo, and its shareholders own a further 50% of NewCo (on a pro-rata basis)
- Overlap products both manufactured at one Ahlstrom plant (Osnabruck), in addition to non-overlap product
- Initial remedy consists of sale of Osnabruck back to Ahlstrom, and then *carve out* of overlap products
- Ahlstrom's structural links to NewCo created input foreclosure concerns
    - Post-remedy, Ahlstrom may have the ability and incentives to render the divested business less competitive, in order to benefit NewCo
- Accepted remedy consists of sale of plant and "*reverse carve out*"

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Conclusions

Effects identified in the economics literature are not just theoretical possibilities

Recent case practice shows that minority stakes (with or without material influence) can affect competitive outcomes

A reform of the merger regulation would allow for a more consistent economic treatment of structural links