Antitrust, Mergers, and Competition Policy

All societies face the problem of deciding how much power should be held by leading enterprises. In the United States and in many other nations, antitrust laws have long been used to foster competition and protect consumers. A particular aim of such laws and competition policies is to assure that mergers and acquisitions do not reduce choice in the marketplace. Advancing technology and globalization have raised new issues concerning business competitiveness. These trends have presented public policy makers with the challenge of protecting consumers and promoting fair competition in an era of great corporate power.

This chapter focuses on these key learning objectives:

- Understanding the dilemmas corporate power presents in a democratic society.
- Knowing the objectives of antitrust and competition laws.
- Recognizing the key issues in contemporary antitrust policy.
- Analyzing the reasons for mergers and acquisitions and how they affect the relationship between business and its stakeholders.
- Assessing how competition policies compare around the world and what impact globalization has had on antitrust enforcement.

In 2005, the two leading providers of online courseware, Blackboard and WebCT, announced plans to merge. Together, the companies served almost 4,000 higher education, K-12, corporate, and government customers, comprising 80 to 90 percent of the market. The CEO of Blackboard hailed the merger as an opportunity to "improve the access, quality, and efficiency of education on a global scale." But some observers expressed concern. "You're talking about the No. 1 and No. 2 companies worldwide in course management software," said the associate vice president of information technology at Purdue University. "This is a big shift in the market, . . . and there are justifiable concerns in terms of costs and software issues."[1] U.S. antitrust regulators approved the merger the following year after the Justice Department completed a review of its competitive impacts.

Coach, the U.S. maker of luxury goods, filed a complaint in 2005 with the Japanese Fair Trade Commission, that country's antitrust agency. Coach said it had been the victim of anticompetitive practices by the French firm LVMH, the producer of rival Louis Vuitton handbags. That brand was extremely popular in Japan, where 92 percent of people in their 20s in Tokyo were estimated to own at least one Louis Vuitton accessory or article of clothing. Coach complained that when it tried to sell its goods in department stores where LVMH was already established, Vuitton had threatened to pull out. After a several-month investigation, Japanese authorities declined to bring action. For its part, Vuitton dismissed Coach's complaint, calling it "a desperate effort . . . to compensate for the inability of their products, manufactured in regions with cheap labor, to compete with true luxury brands manufactured in Europe."[2]

In Europe, antitrust regulators raided the offices of the four leading manufacturers of elevators and escalators, seizing documents and records. The European Competition Commission charged that the companies (ThyssenKrupp of Germany; Schindler of Switzerland; Kone of Finland; and Otis, a unit of U.S.-based United Technologies), which together accounted for two-thirds of the world

market, had conspired to divide up the market for service contracts in several European countries. Much of the revenue from elevators and escalators comes not from the cost of the units themselves, but from ongoing maintenance and repair. By agreeing not to compete for service contracts, the companies had artificially propped up prices, regulators said. If convicted, the companies could face huge fines. Price fixing like this was the "worst kind" of antitrust abuse, the commissioner said.[3]

These examples of conflicts involving private businesses, customers, and government regulators around the world illustrate how anticompetitive practices or the perception of them can arise in the free market system and what can be done about them. This chapter looks at how the United States and other countries and regions have traditionally sought to preserve and enhance competition through antitrust and related policies. As business becomes increasingly global, and as deregulation and technological change reshape many industries, antitrust and other competition policies are being reexamined.

The Dilemma of Corporate Power

At the heart of antitrust policy everywhere is the dilemma of corporate power—and if and to what extent government should constrain it. **Corporate power** refers to the capability of corporations to influence government, the economy, and society, based on their organizational resources.

Power is often a function of size, and by almost any measure used, the world's largest business enterprises are impressively big, as shown in Figure 10.1. As measured by revenue, the "big five" in 2005–2006 were ExxonMobil, Wal-Mart, Royal Dutch/Shell, BP, and General Motors. The most profitable companies in the top 10—during a period of rapidly rising oil prices—were all in the petroleum industry: ExxonMobil, Royal Dutch/Shell, BP, Chevron, and ConocoPhillips.

One way to sense the economic power of the world's largest companies is to compare them with nations. Figure 10.2 shows some of leading companies alongside countries whose total gross domestic product is about the same as these companies' revenue. The revenues of automaker Toyota, for example, are about equal to the entire economic output of Portugal. Wal-Mart's are about the size of the economy of Austria; and BP's are about the size of the economy of Indonesia.

The size and global reach of major transnational corporations such as Wal-Mart and the others listed in Figure 10.2 give them tremendous power. Through their ever-present [illegible] Disney, Microsoft, and Sony products and images are known almost everywhere. These corporations have the resources to make substantial contributions to political campaigns, as discussed in Chapter 9, thus influencing the policies of governments. They dominate not only the traditional domains of product manufacture and service delivery, but also increasingly reach into such traditionally public-sector activities as education, law enforcement, and the provision of social services.

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The dilemma of corporate power concerns how business uses its influence, not whether it should have power in the first place. Most people want to know if

business power is being used to affirm broad public-purpose goals, values, and principles. If so, then corporate power is considered to be legitimate, and the public accepts large size as just another normal characteristic of modern business. On the other hand, when corporate power is misused—for example, to gain an unfair advantage over competitors, as Microsoft was accused of doing—then public policy may be required to check abuses.[4]

At the start of the 21st century, new realities of global competition and technological change are forcing a reexamination of how power and social control are best balanced. We examine those issues after outlining the goals of antitrust regulation and major U.S. antitrust federal laws.

Antitrust Laws

Objectives of Antitrust and Competition Laws

Antitrust and competition laws serve multiple goals. Some of these goals, such as preserving competition or protecting consumers against deceptive advertising, are primarily economic in character. Others, though, are more concerned with social and ethical matters, such as a desire to curb the power of large corporations or even a nostalgic wish to return to a society of small-scale farmers and businesses. The result is multiple, overlapping, changing, and sometimes contradictory goals.

The most important economic objectives of antitrust laws are the following:

The protection and preservation of competition is the central objective. Antitrust laws do this by outlawing monopolization, prohibiting unfair competition, and eliminating price discrimination and collusion. They also protect competition by blocking mergers that would allow a single company to dominate a market. For example, U.S. antitrust regulators blocked a proposed merger of Nestlé and Dreyer's, because the combined firm would control 60 percent of the market for super-premium ice cream.[5] The reasoning is that customers will be best and most economically served if business firms compete vigorously for the consumer's money. Prices should fluctuate according to supply and demand, with no collusion between competitors, whether out in the open or behind the scenes.

A second objective of antitrust policy is *to protect the consumer's welfare by prohibiting deceptive and unfair business practices*. The original antitrust laws were aimed primarily at preserving competition, assuming that consumers would be safeguarded as long as competition was strong. Later, though, policy makers realized that some business methods could be used to mislead consumers, regardless of the amount of competition. For this reason, antitrust laws also prohibit deceptive advertising, as illustrated by the following example.

> One of the hottest areas of advertising today is called "buzz marketing." Is this practice deceptive, and therefore a violation of antitrust law? A consumer advocacy group called Commercial Alert filed a complaint with U.S. regulators, claiming that Procter & Gamble's buzz marketing unit, Tremor, had crossed the legal line. P&G had recruited 250,000 teenagers, mostly girls, to talk with their friends about new products, such as hair coloring. The teens were paid in product samples, not cash. The company defended the practice, saying, "To be a member [of Tremor] is empowering for a teen. You have a voice that will be heard, and you get cool information before your friends receive it." But Commercial Alert said the company was "perpetuating large-scale deception upon consumers," who were often unaware that a company was behind the "buzz."[6]

A third objective of antitrust regulation is *to protect small, independent business firms from the economic pressures exerted by big business competition*. Antitrust laws prohibit **predatory pricing**, the practice of selling below a producer's cost to drive rivals out of business, as shown in the following example.

> Air Canada was investigated in 2003 by the Canadian Competition Tribunal, that nation's antitrust regulatory agency. The tribunal was concerned that the airline might have slashed fares to below cost on some routes in the Atlantic provinces in order to drive smaller competitors out of business. Air Canada, which had filed for protection under its country's bankruptcy laws, said it had lowered prices to stay competitive and had not violated the Canadian Competition Act.[7]

In this instance, although price-cutting by Air Canada helped consumers in the short run, it could hurt them in the long run if it allowed the airline to regain a near-monopoly. In other cases, large businesses may undersell small ones because manufacturers are willing to give price discounts to large-volume buyers. For example, a tire maker wanted to sell automobile and truck tires to a large retail chain at a lower price than it offered to a small gasoline station. Antitrust laws prohibit giving such discounts exclusively to large buyers unless there is a genuine economic saving in dealing with the larger firm. A situation in which a small business used antitrust laws to contest possible collusion by larger firms is profiled in Exhibit 10.A.

A fourth objective of antitrust policy is *to preserve the values and customs of small-town life.* A strong populist philosophy has long been part of the antitrust movement. Late-19th century populists favored small-town life, neighborly relations among people, a democratic political system, family-operated farms, and small-business firms. They believed that concentrated wealth posed a threat to democracy, that big business would drive small local companies out of business, and that hometown merchants and neighboring farmers might be replaced by large impersonal corporations headquartered in distant cities. Antitrust restrictions on big business, populists believed, might further these social and political goals. One hundred years after the first antitrust laws were enacted, however, these populist goals often conflict with business views of what is required in a world of global competition.[8]

The Major U.S. Antitrust Laws

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The Sherman Act

The Sherman Act of 1890 is considered to be the foundation of antitrust regulation in the United States. The Sherman Act:

- Prohibits contracts, combinations, or conspiracies that restrain trade and commerce. For example, if music companies colluded with retailers to set minimum prices for CDs, this would be against the law.
- Prohibits all attempts to monopolize trade and commerce. (A **monopoly** exists when one company dominates the market for a particular product or service.) Using predatory pricing, as illustrated in the example about Air Canada, is one method of monopolization. Monopolies are further discussed later in this chapter.
- Provides for enforcement by the Justice Department, and authorizes penalties, including fines and jail terms, for violations.

The Clayton Act

Originally passed in 1914 to clarify some of the ambiguities and uncertainties of the Sherman Act, the Clayton Act, as amended, now:

- Prohibits price discrimination by sellers, if it would injure competition.
- Forbids requiring someone to buy an unwanted product or service in order to get another one they want. For example, it would be illegal for a computer company to force the purchaser of a new laptop to accept a service contract as a condition of the sale. The customer should be free to buy the laptop without a service contract, or to buy one from another vendor. In antitrust law, this practice is called **tying**.
- Prohibits companies from merging if competition is lessened or a monopoly is created. For example, several years ago U.S. antitrust regulators blocked a proposed merger between Staples and Office Depot, on the grounds that it would eliminate competition between the two office supply stores and lead to higher prices for consumers in some markets.
- Outlaws interlocking directorates in large competing corporations. For example, Chevron and ExxonMobil would not be permitted to have a single person serve as a member of the board of directors of both companies at the same time.

The Federal Trade Commission Act

This act, too, became law in 1914 during a period when populist sentiment against big business was very strong. In addition to creating the Federal Trade Commission to help enforce the antitrust laws, it prohibited all unfair methods of competition (without defining them in specific terms). In later years, the act was amended to give more protection to consumers by forbidding unfair business practices, such as deceptive advertising, bait-and-switch merchandising, and other consumer abuses.

The Antitrust Improvements Act

All of the important additions made to the antitrust laws during the 1930s and 1950s were incorporated into the three major laws as summarized above. But in 1976, Congress put a new and separate law on the books. The Antitrust Improvements Act strengthens government's hand in enforcing the other three laws. This law:

- Requires large corporations to notify the Justice Department and the Federal Trade Commission about impending mergers and acquisitions so that regulators can study any possible violations of the law that may be caused by the merger and order any divestitures necessary to preserve competition.
- Expands the Justice Department's antitrust investigatory powers.
- Authorizes the attorneys general of all 50 states to bring suits against companies that fix prices and to recover damages for consumers.

Exemptions

Not all organizations are subject to these four antitrust laws. Major League Baseball, for example, has been exempt from antitrust regulation since 1922 (although a 1998 law revoked this exemption for labor relations only). This exemption has been criticized for permitting baseball owners to collude to restrict the number of teams, drive up ticket prices, and force concessions from cities eager to attract or keep a major league team. Also not covered by U.S. antitrust laws are labor unions, agricultural cooperatives, insurance companies (which are regulated by state, not federal, laws), and some business transactions related to national defense. The exemption of cooperative research and development efforts is discussed later in this chapter.

Enforcing U.S. Antitrust Laws

The two main antitrust enforcement agencies shown in Figure 10.3 are the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission. Both agencies may bring suits against companies they believe to be

guilty of violating antitrust laws. They also may investigate possible violations, issue guidelines and advisory opinions for firms planning mergers or acquisitions, identify specific practices considered to be illegal, and negotiate informal settlements out of court. Antitrust regulators have been active in prosecuting price fixing, blocking anticompetitive mergers, and dealing with foreign companies that have violated U.S. laws on fair competition. At the same time, regulators have tried to be sensitive to the impact of antitrust policy on the competitiveness of U.S. firms internationally, as described in a later section in this chapter.

Antitrust suits also can be initiated by private persons or companies who believe themselves to have been damaged by the anticompetitive actions of a business firm and who seek compensation for their losses. Nearly 95 percent of all antitrust enforcement actions in the United States are initiated by private parties, not government officials.

Attorneys general of the various states also may take action against antitrust violators, not only to protect consumers from price fixing (under the Antitrust Improvements Act) but also to enforce the antitrust laws of their own states. The National Association of Attorneys General has a special section on antitrust laws, and state officials often cooperate in the investigation and prosecution of cases. For example, 19 state attorneys general joined the Justice Department in its suit against Microsoft Corporation.

Finally, the courts usually have the last word in enforcement, and the outcome is never certain. Cases may be tried before a jury, a panel of judges, or a single judge. The Supreme Court is the court of final appeal, and its opinions carry great weight. Antitrust regulators and businesses alike often appeal their cases to this final forum because the stakes are so high and the judicial precedents created by the high court are so important in the long-run development of antitrust regulation.

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Key Antitrust Issues

The business community, government policy makers, and the general public have to seek answers to several key issues if antitrust laws and regulations are to serve both business and society well. Some of the most important ones are briefly discussed.

Monopoly

The key question here is: Is monopoly always bad? In other words, does domination of an industry or a market by one or a few large corporations necessarily violate the antitrust laws? Should the biggest firms in each industry be broken up? In general, the courts have found that monopoly per se is not illegal. If a company dominates the market because it offers a superior product or service, has invented something unique, or even because it is just lucky, that is not against the law. If, however, a firm uses its market dominance to restrain commerce, compete unfairly, or hurt consumers, then it may be found guilty of violating antitrust laws. For example, in the U.S. government's suit against Microsoft, the government's argument was not that Microsoft *had* a monopoly in the market for computer operating systems, but that it *used* its monopoly to hurt its rivals unfairly.

Innovation

Another current focus of attention in antitrust policy is innovation. In the early years of antitrust, regulators promoted competition in order to provide consumer choice and keep prices down. This was an appropriate strategy for markets in which technologies were relatively stable. But in today's fast-paced economy,

regulators have increasingly promoted competition in order to foster technological innovation. In other words, the rationale for bringing antitrust actions is changing.

> For example, in 2000 the Justice Department brought suit against Visa and - MasterCard. The government's argument was not that these two credit card giants were artificially propping up prices, but rather that they had colluded to restrain the adoption of innovations like smart cards—ones with embedded chips that could make health and other data available—that might pose a competitive threat. In 2003, a court ruled that Visa and MasterCard could not prevent its affiliated banks from distributing American Express and Discover cards, potentially opening the way for more competition—and hence more innovation.[9]

The chairman of the Federal Trade Commission commented, "Innovation is more and more the central arena in which competition plays out. [It] is the hot issue for the foreseeable future."[10]

High-Technology Businesses

A related issue is how competition policy should be applied to high-technology businesses. Most antitrust laws were crafted in the late 19th and early 20th century, an era when the economy was dominated by extractive, transportation, and manufacturing industries. The economy has now been fundamentally transformed by the rise of the information age; the primary currency now is intellectual property.

Some people argue that the basic principles of antitrust law apply poorly to today's economy. One reason is that monopolies in many high-tech businesses are inherently unstable, because barriers to entry are low, and dynamic technological change constantly changes the basis of competition. For example, Microsoft argued that the rise of information appliances, such as smart phones, undermined its dominance of desktop computing software. The counterargument is that the principles of antitrust law apply perfectly well; in fact, certain characteristics of high-tech industry tend to favor monopoly formation. For example, consumers tend to gravitate toward a standard computer operating system because most software is written for it, creating a kind of natural monopoly. New information technologies also enable some kinds of collaboration that might not have been possible before. For example, some companies have established joint-venture Internet sites, sometimes called e-exchanges, to sell either to each other or directly to customers.[11] Do these purchasing exchanges violate antitrust laws, or not? One such e-exchange is discussed in Exhibit 10.B.

The courts are struggling to define in what ways high-technology industries are similar to, and in what ways they are different from, other businesses to which antitrust laws have been applied over the years.

One other important issue in antitrust policy, the impact of globalization, is discussed at the end of this chapter.

Corporate Mergers

A **corporate merger** is a combination of one company with another. Because mergers sometimes lead to monopoly and lessen competition, antitrust regulators are deeply involved in deciding which mergers are acceptable and which are not.

Students of corporate mergers usually distinguish between three different types of business combinations, as shown in Figure 10.4. **Vertical mergers** occur when the combining companies are at different stages of production in the same general line of business. For example, a rubber tire manufacturer may combine with a company owning rubber plantations and with a chain of auto parts dealers that sells the tires. Production from the ground up is then brought under a single management, so it is referred to as a vertical combination. **Horizontal mergers** occur when the combining companies are at the same stage or level of production or sales. For example, if two retail grocery chains in an urban market tried to combine, antitrust regulators probably would not permit the merger if the combined firms' resultant market share appeared to lessen competition in that area. Finally, a

conglomerate merger occurs when firms that are in totally unrelated lines of business are combined. One of the best-known conglomerates, General Electric, combines under a single corporate umbrella an extraordinary diversity of businesses. These include units that make aircraft engines, plastics, buses and trains, appliances, and medical imaging devices; that provide loans, leases, and financing programs to consumers and other companies; that sell insurance; and that entertain with NBC, CNBC, Telemundo, and Bravo.

Mergers may be wanted or unwanted. In some cases, the target firm welcomes the acquisition, seeing an opportunity to benefit its shareholders, reach new customers, or provide its employees with greater professional development. In other cases, however, the target firm does not wish to be taken over. In such **hostile takeovers**, the bidder generally makes an offer to buy outstanding shares of the company for more than the current market price. If enough stockholders come forward to sell their shares, the bidder can gain a majority of votes and take control of the company. (The process of corporate governance is further described in Chapter 15.) Managers trying to thwart a hostile takeover use a number of tactics, including trying to convince shareholders that the merger is not in their long-term interest. For example, Oracle's 2004 merger with PeopleSoft was considered hostile because PeopleSoft and its board of directors vigorously resisted the acquisition, preferring to remain independent. The merger went through, however, after Oracle made an offer high enough to attract many shareholders.

Corporate mergers seem to occur in waves at different periods of history, each wave with its own distinctive characteristics. The 1950s and 1960s saw many mergers that produced conglomerates. This wave may have been motivated in part by strict antitrust enforcement that made vertical and horizontal mergers more difficult at that time. Most observers seem to agree that one factor stimulating a surge in the 1980s, by contrast, was the government's general philosophy of deregulation and a more relaxed attitude toward enforcement of the nation's antitrust laws. In this general climate of greater permissiveness, the number of both horizontal and vertical corporate mergers ballooned. Many of the 1980s mergers were hostile takeovers in which conglomerates were acquired, often with high interest rate financing, and the various parts sold off.[12]

The late 1990s and early 2000s witnessed yet another major wave of corporate mergers, sometimes called the era of the *mega-mergers.* As Figure 10.5 shows, merger and acquisition activity, after dipping in the early 1990s, was up sharply in the mid-1990s, peaking in 2000 with deals valued at $1.8 *trillion*. The pace fell in the early 2000s, as the stock market declined and the U.S. economy slipped into recession, and hit a trough in 2003. Since then, the pace has once again picked up, nearly reaching the trillion dollar mark again in 2005.

The mergers of the 1990s and 2000s were driven by several forces.

Technological change: AT&T's $67 billion acquisition of BellSouth in 2006 was just one of several blockbuster mergers in telecommunications, as major companies jockeyed for a favorable position as rapidly evolving technologies enabled the integration of telephone, wireless, Internet, and television services.[13] The need to keep ahead of advances in biotechnology have driven many recent mergers in the pharmaceutical and chemical industries.

Changes in the regulatory environment: Telecommunications deregulation led to a wave of mergers among long-distance phone companies, regional carriers, and cable operators. Several big combinations in health care were spurred by anticipated regulatory changes in the delivery of health care. In financial services, a cluster of mergers, including one that produced the behemoth Citigroup, followed repeal of a federal law that had prohibited commercial banks, brokerage houses, and insurance companies from operating under the same corporate umbrella.

Globalization: Other deals were prompted by a rapidly globalizing economy where many companies have found they had to be big to compete effectively on the world stage. "We are moving toward a period of the mega-corporate state in which there will be a few global firms within particular economic sectors," commented one investment banker. The acquisition of Chrysler by German automaker Daimler-Benz, for example, gave both companies a wider global reach.

Stock price appreciation: Finally, the long bull market of the late 1990s contributed to the merger wave during those years, as a sharp rise in their market value gave some companies the means to purchase other firms. In 2000, America Online was able to purchase the much-larger Time Warner—then the biggest merger in U.S. history—by swapping its highly appreciated stock shares for those of its acquisition target. This move later seemed foolish to many commentators, who felt that AOL shares had been overvalued at the time.

Many of the same forces have been echoed in Europe, where a new wave of combinations has swept the continent. Many of these mergers crossed national borders to create new, multinational companies. In just one of many transactions, for example, the British cellular firm Vodafone AirTouch acquired the German company Mannesmann in 2000 for $183 billion, creating a telecommunications giant that vaulted from 70 to 6 in that year's rankings of global firms by market value. The European merger wave was driven, in part, by an effort to remain competitive with U.S.-based firms that had recently grown through their own acquisitions. But it was also driven by the European Union's creation of a common currency, the euro, which reduced foreign exchange risk and made cross-border investments more attractive within the continent. In 2001, for the first time, the volume of mergers in Europe exceeded the number in the United States.[14]

The Consequences of Corporate Mergers

When the smoke has cleared from the most recent wave of corporate mergers, what will the results be? What stakeholders were helped, and what stakeholders were hurt? No one knows the final story, but some results are already observable.

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Sometimes, however, mergers may undermine corporate responsibility to various stakeholders. Employees often lose their jobs when companies merge, as duplicate positions are eliminated, and local communities suffer when a large company moves out or shifts its activities to other regions. Following the acquisition of Gillette by Procter & Gamble, for example, 6,000 Gillette workers lost their jobs including 40 percent of the company's top managers.[15] Some worried that Ben & Jerry's, known for its charitable contributions, would cut back in the wake of its takeover by the Dutch conglomerate Unilever.

The results of mergers are mixed for stockholders. Share values often rise when a merger or acquisition is announced if shareholders perceive benefits from synergies (complementary strengths) between the two firms. But shareholders can also be hurt, particularly where an acquisition is overpriced or not well thought out. A study by *BusinessWeek* of major mergers in the United States between 1995 and 2001 found that 61 percent of the time, shareholders did worse than if the merger had never occurred. (The study measured this by comparing the stock performance of the merged firm, after the merger, with that of others in its industry.) Overall, the average return for all buyers [illegible][16]

Mergers and acquisitions can serve as a dynamic stimulus, producing gains for shareholders and the entire economy from improved efficiency and market pressure. When carried to excess, however, experience has shown that such business combinations can be costly in economic and social terms for some stakeholders. Social control, expressed through antitrust policy, will continue to seek the best balance between competition and other social goals.

Comparative Competition Policies

Other nations have their own versions of antitrust laws, often referred to as **competition policies**. By 2000, 80 nations, accounting for 80 percent of world trade, had adopted some form of antitrust or competition policy. Many of these countries modeled their policies after those of the United States.[17]

Europe has historically lagged the United States in antitrust regulation, but it has been rapidly catching up.[18] As late as the 1960s, only one country in Europe, Germany, had an antitrust enforcement agency. Today, the European Union (EU) has a complete set of competition policies, covering many of the same issues as U.S. antitrust law. Because of Europe's unique historical experience, the enforcement emphasis there has differed somewhat from that of the United States, however. Regulators have given special attention to market domination by formerly state-run enterprises in eastern and central European nations, for example. They have also been concerned about price discrimination across national borders within Europe. For instance, regulators fined VW for prohibiting their dealers in Italy from filling orders for German and Austrian customers attracted by lower prices of cars in Italy. EU regulators have also shown a strong inclination to protect small businesses from big business dominance.[19]

EU member states also have their own policies, and they enforce them vigorously within their own national borders.

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Developing nations around the world have also moved to adopt competition policies, as they have increasingly entered the global economy. U.S. antitrust regulators have worked with officials in Zimbabwe and Kazakhstan, for example, to help them develop their own antitrust laws. Competition policies have even been proposed in countries that long shunned them, as shown in the following example.

> In 2003, China—long considered a laggard in promoting fair competition—took the unprecedented step of adopting a comprehensive antitrust policy. Responding to pressure from the World Trade Organization, a Chinese government commission proposed rules that for the first time would ban price-fixing, monopolies, and predatory pricing. Observers noted, however, great resistance within China to these rules. "There are significant political sensitivities," said one business executive with an international firm, who was based in Beijing. The Chinese government still faced the challenge of enforcing the new policy effectively.[21]

Some of the particular challenges faced by developing nations that, like China, are trying to create and enforce competition policies are profiled in Exhibit 10.C.

Globalization and Competition Policy

The first antitrust laws were created in the late 19th century, when most commerce was regional or national in scope. This is no longer the case. Today, business has greatly expanded its global reach. An increasing proportion of products and services purchased by consumers are made in other nations. As shown in Chapter 7, trade barriers are falling, and new regions of the world are rapidly entering the world marketplace.

The rapid globalization of business has created many new challenges for antitrust enforcement in all nations. Regulators, policy makers, and the courts must now address difficult and complex questions, often not anticipated by the framers of antitrust law, such as the following:

- Should a government permit mergers, joint ventures, or other cooperative arrangements among companies, even if they reduce competition within a

country's borders, if they enhance the ability of domestic businesses to compete internationally?

- Should a government move to break up monopolies within a country, if the global marketplace for the products or services offered by these companies is highly competitive?
- Should regulators and the courts try to enforce antitrust laws against foreign companies if these companies operate subsidiaries—or sell their products or services—within their borders?
- What steps can governments take to create a level playing field, so that corporations operate under a common set of antitrust rules and regulations wherever they do business?

Government officials in many countries today face the challenge of maintaining conditions necessary for fair competition in an increasingly global economy. This section will discuss how government, business, and society have tried to answer the above questions in recent years.

Antitrust Enforcement and National Competitiveness

Both in the United States and elsewhere, regulators have become increasingly sensitive to the impact of enforcement on the ability of domestic firms to compete effectively in the global economy. They have been reluctant to block mergers, break up monopolies, or prevent joint research efforts where these would strengthen **national competitiveness**. This sometimes creates dilemmas for regulators, when the goal of a free, competitive market nationally conflicts with the goal of a strong economy, relative to other countries.

In the United States, since the mid-1980s, the government has generally permitted cooperative activities among firms where appropriate to enhance their competitiveness in the global economy. The National Cooperative Research Act (NCRA), passed in 1984, clarified the application of U.S. antitrust laws to joint research and development (R&D) activities. This law sought to balance the positive effects of cooperative R&D with the preservation of competition by instructing the courts to use a "rule of reason" in assessing individual cases. European regulators have similarly permitted some joint R&D aimed at improving the competitiveness of their industries, such as a recent consortium formed to develop integrated circuits with nanometric (microscopically small) dimensions.

Regulators have also loosened the rules governing joint production agreements to permit important economies of scale. Joint manufacturing and marketing deals between U.S. and foreign firms are becoming more frequent, often without serious antitrust objections being raised by government. Hewlett Packard, for example, has formed strategic alliances with Samsung (Korea), Northern Telecom (Canada), and Japanese firms including Sony, Hitachi, Canon, and Yokogawa.

Enforcing Antitrust Laws against Foreign Firms

In recent years, regulators have been increasingly willing to address possible violations of antitrust law by foreign companies.

In some instances, regulators have moved to prosecute international companies that have set up operations or bought a subsidiary in their countries. In others, authorities have gone even further, going after foreign companies that violate antitrust law within their own borders. When Swiss drugmakers Sandoz and Ciba-Geigy merged, for example, the FTC required the companies to divest some product lines to avoid a monopoly, even though neither company was based in the United States. In some cases, the U.S. Justice Department has prosecuted foreign firms for price-fixing if they sell their products or services in the United States, even though they are based overseas. For example, it levied fines against firms in

France, Germany, and Japan for anticompetitive practices in the food additive business.[22]

For their part, European regulators have also become more active in bringing enforcement actions against U.S. firms. For example, in 2005 a European court upheld the EU's veto of General Electric's plans to acquire Honeywell—both American firms—because the merger would make it harder for other firms to compete.[23] U.S. regulators had earlier approved the merger. The Europeans claimed jurisdiction because both firms were active on the continent.

Antitrust actions taken by the EU and South Korea against Microsoft, an American firm, are described in the discussion case at the end of this chapter.

Harmonization

As more and more countries have adopted competition policies, efforts have been made to coordinate laws and enforcement efforts among nations, in a process called **harmonization**. Several bilateral (two-country) treaties are in place, and the Organization for Economic Cooperation and Development (OECD), a 28-nation group, has worked to coordinate antitrust enforcement. Its goal is to create a level playing field among their members' competing national economies. The European Union and the United States now jointly review global mergers that fall under both their jurisdictions to avoid conflicting decisions on the same case. The EU is also now coordinating much more closely with the Japan Fair Trade Commission, the Japanese antitrust authority.[24]

> In one case, antitrust regulators in the United States, Europe, and Canada joined forces to investigate possible price-fixing in the copper industry. Government officials noted that copper prices had risen 25 percent between 2001 and 2003, and suspected that companies might be fixing prices. The problem was that the firms involved were based in many nations, cutting across regulatory jurisdictions. As cartels become global, so must international cooperation among regulators, noted the European Commission.[25]

Issues of antitrust and competition policy have also been taken up in international trade negotiations, such as those conducted under the auspices of the World Trade Organization. But the explosion of international commerce has far outstripped the pace of international negotiations, and global business still lacks a common, enforceable set of competition policies. The lack of common standards poses a problem for businesses engaged in cross-border mergers; they must often face conflicting regulatory hurdles in multiple countries. A report by the Brookings Institution recommended a broad-multicountry effort to harmonize competition policies. Among other ideas, the study recommended the

establishment of regional antitrust authorities in Latin America and Asia and teamwork among regulators of different nations.[26]

Antitrust policy makers are wrestling with the new realities of global business competition. The days of self-contained national economies are gone. Virtually all businesses are touched, directly or indirectly, by the world marketplace. Cooperation among companies of diverse national origins often makes economic sense. But the need for some form of social control on the excesses of anticompetitive business behavior has not disappeared, either in the United States or in other nations. The optimal fit between antitrust protection and the global marketplace is not easily achieved.

- The world's largest corporations are capable of wielding much influence because of the central functions they perform in their respective societies and throughout the world. Corporate power is legitimate when used to affirm broad public purposes, but may also be abused.
- The objectives of antitrust and competition laws in all countries are to protect consumers, small businesses, and others from unfair, anticompetitive practices.
- Courts and regulators have generally maintained that monopoly does not in itself constitute a violation of antitrust laws; what is important is whether a company has competed unfairly. Other key issues include how to use antitrust policy to foster innovation and national competitiveness.
- The key causes of mergers and acquisitions in recent years were technological change, globalization, shifts in the regulatory environment, and increases in stock valuations. Some believed that mergers were good for stockholders and other stakeholders, while others expressed concern about the long-run effects such mergers would have on stakeholders.
- Many countries have adopted or are adopting competition policies, and efforts are under way to better harmonize these policies across national borders.

Discussion Case: *Microsoft's Antitrust Troubles in Europe and Asia*

Microsoft is one of the great business success stories of the information age. Founded in 1975 by Bill Gates, the company first made its mark by developing an operating system for early personal computers (PCs). Microsoft later developed a new generation of operating systems, sold under the brand name Windows. By the late 1990s, Microsoft controlled over 90 percent of the market for all PC operating systems. The company had also branched out into applications software, developing word processing, spreadsheet, and other desktop programs, as well as a Web browser, Internet Explorer (IE).

In the U.S. case, the Justice Department and several states had argued that Microsoft had used its market dominance in operating systems to leverage the competitive success of IE. One way Microsoft had done so was by integrating IE into Windows, making it difficult for users to uninstall and posing a barrier to their adoption of competing browsers. In the final settlement of the long-running dispute, Microsoft agreed not to retaliate against any computer makers that installed non-Microsoft software, such as a competing browser or media player. It

also agreed to ongoing monitoring to ensure compliance with the terms of the settlement.

The European case focused on a similar issue, but with a twist. There, regulators were mainly concerned that Microsoft had used its dominant position in operating systems to thwart the developers of independent software—including open source software popular in Europe—so that customers would be forced to choose Microsoft's own applications. After a five-year investigation, the European Commission ordered Microsoft to disclose publicly the interfaces that enabled applications software to "talk" with Windows. The company was fined $613 million, the largest antitrust fine ever leveled by the European Commission. In 2006, the Commission fined the company again—this time, for $357 million—saying that Microsoft had not yet supplied the necessary technical information to its rivals.

The EU action was criticized by U.S. assistant attorney general Hewitt Pate, who called the penalties imposed on Microsoft "unfortunate." "Sound antitrust policy must avoid chilling innovation and competition even by dominant companies. A contrary approach," he added, "risks protecting competitors, not competition, in ways that may ultimately harm innovation and the consumers that benefit from it."

Meanwhile, South Korea's Fair Trade Commission (FTC) was also investigating possible illegal action by the company. In 2005, it found that Microsoft had been guilty of bundling Windows with Media Player and Instant Messenger, both Microsoft programs. Microsoft's practices had "constitute[d] abuse of a market-dominant position and unfair trade practices," said South Korea's top antitrust regulator. One reason his agency had taken up the case was that a Korean company, Daum Communications, had complained that its messaging software was being unfairly shut out by Windows.

Korean regulators fined Microsoft $32 million and ordered the company to offer two new versions of Windows for sale there, one with Media Player and Instant Messenger removed and the other with links to competitors' Web sites. They also ordered the company to send existing customers a CD allowing them to replace the bundled software. Microsoft was given six months to comply.

Microsoft said it was disappointed and would appeal the Korean decision. "In essence, the FTC is asking us to create two new versions of Windows that are not sold anywhere else in the world," said a company spokesperson. "That is bad for the consumer and bad for the Korean IT industry." Some analysts speculated that Microsoft might withdraw from Korea altogether, if it determined that revenue from sales would not be enough to make up the costs of developing a special product.

Sources: "DOJ Critiques EU's Microsoft Ruling," IDG News Service, March 25, 2004, *www.infoworld.com*; "Microsoft Fined US $32M by South Korea," *TechWorld,* December 7, 2005, *www.techworld.com*; "Regulators Penalize Microsoft in Europe," *The New York Times,* July 13, 2006, p. C1.

[1] "Blackboard and WebCT Announce Plans to Merge," press release, October 12, 2005, *www.blackboard.com;* "Courseware Providers Merge," *Library Journal,* November 15, 2005, p. 19; and "Blackboard's WebCT Deal Spurs Antitrust Questioning," *The Washington Post,* November 26, 2005, p. D1.

[2] "Coach Files Complaint against LVMH Japan," *Financial Times* (London), March 11, 2005, p. 26; "LVMH Escapes Censure in Japan," *Financial Times* (London), September 5, 2005, p. 24.

[3] "Lift Groups Charged with Price-Fixing Support Services," *Financial Times* (London), October 12, 2005, p. 29.

Rank (by revenue)	Company	Revenues (U.S. $ millions)	Profits (U.S. $ millions)
1	ExxonMobil	$339,938	$ 36,130
2	Wal-Mart Stores	315,654	11,231
3	Royal Dutch/Shell	306,731	25,331

4	BP	267,600	22,341	
5	General Motors	192,604	210,567	
6	Chevron	189,481	14,099	7
DaimlerChrysler	186,106	3,536		
8	Toyota Motor	185,806	12,120	
9	Ford Motor	177,210	2,024	
10	ConocoPhillips	166,683	13,529	

FIGURE 10.1

The 10 Largest Global Corporations, 2005–2006

Source: "Fortune Global 500," *Fortune*, July 24, 2006. Data rounded to the nearest million. © 2006 Time Inc. All rights reserved. Used by permission.

FIGURE 10.2

Comparison of Annual Sales Revenue and the Gross Domestic Product for Selected Transnational Corporations and Nations, 2004, in $ Billions

[illegible]

[4]For two classic analyses of corporate power, see Alfred C. Neal, *Business Power and Public Policy* (New York: Praeger, 1981); and Edwin M. Epstein and Dow Votaw, eds., *Rationality, Legitimacy, Responsibility: Search for New Directions in Business and Society* (Santa Monica, CA: Goodyear, 1978). More recent treatments may be found in David C. Korten, *When Corporations Rule the World* (San Francisco: Berrett-Koehler, 1996); Carl Boggs, *The End of Politics: Corporate Power and the Decline of the Public Sphere* (New York: Guilford Press, 2000); and Alastair McIntosh, *Soil and Soul: People versus Corporate Power* (London: Aurum Press, 2004).

[5] "FTC Moves to Stop $2.8 Billion Ice Cream Deal," *The New York Times,* March 5, 2003, p. C6.

[6] "P&G 'Buzz Marketing' Unit Hit with Complaint," *USA Today,* Octobr 19, 2005, p. B1; and "I Sold It Through the Grapevine," *BusinessWeek,* May 29, 2006, pp. 32–34.

[7] "Carrier's Prices Are Below Cost on Atlantic Routes: Tribunal," *Ottawa Citizen,* July 23, 2003, p. D1.

The owner of Traditions Classic Home Furnishings, a small business with two retail stores, took on a big adversary when it brought an antitrust case against Visa USA and MasterCard International. The owner was frustrated with the fees he had to pay each time a customer bought a sofa or chair using a credit card. "The percentage we have had to pay to credit card companies has been climbing over the past few years," he complained.

Normally, when a person uses a credit card—say, at a convenience store or gas station—the merchant has to pay fees both to its own bank and to the bank that issued the card. These two fees combined usually amount to about 1.75% of the purchase price. In 2005, the credit card industry took in nearly $30 billion in such fees. In the case of small businesses, these fees can be significant. For example, in 2004 the average convenience store paid $31,000 in credit card fees, not much less than its pretax profit of $36,000.

The store owner's attorney contacted other retailers, and eventually four trade associations representing drug stores, pharmacies, convenience stores, and cooperative grocers joined the suit. The group charged that the credit card companies had colluded to keep fees high, despite the fact their costs had declined because of technology and economies of scale.

For their part, Visa and MasterCard defended the fees, saying they were necessary to cover the cost of the transactions and to insure against nonpayment by the customer. Moreover, both retailers and consumers benefited by not having to keep a lot of cash on hand. The retail groups disagreed. "The credit card [fee] system serves as a hidden tax, both on merchants and consumers," said the chief executive of the National Association of Convenience Stores.

Sources: "Credit Where It's Due," *The Wall Street Journal,* January 12, 2006, p. A12; "Suit Charges Credit-Card Firms with Anticompetitive Practices," *The Wall Street Journal,* September 27, 2005, p. A8; and "Taking on Credit Card Fees, with Allies," *The New York Times,* October 5, 2005, p. C5.

[8] A lucid historical account may be found in Louis Galambos and Joseph Pratt, *The Rise of the Corporate Commonwealth: Business and Public Policy in the Twentieth Century* (New York: Basic Books, 1988).

FIGURE 10.3

Antitrust Laws and Enforcement at the Federal Level

[9] "Credit Card Ruling Upheld," *The New York Times,* September 18, 2003, p. C2; and "Visa and MasterCard Ordered to Allow Rival Cards at Banks," *The New York Times,* October 10, 2001, p. C17.

[10] "Antitrust for the Digital Age," *BusinessWeek,* May 15, 2000, pp. 46–48; and "The Next Big Antitrust Case," *The New York Times,* June 15, 2000, p. A26.

[11] "E-Exchanges May Keep Trustbusters Busy," *BusinessWeek,* May 1, 2000, p. 52.

The rise of the Internet has enabled the emergence of purchasing exchanges where businesses can buy and sell with other companies online. One of most important of these was Covisint, a centralized electronic marketplace for the automotive industry scheduled to open in 2001. Supported by General Motors, Ford, DaimlerChrysler, Renault, and Nissan, among others, Covisint promised to be a place where big automakers could interact with tens of thousands of parts suppliers to efficiently transact the many deals necessary to equip new cars and trucks. The business-to-business site held out the potential of cutting costs and streamlining purchasing in a very complex industry. But the initiative raised antitrust concerns. Could a small number of powerful buyers (the automakers), acting in concert, dictate prices and other terms to a large number of weaker suppliers? Usually, in antitrust violations, *sellers* are accused of fixing prices; in this case, it was feared that *buyers* would do so. In late 2000, Covisint was reviewed by antitrust regulators in the United States and in Germany, and given a green light to proceed. But a report from regulators in the United Kingdom warned, "Internet technology might seem to offer the ideal micro-climate for collusion."

Sources: Richard Meares, "Inside Track: Watchdogs Eye Online Exchanges," *Reuters News Service,* November 2, 2000; "Electronic Commerce: Covisint's Up and Running, but Are Roadblocks Ahead?" *Investor's Business Daily,* November 27, 2000, p. A8; "Don't Cheat, Children," *BusinessWeek E.Biz,* December 11, 2000, p. 116.

FIGURE 10.4 Three Different Types of Corporate Mergers

[12] This classification of eras of merger activity draws on Patrick A. Gaughan, *Mergers, Acquisitions, and Corporate Restructurings* (New York: John Wiley & Sons, 1996).

FIGURE 10.5 Value of Mergers and Acquisitions, 1990–2005

Sources: Martin Sikora, "The Era of Good Dealmaking," *Mergers and Acquisitions*, February 2006, pp. 24–27; and "M&A Profile," published annually by *Mergers and Acquisitions*. Where applicable, the most recently corrected data have been used. Data for 2005 are preliminary. Used by permission of *Mergers and Acquisitions*.

[13] "Wedding Bells: A Reborn AT&T to Buy BellSouth; $67 Billion Deal Sets Field for a Race with Cable over Phones and TV," *The Wall Street Journal,* March 6, 2006, p. A1.

[14] "Europe's Lead Over U.S. Widens in Merger and Acquisition Deals," *The Wall Street Journal,* March 28, 2003, p. C5.

[15] "Gillette Losing 40% of Its Top Managers," *Boston Globe,* December 7, 2005, p. D1.

[16] "Mergers: Why Most Big Deals Don't Pay Off," *BusinessWeek,* October 14, 2002, pp. 58–70.

[17] "The New Trustbusters," *Foreign Affairs,* January/February 2002.

[18] Antitrust in a Transatlantic Context," address by R. Hewitt Pate, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, Brussels, Belgium, June 7, 2004.

[19] European Commission, "EU Competition Policy and the Consumer," available online at *www.europa.eu.int/comm /competition/publications/competition_policy_and_the_citizen/*.

[20] "A Crackdown on Cartels by European Regulators," *The New York Times,* December 27, 2005, p. C3; "Consumers Suffered after Market-Share Yalta," *Financial Times,* December 2, 2005, p. 26.

Brazil's antitrust regulators faced a difficult decision in 2003 when they were called on to review a proposed acquisition of Garoto, a Brazilian chocolate company.

Brazilians love chocolate: they eat $1.1 billion worth of the sweet confection every year. In 2002, Nestlé, the Swiss-based transnational, offered $230 million for Garoto in a bid to overtake its rival Kraft, which had a strong position in the Brazilian market with its popular Lacta brand. Nestlé's purchase, if it went through, would give the company a 56 percent market share. It would also create a monopoly of some parts of the industry, such as liquid confectioner's chocolate.

Brazil was relatively new to antitrust policy. Regulators there had only achieved real power in 1994, when new legislation strengthened their agency. The decision they faced was politically tricky. On one hand, consumers and small chocolate companies were worried about the merger and urged them to block it. An executive of an independent candy company that bought its supplies from Garoto said that the merger would create "hyperconcentration in the supply chain. . . . We are going to be completely dependent on them." Said an industry analyst, "The consumer will definitely suffer, because there will be less competition and, as a result, serious price hikes."

But others expected strong political pressure on the fledgling agency to approve the deal. Nestlé, which had made a long-term investment in Brazil's developing economy, was a powerful player. "Brazil is under a lot of pressure to be seen to be receptive to foreign investment," said one analyst.

Source: "Brazil Ponders Nestlé's Acquisition of Competitor," *The New York Times,* July 3, 2003, p. W1.

[21] "China Unveils Competition Rules," *South China Morning Post,* July 2, 2003, Business Section, p. 1.

[22] "An Industry under Constant Scrutiny," *The New York Times,* April 17, 2003, p. W1.

[23] "European Court Upholds Veto of G.E.-Honeywell Deal," *The New York Times,* December 15, 2005, p. C7.

[24] "Global Trade: Cooperation Agreement," *The New York Times,* July 11, 2003, p. W1.

[25] "U.S., Europe and Canada Investigate Copper Pricing," *The New York Times,* May 15, 2003, p. W1.

Key Terms

antitrust laws, *210*
competition policy, *221*
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corporate mergers, *217*
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hostile takeover, *218*
monopoly, *213*
national competitiveness, *223*
predatory pricing, *211*
tying, *214*
vertical mergers, *217*

Internet Resources

www.usdoj.gov	U.S. Department of Justice
www.ftc.gov	U.S. Federal Trade Commission
www.abanet.org/antitrust	American Bar Association, Antitrust Section
www.yahoo.com/Government/Law/Cases	Information on current antitrust cases
http://europa.eu.int/comm/competition	-European Commission, Director-General for Competition

[26] Simon J. Evenett et al., *Antitrust Goes Global: What the Future Holds for Transatlantic Cooperation* (Washington, DC: Brookings Institution Press, 2000).

Discussion Questions

1. What differences do you observe in how regulators in the United States, Europe, and Asia dealt with anticompetitive practices by Microsoft? What do you think explains these differences?
2. Antitrust and competition policies are designed to protect both consumers and other businesses from unfair competition. In this case, do you think regulators were more concerned about consumers, other businesses, or both?
3. If you were an executive of Microsoft faced with multiple antitrust actions in different regions of the world, how would you respond?
4. What do you think is the best remedy for Microsoft's market dominance: structural, conduct, intellectual property, or something else? Why do you think so?