Innovation competition in EU Merger Control

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ABSTRACT

This thesis takes a close look at the assessment of innovation competition in EU merger control and discusses the underlying economic principles. Unlike price competition, innovation competition is a dynamic process where over time one innovation may succeed another innovation. Because innovation creates value and benefits for the customers and ultimately leads to economic growth and consumer welfare, assessment of innovation competition to ensure the continuing of innovation activities is important. Unfortunately, merger effects on innovation competition are complex, sometimes ambiguous, and seldom easy to assess. Two seemingly conflicting theories exist: Schumpeter's theory of 'creative destruction' in which high concentrations levels, even a monopoly, does not unduly distort innovation competition, because the next innovator is already working on winning over the market with a new innovation. Arrow, on the other hand, argues that large companies would replace their own pre-innovation sales (the 'replacement effect'). According to Arrow's theory 'competition spurs innovation'.

Despite all controversy, there are three common guiding principles for innovation competition assessment in mergers: appropriability, contestability, and synergies. Appropriability and contestability are about the *incentive* to innovate, synergies are about the *ability* to innovate. 'Appropriability' basically means that the innovator can protect his innovation from imitation while commercialising it. 'Contestability', in general, is about the willingness of customers to switch to better products and about market entry barriers for new entrants. The term 'synergies' is used in the sense of combining complementary assets and know-how.

In recent merger control cases, the EU competition authorities extended their innovation competition assessment from late pipeline products to early pipeline products, and ultimately to innovations spaces. They analysed the R&D effort and output of the merging parties and the industry as a whole. If the merging parties have overlapping R&D lines or pipeline products (close competitors) and operate in an innovation driven high-technology industry with high concentration levels and entry barriers, the Commission requires the divesture of one of the overlapping R&D activities together with all the assets and personnel needed for the divested part to become a viable business, in order to maintain the competitive constraint that is lost if the merging parties reduce the combined effort in the overlapping R&D areas post-merger.