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Horizontal mergers and competition policy in the European Community

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Horizontal mergers and competition policy in the European Community

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Abbreviations and symbols used

Countries

B	Belgium
DK	Denmark
D	Federal Republic of Germany
GR	Greece
E	Spain
F	France
IRL	Ireland
I	Italy
L	Luxembourg
NL	The Netherlands
P	Portugal
UK	United Kingdom
EUR 9	European Community excluding Greece, Spain and Portugal
EUR 10	European Community excluding Spain and Portugal
EUR 12	European Community, 12 Member States

Currencies

ECU	European currency unit
BFR	Belgian franc
DKR	Danish krone
DM	Deutschmark
DR	Greek drachma
ESC	Portuguese escudo
FF	French franc
HFL	Dutch guilder
IRL	Irish pound (punt)
LFR	Luxembourg franc
LIT	Italian lira
PTA	Spanish peseta
UKL	Pound sterling
USD	US dollar
SFR	Swiss franc
YEN	Japanese yen
CAD	Canadian dollar
ÖS	Austrian schilling

Other abbreviations

ACP	African, Caribbean and Pacific countries having signed the Lomé Convention
ECSC	European Coal and Steel Community
EDF	European Development Fund
EIB	European Investment Bank
EMCF	European Monetary Cooperation Fund
EMS	European Monetary System
ERDF	European Regional Development Fund
Euratom	European Atomic Energy Community
Eurostat	Statistical Office of the European Communities
GDP (GNP)	Gross domestic (national) product
GFCF	Gross fixed capital formation
LDCs	Less-developed countries
Mio	Million
Mrd	1 000 million
NCI	New Community Instrument
OCTs	Overseas countries and territories
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
PPS	Purchasing power standard
SMEs	Small and medium-sized enterprises
SOEC	Statistical Office of the European Communities
toe	Tonne of oil equivalent
:	Not available

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Foreword

The realization of the principal potential gains resulting from the achievement of the internal market depends on the growing role played by competitive forces. It is in effect as a result of the pressure of competition that firms are forced to exploit new opportunities, that gains in productivity and cost reductions are translated in lower prices, that quality is improved and the range of goods broadened and, finally, European competitiveness is enhanced.

However, it is not evident that within the new post-1992 context economic agents will accept the free play of competitive forces. As experience subsequent to the lowering of tariff barriers has shown, the European authorities risk being confronted, after a brief interval, by a multiple of private and public strategies to distort competitive conditions or to transfer to the Community level certain trade barriers. Among the main risks are: that of an increase in the instances of mergers and of takeovers which are not inspired by a desire to improve efficiency; the setting-up of multinational oligopolies including those controlled by third countries and likely to abuse a dominant position; the risk of renewed collusive behaviour related to the sharing out of geographic or sectoral markets; a growth in the number of State interventions whose objective is to protect 'national champions' be they privately or publicly-owned firms.

This leads to the basic question already raised in the study conducted by T. Padoa-Schioppa:[1] should European competition policy be strengthened or loosened in the context of achieving the internal market?

If the reply is nowadays in the direction of a reinforcement it is nevertheless clear that this basic theme constitutes a large field for thought which warrants a considerable amount of research. It was in this context that in November 1988 an international seminar was organized within the Commission under the joint sponsorship of the Directorate-General for Competition and the Directorate-General for Economic and Financial Affairs on the theme 'Corporate mergers'. On this occasion a preliminary version of this study was presented and discussed.

The success of this event showed the usefulness of collaboration between the Commission services and international experts. The day's discussions also opened up many new perspectives on the economic analysis of competition.

This subject concentrated on one of these aspects, i.e. on horizontal concentrations. On the one hand the restructuring required for achievement of the internal market should lead in certain areas to beneficial concentrations. On the other hand, these operations may also provoke restrictions on competition and the creation of dominant positions.

It is therefore important to situate these mergers among the many possible modes of concentration and to highlight the principal costs and benefits which may be anticipated. It would also prove of use to identify, on the basis of the characteristics of European industry, those sectors where the beneficial effects are *a priori* capable of outweighing the negative effects. Finally, it is necessary to investigate the conditions under which a European merger policy might be efficacious.

This is the objective of this first study which provides both an excellent synthesis of recent economic analyses in this area as well as an original contribution to their application in the Community context.

Antonio Maria Costa

Director-General for Economic
and Financial Affairs

[1] T. Padoa-Schioppa *et al.*, *Efficiency, stability and equity*, Oxford University Press, 1987.

Introduction

With 1992 just over the horizon, Europe is experiencing a proliferation of mergers and takeovers, especially among its largest firms. These strategies, as distinct from purely financial operations, are altering the structure of markets for goods and services and engendering new types of corporate behaviour. Such transformations may lead to greater efficiency, but they may also create or strengthen dominant positions leading to a reduction of competition.

The object of this study is to analyse these phenomena and, in the light of the analysis, to evaluate the proposed EC policy for controlling cross-frontier mergers.

Part A distinguishes mergers from alternative types of alliance between firms and discusses the main theoretical arguments concerning the costs and benefits of mergers from an international perspective.

In Part B these arguments are applied to mergers in the context of the future single European market. The study attempts to analyse the effects of mergers according to the features of the industry concerned. It also looks at recent trends of merger activity in Europe.

With specific reference to the proposals for Community regulation of mergers, Part C discusses the criteria the EC competition authorities should apply in evaluating the impact of mergers and suggests an order of proceeding in applying the criteria.

Part A — Forms and effects of horizontal mergers

Three basic types of merger can be distinguished according to the relationship between the businesses being merged. Horizontal mergers bring together businesses at the same level in the production chain making substitute products; vertical mergers — or vertical integration — incorporate within an organization businesses which are vertically related in the production chain, i.e. one of which produces inputs for the other; finally, conglomerate mergers bring together businesses making products which, from the point of view of demand, are neither substitutes nor inputs for one another.

This study will confine itself to mergers of the horizontal type. These can take a variety of forms ranging from incorporation into a loose group structure to full legal mergers in which one or both of the merging companies ceases to exist as a separate legal entity. The impact of mergers can also vary, some leading to increased economic efficiency, others causing distortions in resource allocation.

Part A prepares the ground with a brief discussion of these two subjects: the forms and the costs and benefits of mergers.

Chapter 1 — Forms of merger and other more or less permanent link-ups

Firms wishing to expand face a fundamental choice between external growth by merger or acquisition and internal (or organic) growth. External growth has advantages from the firm's point of view:

(i) The firm obtains assets that are already working and so yield a quick return, as opposed to the long time-lag before the payoff from fixed investment.

(ii) Acquisition of a competitor automatically increases the acquirer's market share and enlarges its markets, without creating additional capacity for which there might be no demand.

With the 1992 programme speeding up progress towards integrated markets in Europe, the merger and acquisition route also allows firms to enter new geographical and product markets more quickly in order to exploit first mover advantage.

But growth by acquisition also suffers from various problems:

(i) Human problems and particularly the deterioration in the working atmosphere that may be caused by a merger are often acute: clashes of management styles, redundancies, compensation for loss of management position and reorganization may create uncertainty within the firm that is harmful to efficiency.

(ii) The integration of the new business units into the firm's central accounting system and the determination of joint objectives and strategies may be a laborious process.

(iii) The administrative, legal and tax difficulties in Europe are still formidable and sometimes lead to considerable internal inefficiencies.

A matter of wider public interest is the fact that external expansion can absorb resources, in terms of capital investment, R&D and management time, which internally could have been used to create new assets.

External growth can take many forms. At the most general level one can distinguish between full legal mergers and mergers involving only changes in the ownership of the companies concerned.

A legal merger (in French 'fusion') transfers the assets and liabilities of two or more companies to a single new or existing company. The companies whose assets are merged may all disappear into a new company or one of the companies involved may absorb the other(s).[1]

Legal mergers obviously involve major reorganization, from changes in the membership of the board right down to the product range. The reorganization serves the same aims as any merger: expansion or consolidation of market share, rationalization on a secularly declining or cyclically depressed market, realization of economies of scale or increase of monopoly power.

An important point to note is that compared with alternative forms of external growth, legal mergers generally lead to thorough integration of the constituent parts and to a new situation which is irreversible or reversible only at high cost.

In Europe, there are institutional obstacles to cross-frontier mergers of this type.

The main problem is the absence of a framework of European legal rules and practices. At present, all intra-European acquisitions or mergers must be carried out under national company law.

Two consequences flow from this.

First, the organization and administrative costs of multinational firms in Europe are often very high because of the duplication made necessary by the requirements of multiple establishments and adaptation to specific local rules. Comparisons with similar activities in the USA bear out the high costs due to this situation. Furthermore, the legal arrangements that have to be constructed are often complex and opaque.

The second consequence is that mergers appear not as European operations but as acquisitions of one national company by another of a different nationality, which tends to offend national susceptibilities and to provoke nationalist reactions. This is all the more true as, in the absence of Community provisions, the takeover bid (often hostile) is one of the main means of reorganization involving companies of different nationalities.

[1] In both cases at least one of the companies ceases to exist and the assets and liabilities of the defunct company are transferred to another company which becomes its sole successor. But in the first situation the shares of the old companies are generally exchanged for those of the new, whereas in the second the transfer of assets and liabilities to the absorbing company takes place through the issue of its shares to the absorbed company.

As full legal mergers on a European scale are not possible, the form taken by transnational mergers in the Community is that of the merger involving only changes in ownership. The most common type is the takeover of one company by another by acquiring a sufficient number of its shares, but with both companies continuing to exist as separate legal entities. Takeovers may be carried out by purchases of stakes from other companies, buying up shares on the stock market, or public takeover bid. The result is a group of companies subject to central control through various kinds of links, ranging from financial interests to the presence of the same individuals as directors or managers. It is more an economic than a legal entity, in which a high degree of decentralization between the group companies exists side by side with common ultimate control. Usually the internal structure of the group is complex and there are chains of command along which instructions are passed to particular groups of businesses. Sometimes, the intermediate links in this chain are subsidiaries which have become large enough to have set up subsidiaries in their own right or they are financial holding companies occupying strategic positions in a web of financial relations.

It is possible to identify various reasons why groups do not appear to be merely transitional forms on the way to more tightly run organizations, but stable structures which, though subject to frequent reorganization, show little tendency towards complete integration.

They boil down to two factors: flexibility and decentralized management.

With regard to flexibility, organization as a group makes market entry and exit easier. Geographical diversification requires adjustment to the economic, social, political and institutional conditions of the various countries in which the firm operates. This adjustment is facilitated by a network of legally independent subsidiaries.

Similarly, entry into a new product market is less risky by acquisition of a company in that business (or merely a stake in one) than by organic growth or legal merger.

The group structure also makes such moves more easily reversible: if a subsidiary is doing badly, getting out of that business is a more feasible option than if it was legally integrated. In the event of a change in the strategy of the group, it is also easier and quicker to sell a financial stake than to dispose of fixed assets.

From the management point of view the form of a group, in which each company is a legally independent entity and the assets and liabilities of the parent and the subsidiaries are separate, both reduces risk and allows extensive control to be exercised at low cost. Also, subsidiaries may be more easily manageable units in which managers have a keener sense of their responsibilities than in the case of companies with a divisionalized or branch structure. Finally, in a group company staff relations tend to be on a more personal level and the management of human resources is easier.

What we find, then, is a combination of the advantages of concentration of physical and intangible assets and of a decentralization of management and responsibility which permits flexibility.

Nevertheless, for these advantages to be realized the group must have a strategic overall view of its operations, reflected in group policies for employees, products, geographical coverage, finance, research, etc., which exploit synergies and serve a general objective defined at headquarters level.

As in the case of legal mergers, the approach of 1992 makes EC regulation of takeovers and the provision of European legal forms for companies an urgent priority. Otherwise, we could well see a proliferation of reorganizations and link-ups, of varying degrees of reversibility, which are neither based on a common strategy, nor offer the necessary security and transparency for employees, minority shareholders and creditors.[1]

Finally, among the forms of link-up between companies that do not involve a legal merger are contractual arrangements under which a number of separate firms work together on a project, normally as legal equals and in a manner requiring complete unanimity between them. Compared with the previous forms, such arrangements are highly flexible and reversible. They are also relatively unstable.[2] The limiting case is the joint venture controlled by two or more companies. This form of cooperation involves the setting up of a more or less permanent organization which may become a new legal entity. It tends to go beyond the largely informal relationship existing under a cooperation agreement and to lead to relationships that are stable and organized. The first European legal framework catering for such transnational cooperation arrangements, which will be available from 1 July 1989, is the European economic interest grouping.

1 The new European directive which from 1990 will require those acquiring large blocks of shares on the stock exchange to inform the company concerned is a step in the right direction. The draft statute for a European company also contains a section on groups, which recognizes the right of the group to require the member companies to pursue its interests but, at the same time, gives protection to minority interests which could thereby be threatened. The European company project is also a useful contribution to the development of a legal framework for mergers in the EC.

2 For a general analysis, see Jacquemin and Remiche (ed.) (1988).

For the purpose of competition policy, joint ventures may be viewed as restrictive practices or mergers. According to the 1977 De Laval-Stork decision[1] a joint venture is a partial merger rather than a restrictive practice where the partners put their existing production facilities or marketing organizations into the joint venture and having done so effectively and irreversibly cease to be actual or potential competitors and lose the capability to return separately to the market.[2] Joint ventures of this type should be subject to the merger control rules.

It should be pointed out, however, that most mergers and restrictive practices involve complementarity rather than substitution.

The conclusion of this rapid survey of forms of merger and other more or less permanent link-ups between firms is that increases both in efficiency from large-scale operation and in market power can be pursued in many ways through internal or external growth, and among the forms of external growth are full legal mergers, mergers by takeover, joint ventures and others. Hence, there is no clear correlation between the desire to exploit economies of scale or to increase market share and the choice of a specific type of link-up, such as a full merger.

The selection of a particular form of link can be inspired by a desire to reduce transaction costs (efficiency) and to gain better control over a market (monopoly power).[3] Among the criteria for this choice, we have seen that the speed of the operation and the desired degree of flexibility and reversibility are important.

Evaluating the role of these factors in a given case requires a difficult balancing act. For example, a full legal merger may represent a long-term commitment and quest for control: such an operation, involving largely irrecoverable (sunk) costs, gives notice to actual or potential competitors that the company intends to enter a (geographical or product) market on a permanent basis, and perhaps to dominate it. The decision also ties down the merged company, in that the cost of exit from the market will be high: the disinvestment and dismemberment involved would result in much larger losses than in the case of a joint venture or a simple cooperation agreement. In applying the future European merger control regulation, it will be important to bear in mind that alternative forms of link-up exist to achieve the objectives of such operations.

1 OJ L 215, 23.8.1977, p. 11.

2 A thorough study of this question was made by Caspari (1986). See also Overbury (1986).

3 See Boyer and Jacquemin (1985).

Chapter 2 — Costs and benefits of mergers

Three main types of benefits are attributed to mergers: economies of scale, the internalization of activities that involve high transaction costs when firms rely on the market for them, and the threat of takeover as a sanction on inefficient management (the 'market for corporate control'). But against each of these potential benefits can be set possible inefficiencies resulting from mergers, inefficiencies both within and outside the firm. Benefits and costs will be discussed together.

2.1. Economies of scale versus monopoly power

Compared with the other two types of effects, the cost savings obtainable from increases in the scale of production (economies of scale) and the possible reverse implications in terms of creating or increasing monopoly power have been studied in considerable depth. The role of economies of scale in production is well-known. These cost savings can accrue from a better division of labour within the production unit, the spreading of fixed costs, and longer production runs.

Mergers which lead to reorganization may help firms to realize these economies and to attain the optimum efficient scale. The size of the economies achieved will depend on the slope of the average cost curve for outputs below the optimum scale. There can also be scale economies in functions such as transport, distribution and research.

Besides these static scale economies there is the phenomenon of learning effects associated with the increasing experience of production of a product or service. These mean that the cost of producing each extra unit decreases as the cumulative previous output increases.

Finally, we must mention the role of 'scope economies', whereby the sum of the costs of producing two products separately may be higher than the cost of producing them together. Here factors such as complementarity are at work, whereby for example the same indivisible input can be used at once in the production (or distribution) of several goods. By extending its range of products, a firm can thereby not only better control demand but also reduce its costs.

These phenomena have led many authors (see for example Demsetz (1973); Peltzman (1977)) to conclude that high concentration — chiefly brought about by mergers — and large market shares are a sign of efficiency, because they show that firms with low costs have increased their market shares at the expense of the less efficient firms. The low costs lead in the short run to higher profitability.[1]

Other economists however, stress the role of horizontal mergers as a means of reducing the number of competitors in a market or of gaining better control over substitute products, which under certain conditions may directly increase prices and profit margins (see Encaoua, Jacquemin and Moreaux (1986)). High concentration could also encourage collusion: the fewer the firms in a market, the greater is the likelihood of collusive behaviour (see especially Scherer (1980); Martin (1988)).[2]

These two points of view can be combined in the well-known model representing the case of an industry composed of n firms producing a homogeneous product and using output as a decision variable. The corresponding equilibrium relation can be written:

$$L = (p - \sum_{i=1}^{n} c_i)/p = H(1 + R)/\varepsilon$$

where L is the aggregate Lerner index, i.e. the proportionate difference between the market price, p, and the sum of the marginal costs, c, of the n firms, H is the Herfindahl concentration index, i.e. the sum of the squares of the market shares, R is the sum of each firm's expectations as to the change in the output of the whole industry should it increase or reduce its own output by one unit, and ε is the price elasticity of market demand in absolute terms.

It is apparent from this simple model that market share alone or the degree of concentration alone do not account for the difference between price and marginal cost. The price elasticity of demand, which itself depends on the degree of product differentiation and the existence of more or less close substitutes, is also an important factor. Once product differentiation (or local market differentiation, which is equivalent) is explicitly introduced into the equation, it becomes clear that supranormal (monopoly) profits can exist at equilibrium, even in an apparently competitive market. The combination of product (or regional) differentiation

1 In the medium and long term, the entry of new competitors into the market will tend to erode supra-normal profits.

2 A third argument is that much of the investment undertaken by firms established in a market represents irrecoverable, sunk costs which create an exit barrier. This investment is seen as a credible commitment to the market, reducing the profit expectations of potential entrants. By having a restrictive effect on the entry of new firms, sunk costs tend to encourage concentration. For empirical results pointing in this direction, see Kessides (1988).

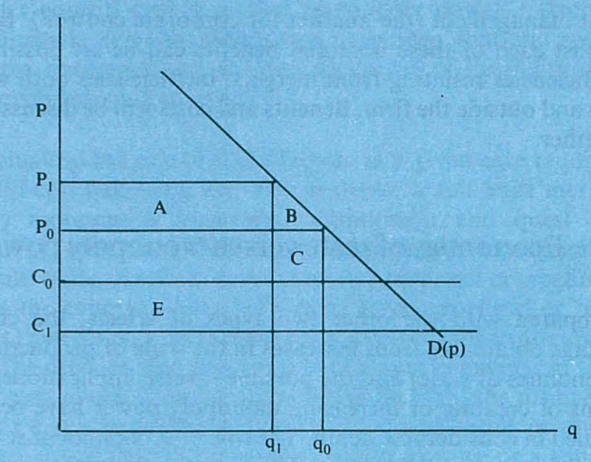
economies of scale increases the possible size of such profits (see for example Eaton and Lipsey (1986)). Finally, if the openness of markets to trade is taken into account, as it must in the context of post-1992 Europe, the expression must be adapted to incorporate the effect of the competitive pressure exerted by imports[1] and exports.

Of course, an equilibrium relation says nothing about the direction of causality. Those who give precedence to the efficiency effects believe that the increased concentration resulting from mergers leads to cost reductions which, other things being equal, allow increases in margins.

Those, on the other hand, who focus more on the dangers of monopolization see the causality as working mainly in the opposite direction: mergers tend to induce price rises, as a result both of increased concentration and the expectation of more collusive behaviour (increase in R).[2]

In fact, it is probable that in many cases mergers simultaneously produce some efficiency gains, notably in the form of cost reductions, and some increase in monopoly power which may manifest itself in higher prices. There is thus the question of a trade-off between the two types of effect. This is suggested by Figure 2.1.

FIGURE 2.1: **Mergers and the welfare trade-off**



The price p_0 is that prevailing before the merger and is slightly above the marginal cost c_0 (the perfectly competitive price). After the merger there is both a reduction in costs to c_1 (efficiency gains) and an increase in price to p_1 (monopoly power). The consequences in terms of net social welfare were analysed by Williamson. The sum of areas A and B is the loss of consumer surplus due to the rise in price, while the areas A + E − C represent the extra profits accruing to the firms.

The net gain (or loss) in social welfare due to the merger is the sum of the two effects: BN = (A + E − C) − (A + B) = E − (B + C).

Williamson showed that quite small efficiency gains are usually sufficient to offset the adverse effects due to the increase in monopoly power.

In the context of the single European market, the model needs to be adapted to take account of international trade.

A starting point is the question of the impact of the lowering of non-tariff barriers. On the one hand, this will increase competition from imports. On the other, it may in the longer term lead to restructuring which reduces the number of firms in the market and increases concentration. Recent work (see Venables and Smith (1988)) has attempted to answer this question, using a partial equilibrium model which takes into account phenomena of economies of scale and situations of imperfect competition. It suggests that the lowering of non-tariff barriers will produce a net gain in social welfare even if the number of firms decreases, because the smaller consumer surplus associated with increased concentration would be more than offset by the improvement in returns to producers due to exploitation of economies of scale. The work also

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1 For this extension, see especially Jacquemin (1982). If imports are taken into account, the expression becomes:

$$L = \frac{H}{E}(1 + R)(1 - t_m),$$ where t_m is the degree of import penetration.

It should be noted that a major part of import flows consists of intra-firm transactions between the parent company and subsidiaries of multinationals. The competitive pressure exerted by this type of trade is slight or nil. Such flows may even increase monopoly power (for a general view see de Ghellinck (1986)).

2 In both approaches it is predicted that the increase in concentration as a result of mergers will increase the total rate of profit in the industry and the rate of profit per firm. But some theoretical work suggests that on certain assumptions the profitability of a merged firm may well be less than that of its constituent parts before merger (Salant, Swritzer and Reynolds (1983)). However if more reasonable assumptions are made (Perry and Porter (1985)) the opposite result is obtained.

indicates that a complete integration of the Community market, involving a considerable reduction in the monopoly power of firms on their national markets,[1] should result in much larger gains in social welfare than in the previous case because the benefits of large scale would be combined with increased competition.[2]

A second aspect of the international dimension has been investigated by work which has tried to isolate the effect of mergers solely on domestic welfare and to identify the types of foreign competition conducive to it.

The starting point is the fact that national competition policies only take account of behaviour that has an impact on their own countries' economy and ignore the interests of consumers of the product in other countries and the profits of foreign firms. Applied to the European context, this approach says that in evaluating the effects of a merger, the only losses that need be considered are the reduction in the European consumer surplus and the only gains the increase in the profits of European producers.

Let us suppose, for example, that in Williamson's model α represents the consumer surplus, obtained by European consumers and β the proportion of profits accruing to European producers.

The net gain or loss in European social welfare is then:

$$-\alpha(A + B) + \beta(A + E - C) =$$

$$\beta \left[\left[\frac{\beta - \alpha}{\beta}\right](A + B) + E - B - C \right]$$

All other things being equal, the net European gain in welfare resulting from a merger would be the greater, the larger the degree of European involvement in the merger and the lower the proportion of the output consumed in Europe. Hence the size of the gains and losses for EC consumers and producers will be affected both by the intensity of competition from foreign firms and by the trade policies that are adopted.

This international aspect has been considered in a series of recent studies of the effects of mergers. Ross (1988), for instance, shows that the lowering of tariff barriers is more effective in limiting the price-increasing effects of a merger, the larger the number of foreign firms. Ordover and Willig (1985) have put forward a model which suggests that the effectiveness of competition policy in this context depends on the protectionism or otherwise of trade policy, via tariffs and quotas. Macroeconomic policy also plays a role: the effect of a reduction in the number of domestic producers is very sensitive not only to the number of foreign firms, but also to the level and variability of the exchange rate. If the main protection against domestic monopoly power is imports, exchange rate volatility will lessen this protection. From this point of view, the European Monetary System indirectly has a beneficial impact on competition in the common market.

The cost-benefit approach to horizontal mergers indicates that the problem is complex and that an efficiency defence of mergers is not straightforward. But even this approach is a simplification of reality and therefore questionable: it is a static approach, reduced to two variables (price and output) in partial equilibrium and neglecting the problems of imperfect information. Efforts to extend it to dynamic situations involving uncertainty and allowing for the role of non-price strategies (quality and durability of products, technical progress, etc.) are unconvincing.[3]

At the present time, judgments as to whether a merger presents a danger of monopolization, potential efficiency gains or a combination of the two must be based on general indicators.

As far as monopoly power is concerned, the indicators favouring its emergence are well-known: high market share with a scattered competitive fringe, low import penetration and high entry barriers, demand that is inelastic and also static or only slowly increasing, and a differentiated product, etc.

Among the factors that point to the likelihood of efficiency gains are large-scale economies and learning effects, substantial excess capacity,[4] and high capital intensity and technology content. It is criteria such as these that will be used to examine the present situation in the EC in Part B of this paper.

[1] In an econometric study of European industry Sleuwaegen and Yamawaki (1988) have shown that even by the end of the 1970s the Herfindahl index, calculated at Community level, was more strongly correlated with national marginal rates of return than the national index of concentration.

[2] Smith and Venables show, using their Cournot (competition on output) model, that welfare gains are greater when the number of firms changes than when it remains the same. This result is not confirmed by a Bertrand (price competition) model with product differentiation.

[3] Innovation is a very controversial issue. It is often argued that market power increases capacity to innovate, suggesting a trade-off between static efficiency gains favoured by competition and dynamic gains arising from monopolization. Recent work indicates however, that this trade-off is not the rule and that market monopolization is generally bad for innovation. See especially *European Economy* No 35 (1988).

[4] Usually in declining industries which are in need of rationalization.

2.2. Reduction in transaction costs versus internal inefficiency

The internalization of functions within large firms instead of relying on the market for them is partly explained by the desire to realize economies of scale. In situations of asymmetric access to information or to specific assets or human resources for which markets are imperfect or nonexistent, a merger may be undertaken to absorb a competitor who possesses information, key assets, brands, distribution networks or management that can improve the performance of the acquiring firm. Obtaining these resources through the market could take too long, be too expensive, or even not be possible. Hence, a merger would be less expensive in terms of transaction costs than the alternatives of cooperation or internal growth.

These phenomena of the internalization of transactions within an organization are thus prompted by the search for efficiency.

But for an organization to be able to replace the market advantageously and for such mergers to yield real synergies, it is necessary to set up machinery within the new entity which makes its internal operation efficient. Yet the pitfalls awaiting the large merged organization are legion: poor communications, failure to cut out costly duplication, insufficient coordination, and, finally, lack of flexibility.

In recent years the question of firms' flexibility in an increasingly uncertain world has become more and more important. Some of the difficulties large firms have in adapting to their changing environment may be due to the over-rigid organization imposed in the course of increasing concentration so as to exploit economies of scale.

In conditions of great uncertainty about the level of demand, the lesser exploitation of economies of scale by small to medium-sized firms using a flexible technology may be more than offset by their ability to respond to changes in demand. To make a success of a merger, it is necessary to organize the merged unit in such a way as to achieve flexible decentralization. Otherwise, production economies could be more than offset by organizational diseconomies.

2.3. An efficient 'market for corporate control' versus the perverse effects of takeovers

A third possible benefit of mergers arises from the takeover process. The various forms of takeover can be just as effective a means of transferring control of one company's assets to another as a full legal merger, and the replacement of the acquired company's management can likewise lead to better exploitation of its resources. This 'market for corporate control' also reduces the danger of conflicts of goals between the owners and managers of companies. To the extent that managers have different preferences from shareholders, in terms of profits, sales or degree of risk aversion, the takeover mechanism helps reduce the associated distortions. The mere threat of takeover is an incentive for management or the controlling shareholder to run the business in the best interests of the company (see Wtterwulghe (1988) and 'Symposium on takeovers', *Journal of economic perspectives*, No 1, winter 1988).

Conversely, many of the defence tactics used against hostile takeovers may be damaging to the interests of the shareholders of the target company and serve only those of its management. A very strict regulation of takeovers might therefore have undesirable consequences (see Jarrell, Brickley and Netter (1988)).

On the other hand, a basic assumption behind the favourable view of hostile takeovers is that the stock market correctly reflects the value of the acquired and acquiring firms. This is not necessarily the case. The expected benefits may not be realized, with the takeover failing to improve performance but only redistributing profits from the managers to the owners. Moreover, the management of the predator company may be guided by motives other than profit maximization, motives which reflect their own interests and cause them to pay too high a price for the acquisition. Added to these aspects are various considerations concerning the perverse effects that takeover activity can have on the actual management of companies.

Takeovers may absorb a large proportion of management time and induce some managers to give more attention to financial transactions than to productivity and competitiveness. The threat of takeover encourages the maintenance of excessive liquidity and the pursuit of short-term profit, at the expense of strategic investment that would yield a high return only in the long term. There are also dangers in firms taking on increasing debt either to finance or ward off takeovers. In some cases, key assets needed for an industrial growth or diversification strategy are sold off to finance or prevent a takeover. Finally, frequent changes in the controlling shareholders, decision centres and headquarters of companies are apt to affect the ability of management to enter into lasting commitments in relation to specific human capital and their loyalty to the company.

2.4. Empirical research into the effects of mergers

The theoretical argument about the costs and benefits of mergers does not allow a general presumption for or against. It is therefore illuminating to look at the results of empirical research into the effects of mergers. Only two aspects will be considered here: the impact of mergers on concentration and the effects on performance.

During the 1960s and 1970s, most mergers in Europe were horizontal rather than vertical or conglomerate. The little research that has been done in this area found that merger activity considerably increased national industrial concentration ratios. In the UK, for example, it has been shown that between 1954 and 1965 most of the increase in the market share of the largest firms was due to mergers (see Table 2.1).

Table 2.1

Market share of the 10 largest firms

	1954	1965	% of change due to mergers
Food	62,1	80,5	70,1
Drink	40,8	87,2	76,3
Chemicals	80,6	86,4	31,2
Metal goods	58,7	74,3	107,1
Electrical engineering	60,4	81,2	105,8
Vehicles	57,2	85,8	70,6
Textiles	55,9	74,2	127,8
Paper and publishing	63,6	78,1	111,1
Miscellaneous	58,3	65,6	95,9

Source: Cowling *et al.* (1980).

Similar results have been obtained for Germany (Müller (1976)), The Netherlands (de Jong (1976)) and Sweden (Ryden (1972)) etc.

The statistics published in the Commission's annual competition reports show that in recent years the vast majority of the takeovers occurring in the common market have been by firms belonging to the 1000 biggest with sales of over ECU 1 billion. Such mergers clearly increase concentration.

As for the effects in terms of profitability and growth, many studies point to the absence of substantial efficiency gains. A comparative study, directed by Mueller (1980), of results from various EEC countries concerning full legal mergers concluded that:

(a) tests to identify economies of scale as a possible objective proved insignificant: for one thing, the size of acquiring firms was usually greater than the minimum optimum scale for the industry;

(b) the tests of post-merger profitability suggested that the mergers had little or no effect on the profitability of the merging firm in the three to five years following the merger; nor was there any significant difference in the return per share three years after the merger. This confirms the results obtained in many American studies (see Scherer (1980) pp. 138-139);[1]

(c) the mergers did not lead to lower prices or higher sales. Thus, the largely negative results of the research suggest that it is not possible to find a single explanation of mergers: neither greater efficiency nor monopoly power seem *ex post* to be the dominant objective.[2] They also suggest that the chances of success are slim and that the costs of the changes in organization (difficulty of 'digesting' the acquisition, diseconomies of large organizations) are often greater than the benefits claimed by the promoters.

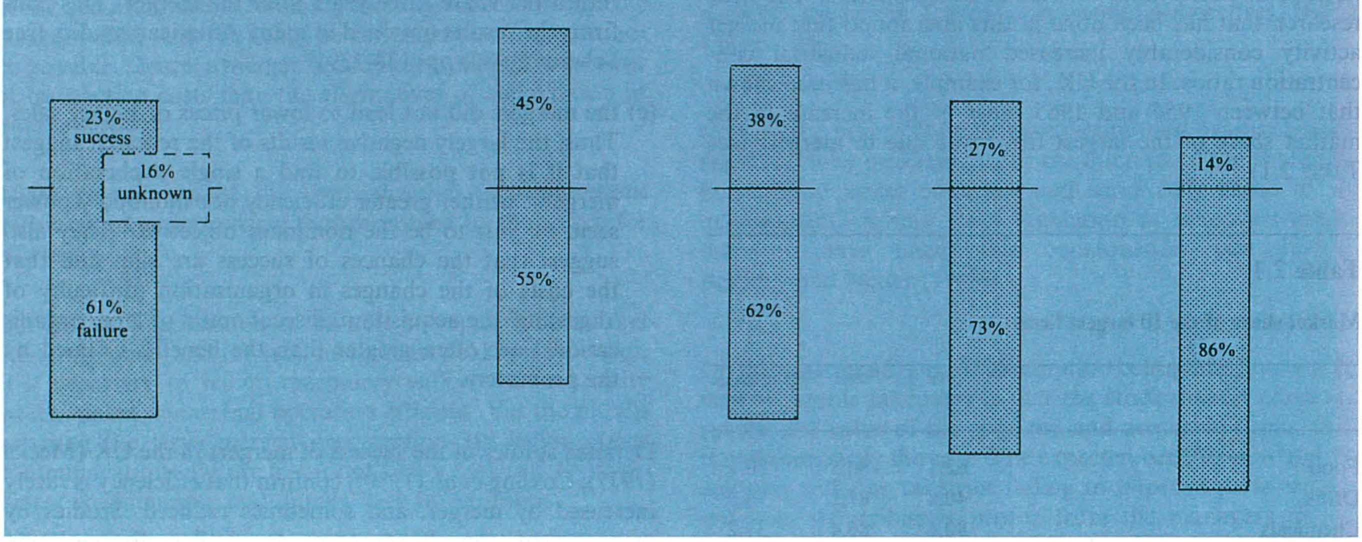
Detailed studies of the success of mergers in the UK (Meeks (1977); Coxling *et al.* (1980)) confirm that efficiency is rarely increased by merger, and sometimes reduced. Studies by management consultants come to similar disappointing conclusions. Coley and Reinton (1980) looked at US and British companies in the *Fortune* 250 list and the *Financial Times* 500 which in the past had made acquisitions to enter new markets. Figure 2.2 shows that only 23% of the 116 firms analysed were able to recover the cost of their capital or better still the funds invested in the acquisition programme. It also appears that the higher the degree of diversification, the smaller is the likelihood of success. For horizontal mergers in which the acquired firm is not large, however, the success rate is high (45%).

[1] A number of American studies have looked at changes in the market price of the shares of firms involved in mergers. A general result is that the shareholders of acquired companies realize substantial gains following the acquisition. The important question for judging the benefits of a merger however is how it affects the shareholders of the acquiring firm. The gains for these shareholders are slight or nil at the time of the acquisition, and one year after the merger have generally turned negative. For a discussion see Mueller (1986).

[2] Other explanations such as risk spreading (more associated with diversification) or speculation on the stock market undervaluation of some companies compared with their long-term profit potential are even less generally applicable, though they may well be present.

FIGURE 2.2: **Success and failure of 45 British and 52 US acquisitions**

	Type of acquisition			
116 acquisition programmes	20	16	26	35
Size of company acquired	small	small	large	large
Degree of diversification	low	high	low	high



The main reasons for failure appear to be: too high a price paid for the acquisition, over-estimation of the potential of the acquired business in terms of synergies and market position, and inadequate management of the process of integration after the acquisition.

Hence, a body of convergent evidence suggests that mergers are far from being a panacea to improve competitiveness. It should be noted, however, that the empirical research does not refer to the dynamic market conditions such as are being created by the 1992 programme.

As we shall see in Part B, in some industries that have hitherto been fragmented, horizontal mergers may be necessary in order to exploit the new opportunities created by an integrated market. The only conclusion to be drawn from the empirical evidence is that a general presumption in favour of such mergers is not justified.

Part B — Features of industries and of EC merger activity from the point of view of competition policy

The theoretical arguments presented in Part A showed that mergers could yield benefits in the form of efficiency gains as well as imposing costs in terms of increases in monopoly power. In Part B we first suggest a series of indicators that can be used to make a preliminary classification of industries into those in which mergers — and thus concentration — are likely to have on balance beneficial effects and those in which the overall effect is likely to be negative. We then go on to describe recent EC merger activity in these terms.

Chapter 3 — Typology of industries for merger control purposes

The purpose of this section is to put forward a method for analysing mergers in relation to the industries of the merging firms and to illustrate the use of the method to classify the industries into distinct groups according to the likely balance of the benefits and costs of mergers in the industries.

At the outset, two words of caution are in order about the interpretation placed on the classification, and about the limitations of the method. The first is that the classification merely attempts to identify the industries in which larger size may yield economic benefits without a great risk of reduction of competition; it does not imply that a merger is necessarily the best way of achieving these benefits, for as we have seen in Chapter 1 of Part A, various other forms of alliance between firms are possible.

Secondly, the classification is intended only as an aid — as one means among others — that may help in analysing mergers. Clearly, the features of the industry are not the only factor to be taken into consideration in assessing the justification of a merger. As was shown in Part A, other criteria relating to the firms involved (for example, their market share) or to the products (such as whether they have close substitutes for the same end-use) must also be taken into account. Hence, the classification of an industry in one of the four groups does not prejudge the final verdict on a specific merger in the industry. Nor do negative verdicts on certain mergers in an industry mean that any merger at all in the industry should be condemned, especially if the industry has features indicating that large size may be a source of efficiency gains.

3.1. Method

The object is to identify the industries in which mergers are more likely to produce efficiency gains and those in which the danger of reduction of competition is uppermost. To do this, we need to find indicators for the degree of competition in an industry.

In general, concentration ratios like the Herfindahl index which show the combined market share of the n largest firms, are an approximation to the degree of competition. But Part A showed that they are not a sufficient guide. Another problem is that the subdivisions of the industrial classification used may not necessarily coincide with the definition of the relevant market. For these reasons, other criteria than concentration data are used here. Some of these criteria emphasize two aspects of competition that are tending to become more important than in the past, namely the internationalization of competition and the competition from innovation and technical progress (see especially de Woot (1988)). These two aspects are often linked.

In many markets, competition now operates on a world scale and the relevant geographic market is no longer national but covers all the industrialized countries, and more particularly the 'triad' of Europe, North America and Japan. In these industries, European firms need to be allowed to strengthen their position on the world market by establishing a strong base for the internationalization of their operations on the European market.

Secondly, for a growing number of industries the main thrust of competition comes from technological advances and the ability to use this new technology to conquer new markets. Thus, in high-technology sectors in which the cost and complexity of technological development are often beyond the means of firms operating only on their domestic market, it is necessary both to increase competition in Europe by ending the preferment of national champions and to encourage cooperation between firms, especially by promoting large-scale European projects.

Let us look at each of the proposed indicators in turn.

(a) Indicators

Four indicators are used to characterize industries. The first two help to identify the industries in which the danger of a reduction in competition is greater, the other two those in which further concentration may produce efficiency gains. (Definitions of the indicators are given in Annex 1(a).)

Demand growth. The rate of growth in demand over the period 1980-85 shows the stage of the life-cycle of the industry (developing, mature, declining). Other criteria too can be used to establish this, for example profitability, the pace of technological change or the number of new entrants. But comprehensive data on these are not available for all industries. Moreover, demand growth is a key component of the competitive environment of firms.

It can be assumed that the danger of a reduction of competition is greater in mature or declining industries. This is because in such industries firms are more eager to increase their market share to make up for the slowing in growth and to gain better control over their costs, a key factor in competition at this stage of an industry's life cycle. Consequently, firms react vigorously to new entry because the slow growth of the market limits their ability to absorb a new firm and to try to eliminate their weaker competitors. Entry is further limited by the advantages incumbent firms have in terms of experience, long-standing relations with customers and control over certain resources. The number of exits from the market also tends to be high as some firms opt for a strategy of rapid disinvestment in the face of the decline of the industry.

Conversely, in expanding industries the danger of a reduction of competition is less. This is because a growing market attracts many entries because of the higher profits that can be made, and entry is relatively easy as incumbent firms have no real advantage in terms of cost, experience and reputation. Also, with technology tending to be in a state of flux, competition through innovation and technological change is keener.

Import penetration. As was stressed above, the degree of concentration of an industry is not always a sure guide to the amount of monopoly power held by the leading firms. Another factor which affects the intensity of competition on a market is its degree of openness to international trade. Many empirical studies (see Jacquemin (1982)) have shown that competition from imports considerably limits the market power of domestic producers. For this reason, import penetration is used here as an indicator of the intensity of competition. There is a caveat, however, namely that import figures may overstate the intensity of competition where there are large intra-firm trade flows. In that case, the competition from imports is more apparent than real since the imported goods are made by foreign subsidiaries or sister companies of domestic firms. Subject to this qualification, it may be assumed that the danger of a reduction of competition is greater in industries relatively closed to international trade, whether from within or outside the Community. Incidentally, competition from non-EC imports appears to be stronger than that from intra-EC imports.

Economies of scale. The existence of economies of scale in an industry may be interpreted in two different ways. On the one hand, it may represent a disincentive to new entrants and thereby reduce competition; on the other, it may point to a possibility of efficiency gains as the size of firms increases. Let us look at both these aspects in turn.

Economies of scale put large or diversified firms at an advantage because they can spread their fixed costs over a larger number of units produced. But as a barrier to entry, they suffer from limitations (see Porter (1982)): exploiting scale economies may conflict with other objectives of the firm (brand image, quality, etc.), and plants big enough to reap scale economies may be too specialized and not flexible enough to adapt to new technologies.

Also, various writers (see Jacquemin (1985) and Kessides (1988)) have shown that it is more the presence of sunk costs rather than economies of scale that acts as a barrier to entry. The argument is that if fixed costs are recoverable, an entrant who fails can withdraw without penalty. But if costs are irrecoverable, that is if they cannot be clawed back when the entrant completely leaves the business, there is an imbalance between the incumbent firms and entrants.

Hence, the existence of economies of scale will be regarded here rather as an argument in favour of concentration. The industries in which the potential gains to be expected from exploitation of economies of scale are substantial are identified using the data presented in the study by Pratten (1988). This study, which surveys recent work on economies of scale, estimates for a large number of industries the extra unit costs supported by firms operating at less than 50% of the optimum scale. The higher this cost penalty the more profitable it is for a firm to approach the optimum scale.

Here too, one must be aware of the possible failings of this indicator. Estimates of scale economies are based on microeconomic data and their aggregation, even at fairly narrowly defined industry level, is problematic. Nevertheless, it is acceptable to use them as an indicator in this study because its object is not to quantify precisely scale economies but only to identify the industries where they are important.

Technological content. There is an arguable case for saying that mergers can also be beneficial in high-technology industries. These industries are highly R&D-intensive and because of indivisibilities in R&D up to certain thresholds firms require a sufficient scale of operation in order to undertake research programmes. There are many other economic reasons why link-ups between European firms in such industries are justified. They increase the resources available and so encourage the undertaking of more ambitious and risky projects which single firms cannot afford. They also help cut out duplication and may encourage transfers of technology, thus speeding up the dissemination of innovation.

But as well as strengthening the performance of European firms in advanced technology, it is necessary to improve their ability to translate their research into positions of international competitive advantage. To do this, greater competition needs to be introduced into the European market by opening up public procurement and increasing the number of large European projects. This conclusion is borne out by recent empirical work, which shows that markets which are more competitive, have low barriers to entry and are open to international trade show a greater propensity to innovate (see *European Economy* No 35 (1988)).

Around 20 high-tech industries are investigated in this study. They were identified mainly on the basis of the classification proposed by the OECD (see OECD (1986)) but with help from supporting sources. The list of the industries and the sources are given in Annex 1(a).

(b) Classification matrices

The four indicators are used to compose two classification matrices. The first combines the first two criteria and allows industries to be classified into two broad categories:

(i) those in which there is a danger of a reduction of competition: mature or declining industries and industries relatively closed to trade;

(ii) those in which prima facie there is less danger of a reduction of competition, because they show strong growth or are relatively open to trade.

The second matrix links the last two criteria and identifies industries in which an increase in concentration could produce efficiency gains. These are those which are highly technology intensive and/or offer substantial economies of scale.

Combining the results of the two matrices allows the industries to be classified into the four groups shown in Figure 3.3.

Group 1: industries in which mergers present a danger of a reduction in competition without any likelihood of efficiency gains (I ∩ III);

Group 2: industries in which mergers should produce neither efficiency gains nor a danger of reduction of competition (II ∩ III);

Group 3: industries in which mergers offer potential efficiency gains without a danger of reduction of competition (II ∩ IV);

Group 4: industries in which mergers may simultaneously produce efficiency gains and accretions of monopoly power (I ∩ IV).

3.2. Classification of industries

This section describes the results of the classification of manufacturing industries into the four groups using the

FIGURE 3.1: **Matrix 1 — Identification of industries in which there is a danger of reduction of competition**

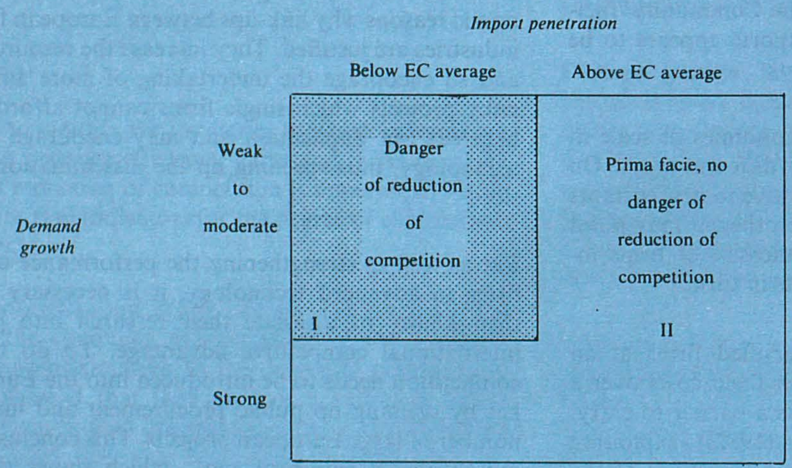


FIGURE 3.2: **Matrix 2 — Identification of industries in which mergers may lead to efficiency gains**

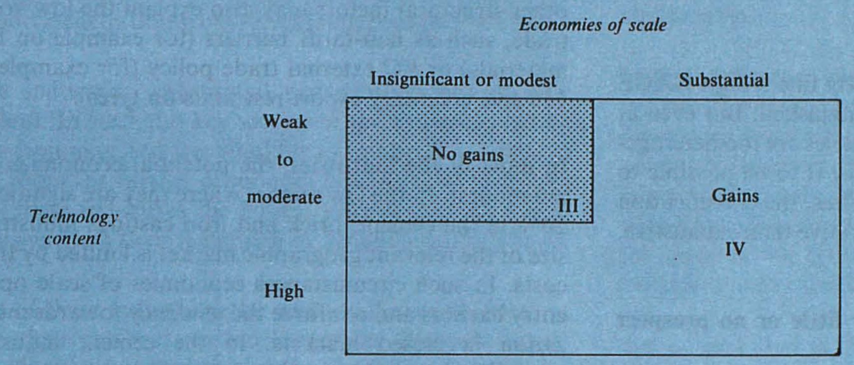
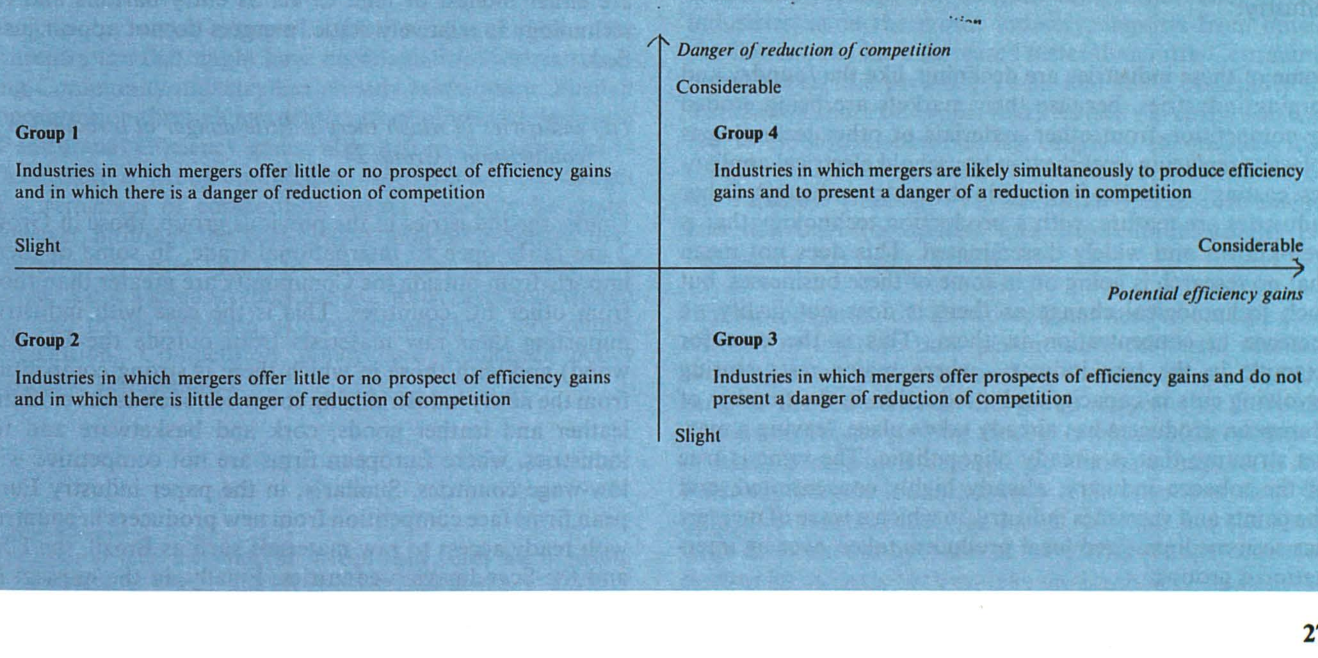


FIGURE 3.3: **Classification of industries into four groups**



two classification matrices. Some of the criteria used in the classification matrices are also valid for service industries. For example, the extent of international trade and economies of scale could in theory be estimated for services as well as for manufacturing industries. But the empirical measurement of such factors for service industries runs up against major difficulties, because of both problems of definition (for example a suitable measure of output for banks) and lack of data. For this reason, this limited study will only attempt to classify manufacturing industries.

The subdivision of industries is the fairly fine 3-digit NACE level, in which 120 industries are distinguished. But even at this level of disaggregation, some industries are too heterogeneous or data too difficult to obtain for it to be possible to classify them into one of the groups. Thus, the classification given here is intended to be more illustrative than exhaustive.

(a) Industries in which mergers offer little or no prospect of efficiency gains

Within this category, two groups can be distinguished according to whether or not there is a danger of a reduction of competition.

(i) Industries in which there is a danger of reduction of competition (Group 1)

This group includes the building materials (except advanced materials), metal goods (except boilermaking), furniture, paper and rubber goods, paints and varnishes, and tobacco industry.

Some of these industries are declining, like the foundry and forging industries, because their markets are being eroded by competition from other materials or other technologies (plastics replacing steel sheet in household electrical appliances, castings replacing forgings in the motor industry). Other industries are mature, with a production technology that is well-known and widely disseminated. This does not mean that no research is going on in some of these businesses, but such technological change as there is does not justify an increase in concentration in them. This is the case for example in the tyre industry, where major restructuring involving cuts in capacity and a reduction in the number of European producers has already taken place, leaving a market structure that is already oligopolistic. The same is true of the tobacco industry, already highly concentrated, and the paints and varnishes industry, in which a wave of mergers has seen medium-sized local producers taken over by international groups.

In these industries, the competition faced from imports is generally at a quite low level and invariably less than the average for EC industry. Some of them are indeed virtually closed to international trade because of the low value-to-weight or volume ratios and the high transport cost of their products. Industries in this position are the cement, lime and plaster industry, iron castings and some of the metal goods industries. In these industries, import penetration is under 10 %, compared with the all-industry average of 35 %. But other structural factors may also explain the low volume of trade, such as non-tariff barriers (for example on building materials) or EC external trade policy (for example Article 115 and voluntary export restraints on tyres).

In most of the industries, the potential economies of scale are modest. In the few sectors where they are significant (10-20% in the cement, brick and iron castings industries), the size of the relevant geographic market is limited by transport costs. In such circumstances economies of scale operate as entry barriers and reinforce the tendency towards monopolization in closed markets. In the cement industry, for example, the market is already very concentrated in some EC countries. In Denmark, the market structure is very close to a virtual monopoly, in the UK the leading group has held 60% of the market since 1970 and in France and Germany the market share of the four biggest firms was 80% and 67% respectively even as far back as 1975 (EEC, *Tenth Report on Competition Policy* (1981)).

To sum up, the industries in Group 1 are those in which demand is not growing and there is little or no competition from imports. There is therefore a danger of a reduction of competition in the industries. Also, as economies of scale are either modest or tend to act as entry barriers and the technology is relatively static, mergers do not appear justified.

(ii) Industries in which there is little danger of a reduction of competition (Group 2)

Unlike the industries in the previous group, those in Group 2 are fairly open to international trade. In some of them, imports from outside the Community are greater than those from other EC countries. This is the case with industries importing their raw materials from outside the EC (fur, wood) and with those in which there is strong competition from the newly industrializing countries, such as the clothing, leather and leather goods, cork and basketware and toy industries, where European firms are not competitive with low-wage countries. Similarly, in the paper industry European firms face competition from new producers in countries with ready access to raw materials such as Brazil, the USA and the Scandinavian countries. Finally, in the musical instruments industry, which is relatively undeveloped in Europe, Japan exercises leadership.

Competition is also on a world scale in mature or declining industries like steel, textiles and certain industrial and agricultural machinery, but in these industries intra-EC trade predominates.[1] In textiles for example capital intensity is higher than in the clothing industry. Consequently, the labour cost advantage of developing countries is less important and import penetration from developing countries is lower.

In these industries, substantial restructuring has already taken place. In steel and key sectors of the European textile industry (spinning and weaving) for example there seems to be little room for further economies of scale in production. Also, in these industries the largest European firms are as big or bigger than their American or Japanese counterparts.

In some of these industries, the way for European firms to improve their performance no longer lies through larger-scale production but through greater flexibility, which large size sometimes does not allow. A relatively flexible plant can adapt to new technology and changes in demand more quickly. With such plants EC firms would be able to specialize in high value-added niche markets. Such a strategy is already being pursued in the clothing industry, where mass-produced garment manufacture has been partly transferred to developing countries, whereas European clothing manufacturers largely specialize in top-of-the-range fashion garments (see IFO-Institut and Prometeia (1988)). Similarly, in the machine tools industry flexibility and speed of response to demand are new requirements for production plant.

Thus, in this second group of industries, it appears that the concentration that might have been beneficial for restructuring Community industry has already taken place. Further concentration through merger therefore offers little prospect of additional efficiency gains, although in the industries in which there is strong competition from imports the danger of a reduction of competition would generally be slight. However, although the 'cost-benefit' analysis of further concentration of these industries leads to the conclusion that merger is not a good strategy for EC firms, this result should not lead to the rejection of mergers which do not reduce competition. Competition policy and industrial policy should be kept separate.

[1] In some of these industries, EC foreign trade policy has a decisive influence, as for example with the Multifibre Arrangement for textiles.

(b) Industries in which merger activity is prima facie beneficial (Group 3)

Group 3 consists of industries in which there is less danger of a reduction of competition and mergers offer real prospects of efficiency gains. Industries in this category include advanced materials (glass, ceramics), chemicals and pharmaceuticals, computers, telecommunications, electronics, the motor and aerospace industries and precision instruments.

In these industries mergers that make economic sense should not be discouraged provided they do not harm competition. Therefore, in scrutinizing actual merger proposals, it will be necessary to assess the impact the merger will have on the degree of competition. To do this, the battery of indicators used here will have to be supplemented with criteria showing the position the firms involved have on their market (for example market shares).

Let us look first at the case for saying that the danger of a reduction of competition is less in this group. First of all, in some of the industries demand is growing strongly, leading to greater uncertainty of market positions. This is so in pharmaceuticals, computers and office automation, telecommunications and in the motor and electronics industries. Secondly, in these industries competition is on a world scale as is shown by the high level of import penetration (the only exception is pharmaceuticals but here foreign multinationals tend to supply the EC market from local subsidiaries). In most of them, imports from outside the EC account for a major proportion of imports. This is the case with computers, telecommunications, electronic goods, optical instruments and medical and surgical equipment. Also, in these industries, as in the motor industry, imports from outside the Community have increased faster than intra-Community imports over the period 1979-86 and the Community has lost market share on export markets (see *European Economy* No 35 (1988)). Looking at the origin of the imports from outside the EC it is found that the main competition is from the Japanese (radios, TVs, cars and optical instruments) and the USA (computers and telecommunications) (see Jacquemin and Sapir (1988)).

In these industries, the European firms need to become more efficient to improve their performance on world markets. Would greater concentration help them to do so? The features of the industries in this group suggest that it would. The industries are passing through a phase of development in which competition through innovation is important and R&D expenditure is consequently high. Also in most of the industries the potential economies of scale are such that large firms should have a cost advantage. In the consumer electronics industry for example, the low rate of exploitation of economies of scale by European manufacturers partly explains why their production costs are often 20-35% higher than those of their Japanese competitors (see *Fourteenth Report on Competition Policy* (1985)).

The performance of European firms in these industries has so far been handicapped by the fragmentation of the Community market. The national division of public purchasing of telecommunications and computing equipment, and the existence of conflicting standards and administrative barriers, for example in the motor and pharmaceutical industries, restrict the ability of national firms to tap the wider European market and hamper cross-frontier cooperation. This may explain why the top four or five European firms in these industries tend to be considerably smaller than their American counterparts and in two industries (computers and electronics) are even smaller than any of the top five Japanese companies (see also Chapter 5).

Two industries require a word of explanation, namely the motor and pharmaceutical industries. It may be surprising to see the motor industry in this group, considering that it is an oligopoly in which in 1986 seven firms together held 77% of the West European market. The fact is however that differences in technical regulations and taxation have prevented a rational organization of the industry and the resulting segmentation of national markets has led to substantial price differences. In this industry, therefore, the completion of a single European market is expected to lead to the exploitation of considerable economies of scale through production agreements between European groups[1] and simultaneously to intensify competition by ending the segmentation of the EC market (see Ludvigsen (1988)).

The case of the pharmaceutical industry differs from that of the other industries in the group in that it is relatively protected and already highly concentrated. It is an industry in which a few large multinationals operate alongside a large number of smaller firms and already control 70-80% of the market in France, Germany, Italy and the UK (see Economists Advisory Group Ltd (1988)). In this industry, in which R&D investment is very heavy and very risky, increased precompetitive research cooperation between large European firms could improve their performance on the world market in which the best placed firms are now American or Swiss. Also, mergers involving the smaller firms in the industry would not harm competition.

Finally, a general feature of the high-growth industries in this group is that European firms often prefer alliances with non-European firms. The proportion of mergers involving non-European partners is higher than in other industries (see Chapter 5), and of 142 joint ventures formed in the industries over the period 1983-87, 71 were with firms from non-EC countries (see *Seventeenth Report on Competition Policy* (1988)).[2] As de Woot (1988) points out, there is a danger that European firms will be handicapped in the globalization of these industries because they are internationalizing without possessing a strong European base. The example of Airbus in the aerospace industry illustrates the advantages of increased cooperation between European firms.

All these arguments point to the need to encourage link-ups between European firms in the industries of this group. But as we have seen (Part A, Chapter 1), link-ups can take different forms and the most appropriate may not necessarily be merger. This issue will be addressed in Part C.

(c) Industries in which mergers are likely simultaneously to produce efficiency gains and to present the danger of a reduction of competition (Group 4)

In this last group are a number of industries that will be greatly affected by the completion of the single European market (see Buigues and Ilzkovitz (1988)) because their markets are now divided by high non-tariff barriers which are to be dismantled by the end of 1992. They are industries in which competition is presently stifled by protectionist national regulations.

In these industries the advent of the single market should lead to restructuring and considerable merger activity. Mergers have advantages in terms of efficiency but might reduce competition at Community level. Two types of industries belong to Group 4, those heavily dependent on the public sector and parts of the food and drinks industry.

The industries mainly serving public-sector markets are boilermaking, heavy electrical plant, railway equipment and shipbuilding. In these sheltered industries each Member State has hitherto been able to support its 'national champion'. Consequently, intra-Community trade has remained at a very low level and the number of European producers is much higher than in the USA. The result is that EC firms have excess capacity and are less efficient (see Atkins (1988)).

Hence, the opening up of government procurement markets by the end of 1992 is expected both to increase competition

[1] It is thought that production agreements will mainly involve joint use of 'platforms' by different manufacturers. This production technique combines some features of assembly lines and flexible manufacturing.

[2] These are the chemical, electronics and computer industries.

and to lead to restructuring of the European industry. As the industries show substantial economies of scale and require large-scale units, this rationalization and the attendant reduction in the number of producers should allow the firms that remain to lower their costs. Also, in some of the industries there is considerable technological change, as for example fibre optic cables in the electric cable industry and high-speed trains and robotization in the railway equipment industry.

Thus, the industries in this group might benefit considerably from greater concentration but also present a real danger of monopolization. They are already concentrated, demand is not growing very fast, and competition has been blunted by government subsidies. Hence, care must be exercised to prevent the monopoly positions that exist in many of the national industries being replaced by monopoly power over the whole Community market.

Group 4 also contains parts of the food and drink industry, which is hampered by differences in standards in different Member States (see MAC Group (1988)). These differences restrict intra-Community trade and reduce the exploitation of scale economies. In these industries (pasta, flour milling, chocolate and beer) the prospect of 1992 is already producing a wave of mergers designed to lead to groups of world scale. In 1986-87, for example, the number of takeovers above the ECU 1 billion mark was more than double that in the previous two years in the food and drink industry as a whole (see *Seventeenth Report on Competition Policy* (1988)). These mergers have some benefits because they allow greater exploitation of economies of scale but they could also reduce competition.

*

* *

Table 3.1 summarizes the main features of the four groups distinguished here and their implication as to the costs and benefits of mergers. The table illustrates the results of a classification based on the 120 manufacturing industries at the 3-digit NACE level. As we shall see at the end of Part C, this level of aggregation is sufficient for a first screening of merger proposals. Knowledge of the environment in the industry and of the relative and absolute size of the firms involved could also be used at this stage. But in cases which on this preliminary screening appear to raise problems, more detailed data about the products and firms will be needed. A further point to be borne in mind is that although the classification indicates that link-ups between firms in industries classified in Groups 3 and 4 could lead to efficiency gains, it does not necessarily lead to the conclusion that merger is the only way of achieving them. As we have suggested in Part A, other arguments such as the requirement for speed or difference in transaction costs should exist to justify the choice of merger rather than an alternative form of link.

Table 3.1

Illustration of classification of industries for merger control purposes[1]

Group	Industry	Characteristics	Implications
1	Building materials Metal goods Paints and varnishes Furniture Paper goods Rubber goods Tobacco	• Declining or mature industries • Markets closed to international trade • Not technology-intensive or only slowly changing technologically • Economies of scale limited or acting as entry barriers	In these industries mergers offer little prospect of efficiency gains and present a danger of a reduction of competition
2	Steel Industrial and agricultural machinery Leather and leather goods Fur Clothing and textiles Sawn and processed wood and related products Pulp, paper and board Jewellery, toys, musical instruments	• Declining or mature industries • Fairly open to imports from inside and outside EC • In some industries, strong competition from low-wage countries • Economies of scale limited or already exploited • Not technology-intensive or with technology known throughout the world • Some industries highly fragmented (toys, furs)	Less danger of reduction of competition because of high import penetration and the fragmentation of some industries. But growth by merger is no longer an appropriate strategy for European firms. Instead, they should set out to specialize in top-of-the-range products, requiring modern and flexible production facilities
3	Advanced materials Chemicals/pharmaceuticals Computers/office automation Telecommunications Electronics Motor vehicles Aerospace Instruments	• Growth industries • Open to international trade • Strong competition from American and Japanese products • Large economies of scale • R&D very important, fast-changing technology	Less danger of monopolization and prospects of substantial efficiency gains from mergers. In these industries, link-ups between European firms would allow them to internationalize their operations from a solid European base
4	Boilermaking Cables and heavy electrical plant Railway equipment Shipbuilding Some food industries (confectionery, chocolate, flour and pasta) Beer	• Mature industries • Little intra-Community trade and competition restricted by segmentation of public procurement markets or differences in standards and regulations • Not technology-intensive (food and drink industries) or only moderately so • Large economies of scale	In these industries the removal of barriers with the single market programme will lead to rationalization and European-scale mergers. These may produce efficiency gains but there is also a danger of reduction of competition

[1] The two classification matrices on which this table is based are given in Annexes 1(b) and 1(c).
Source: Commission services.

Chapter 4 — Main features of mergers in the EC

The points set out above provide certain criteria which make it possible to assess to what extent, in certain sectors, mergers will have had economic effects that are, overall, favourable, or, on the contrary, unfavourable. Here it is a question of presenting the overall trends revealed, in more recent years, by the process of mergers and acquisitions. Thus, the more recent major operations will be identified, according to different criteria (number, size, country).

Like the previous section, this section will concentrate on manufacturing. A separate subsection (4.6) will however look at mergers in services.

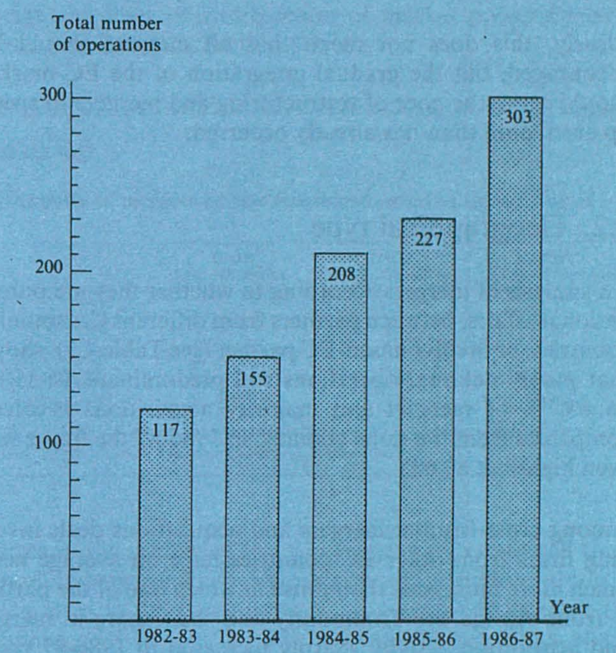
4.1. Increase in total numbers

The results given here are based on Commission analysis of reports in the business press of mergers and acquisitions of majority stakes involving at least one of the 1 000 largest firms in the Community, according to their financial data (*source*: European Commission, Directorate-General for Competition, annual reports on competition policy).

Most of the analysis is based on absolute numbers of deals, rather than value. This is because data on the value of acquisitions are not always available although prima facie such data would be more relevant.

The results show that the total number of mergers and acquisitions involving at least one of the top 1 000 EC firms has been steadily increasing, from 155 in 1984, to 208 in 1985, 227 in 1986 and 303 in 1987. The sharp increase in merger and acquisition activity in 1987 is a trend which looks set to accelerate in the run-up to the single European market (Figure 4.1).

FIGURE 4.1: **Numbers of mergers and acquisitions of majority stakes involving the 1 000 largest European firms**



Source: Competition reports.

This is because merger is one way of implementing strategies to achieve a broader geographical coverage and to exploit economies of scale. The studies of industries made by the Commission in connection with the single market programme have clearly shown the degree of restructuring required in European industry.

(i) The single market programme is aiming first of all to create an integrated demand in the Community. This integration should elicit a twofold strategic response from firms. First, they will have to specialize more in the activities they are best at and dispose of assets related to activities in which their competitive position is weak. Secondly, they will have to extend their geographical sphere of operation and so will tend to buy up firms in other Member States in their core businesses. Both these factors should lead to a sharp increase in merger activity. In some industries such an increase has been observable since the early 1980s. In the food industry for example the number of takeovers of European firms averaged 17 a year between 1980 and 1984; over the period 1985-86 the average was as many as 42 a year (MAC Group (1988)).

(ii) In some sectors supply is highly fragmented. This is especially true of industries supplying the public sector, in which the number of European producers is very high by comparison with the United States of America. For example in the industry making boilers for electric power plants there are 12 producers in the Community against only six in the USA, for turbine generators we have 10 producers compared with two in the USA, and we have 16 makers of electric locomotives to the USA's two. The opening up of government and public utility procurement should eventually lead to mergers in these industries also (Atkins (1988)). In the railway equipment industries mergers are already under way. Alsthom for example after buying up the railway equipment business of Jeumont-Schneider has just acquired a majority stake in the Belgian firm ACEC which has railway and energy interests. Following its successful bid for the Spanish high-speed train contract, Alsthom is now planning to take control of the two Spanish firms in the industry which are at present State-owned.

Clearly, this does not mean that all mergers should be encouraged, but the gradual integration of the EC market should cause the pace of restructuring and mergers to speed up even more than has already occurred.

4.2. Geographical type

An analysis of mergers according to whether they are purely national affairs, between partners from different Community countries, or involve a non-EC partner (see Table 4.1), shows that purely national operations still predominate. In 1985-86 63,7% of mergers and majority acquisitions involved companies from the same country; in 1986-87 the figure was even higher at 69,6%.

Among cross-frontier mergers and acquisitions deals involving firms from other EC countries have on average been much more numerous than those in which one of the parties is from outside the Community and their share in merger and acquisition activity sharply increased in 1986-87 compared with that of wider international link-ups. In relation to 1992 the recent trends are interesting for two reasons.

The first point is that on their home markets firms seem to be stepping up their merger and acquisition activity ready for the advent of the single market in order to achieve by 1992 the critical mass necessary to face European competition with the maximum chance of success. Secondly, link-ups with other EC firms have been on a steadily rising trend since 1983-84, when there were 29, increasing to 44 in 1984-85, 52 in 1985-86 and 75 in 1986-87. It is mainly the larger firms which are forming such links, apparently in an effort to attain European scale as soon as possible.

Whereas for many years it was only American firms that had an overall strategy for Europe covering all the EC countries, recent trends show that this is now changing. For example, in the food and drink industry, 44% of 46 major European manufacturers only had a presence in their home country or at most in one other Member State in 1987. The quest for European scale is now pushing them to acquire firms in other EC countries. Over the period 1980-84, only 59% of acquisitions of European firms in this sector were made by other European based firms. In 1986-87, the percentage was 76%. European firms are thus increasingly engaging in restructuring (MAC Group (1988)).

4.3. Main motives for mergers and acquisitions

The results of an analysis of the main motives for mergers and acquisitions, as given in public statements about the transactions, throw interesting light on the subject (Table 4.2). In a third of cases, the main motive was production rationalization and restructuring.

Expansion was the second most common reason cited, while complementarity and strengthening of market position were among those less frequently mentioned.

Hence the reasons managers are giving for merger activity are fully consistent with the findings of the report on 'The economics of 1992' (*European Economy* No 35 (1988)). On the one hand, the restructuring is intended to bring about rationalization of the production base and to achieve pro-

Table 4.1

Mergers and acquisitions of majority holdings 1982-87, by nationality of parties (from same EC country, different EC countries, or an EC and a non-EC country)

Year	National (same EC country)		EC (different EC countries)		International (EC + non-EC)		Total	
1982-83	59	(50,5)	38	(32,5)	20	(17,0)	117	(100)
1983-84	101	(65,2)	29	(18,7)	25	(16,1)	155	(100)
1984-85	146	(70,2)	44	(21,2)	18	(08,7)	208	(100)
1985-86	145	(63,7)	52	(23,0)	30	(13,3)	227	(100)
1986-87	211	(69,6)	75	(24,8)	17	(05,6)	303	(100)

NB: Figure in brackets is percentage of total operations.
Source: EC Commission (1988), *Seventeenth Report on Competition Policy.*

Table 4.2

Main motives for mergers and acquisitions in 1985-86 and 1986-87

%[1]

	1985-86	1986-87
Rationalization, restructuring	35,0	29,7
Expansion	18,1	22,1
Complementarity	14,4	12,4
Strengthening of market position	11,3	11,5
Diversification	12,5	5,7
R&D	2,5	5,3
Specialization	1,9	1,3
Other	4,4	11,9
Total	100	100

[1] Percentage of all merger cases for which precise information about motives is available.
Source: Seventeenth Report on Competition Policy (1988).

ductivity gains, which corresponds to the first reason given for mergers. On the other, the incremental growth induced by the creation of a single market will encourage mergers and takeovers for the purpose of expanding production capacity, the second of the main motives given by managers.

R&D is rarely mentioned as a motive for mergers. However, it is one of the main reasons given for joint ventures: 26% of joint ventures in 1985-86 and 19% in 1986-87 were prompted at least partly by R&D considerations. In high-tech industries in particular, such alliances may clearly be justified in strategic terms (see Group 3 in Section 3.2(b) above).

4.4. Prominence of large groups

Looking at the size of the firms engaging in mergers and acquisitions, one finds that the very large among the top 1 000 firms are the most active. Firms with sales of over ECU 1 billion were involved in 57% of mergers in 1986/87 compared with 53% in 1985-86. A large number of operations involved a combined turnover of over ECU 5 billion (67 in 1986-87 against 31 in the previous year).[1]

This trend towards increased merger activity by large industrial groups could eventually pose problems for competition policy, as monopoly situations could develop and restrict competition. This is especially true of industries relatively closed to international trade (Group 1 in Chapter 3). On the other hand, in industries where demand is growing strongly, the benefits in terms of efficiency may well outweigh the costs of an accretion of market power by large firms (see Group 3, Section 3.2(b)).

Table 4.3

Breakdown of mergers by size (combined sales) of firms involved

	Under ECU 500 million	ECU 500-1 000 million	Over ECU 1 000 million
1983-84	29	18	85
1984-85	62	31	92
1985-86	63	33	108
1986-87	101	31	171

Source: EC, *Seventeenth Report on Competition Policy* (1988).

Firms in the middle of the size range, with combined turnovers of between ECU 500 million and 1 billion, are least prominent in the sharp increase in merger activity since the beginning of the 1980s. The increase among firms at the bottom end of the sample, those with combined sales of under 500 million, has been very rapid, however. This is borne out by an analysis of the data for all mergers (even smaller ones) reported in the business press (*Seventeenth Report on Competition Policy* (1988)). It emerges that smaller firms use the merger route to growth even more frequently than any other category. This situation is healthier from the point of view of competition policy. The creation of larger units from medium-sized firms may promote competition with larger firms and lead to greater exploitation of economies of scale and efficiency gains.

4.5. Marked differences between Member States

The number and size of cross-frontier mergers and acquisitions involving large European firms show clearly the importance of a Community approach to competition policy. But there are substantial differences in patterns of merger activity between Member States. Historical, as well as economic, institutional and legal factors partly explain this situation.

The scrutiny of mergers by national competition authorities varies widely for firms based in the UK, Germany or France (both in the underlying philosophy of the approach and in

[1] For example, Volkswagen's takeover of Seat in Spain for DM 1,3 billion, CGE's acquisition of ITT's European interests for USD 1,5 billion. Never before have large companies' mergers been so numerous; in 1986-87 there was a total of 171 such deals (see Table 4.3).

the criteria applied). The vast differences between takeover legislation provide a striking example.[1]

The study of mergers and acquisitions in three EC countries by Booz Allen and Hamilton[2] (*Financial Times*, 1987 and 1988) shows how much the situation varies between countries.

British firms are involved in over three times as many mergers in the US as in Europe, and this trend has increased in the last few years. The share of mergers with European partners fell from just under 40% in 1984 to only 20% in 1987. But a reversal of this trend now seems to be taking place in the UK. In the first four months of 1988, British firms were involved in more takeovers in the EC than a year earlier (70 compared with 27), whereas takeovers of American firms were down from 177 to 66. Of course, the observation relates to a very short period.

In Germany the preference for mergers with EC firms continues to predominate (accounting for two-thirds of the total in 1987). The fall in the share of mergers with European partners since 1984 (from 86% to 66% in 1987) will probably be reversed. Another point worth noting is how open the German market has become to takeovers. Booz Allen noted 262 takeovers of German firms in 1987 compared with only 106 in 1986. French companies with 156 takeovers in Germany in 1987 led the field.

In France the most striking feature is the explosion of merger activity: up from 35 in 1986 to 196 in 1987. In 1987 French firms are reported to have been involved in 97 cross-frontier takeovers in the EC (Figure 4.2).

A recent study by MacDermott and Gray (1988) is based on different data (the American magazine *Mergers and acquisitions* and the M&A specialists Gumin & Co.), but has the advantage of giving European data alongside comparable figures for the USA and Japan.[1]

The MacDermott and Gray study shows that the creation of an integrated market of 320 million consumers is of interest to American firms which do not want to be left out of the process. In many industries American companies are making major acquisitions in Europe. Over the period 1980-87, US firms acquired 314 companies in the UK (which continues to be the prime destination of American overseas investment), 95 in Germany and 88 in France, as against only 22 in Japan. In 1987 of USD 11 billion worth of acquisitions made by American firms, 78% was concentrated on the UK and Canada.

Unlike the Americans, Japanese firms have traditionally preferred domestic production for cultural and historical reasons. Since the beginning of the 1980s, however, many large Japanese groups have begun to internationalize their operations, as the high yen has reduced the cost of foreign acquisitions. But there have been only a few Japanese acquisitions of European firms, like the takeover of Glaverbel by Asahi Glass or of Dunlop by Sumitomo Rubber Industries. This situation could change rapidly with the coming of the single market.

4.6. Mergers in services

While the number of mergers involving the 1 000 biggest manufacturing firms in Europe rose from 208 to 303 between 1984-85 and 1986-87, the number of mergers recorded by the Commission's Directorate-General for Competition in distribution, banking and insurance over the same period rose from 67 to 112 (Table 4.4).

In 1986-87 operations involving firms from the same country accounted for 70% of the total (79 of 112), a similar pattern to that observed in manufacturing.

In banking and insurance, merger activity has sharply increased.

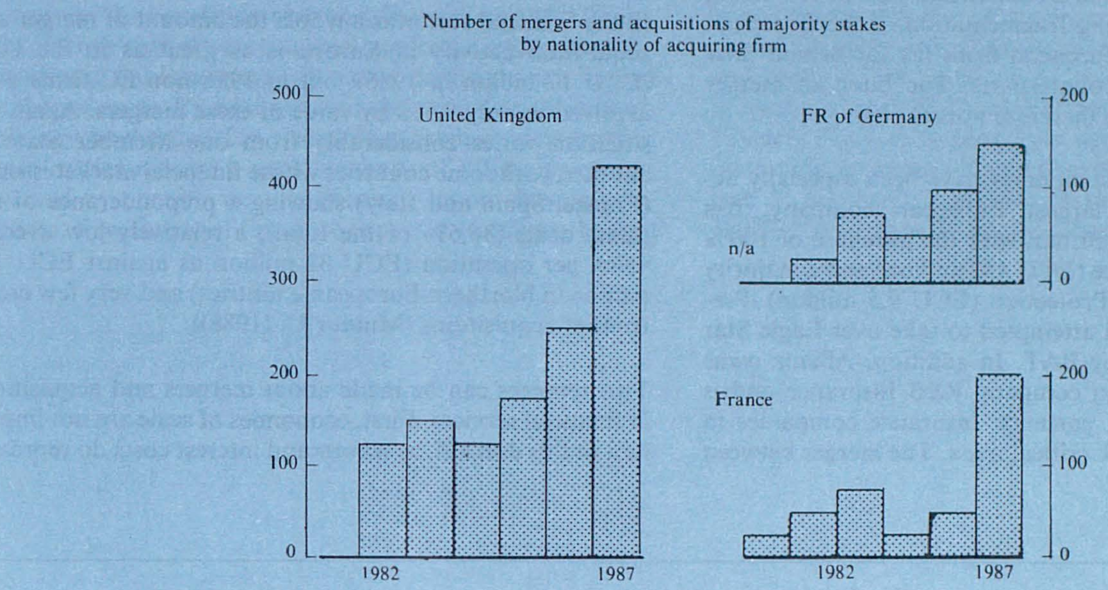
(i) In banking, the 200 largest banks in the world by asset value in 1986 included 46 Japanese with total assets of USD 79,4 billion, 38 American with total assets of USD 75,6 billion and 75 European with assets of USD 158 billion. Acquisitions are a quick way of establishing a presence in another Member State, and since 1986 they have proliferated, as shown in Table 4.5.

The purpose of these mergers is not so much the achievement of economies of scale as a broadening of the product range and an extension of geographical coverage. Mergers allow banks to offer their customers a wider range of services (international network) and to achieve cost reductions from this wider range ('scope economies').

[1] A first step towards harmonization has however been made with the adoption in July 1988 of a directive obliging purchasers of shares to disclose holdings of quoted companies' shares once they exceed a certain percentage of the total.

[2] Booz Allen and Hamilton used national sources and assembled data on all mergers and acquisitions of majority holdings disclosed by the sources. The figures should therefore be treated with caution and a comparison of numbers of operations between countries would not be meaningful. The results obtained are also markedly different from those of the EC Commission's Directorate-General for Competition, which only relate to the 1 000 biggest European firms.

FIGURE 4.2: Mergers by nationality of acquirer[1]



Share of mergers and acquisitions involving other EC firms in total

%

	1982	1983	1984	1985	1986	1987
UK	37	34	39	31	27	20
France	95	60	63	47	77	50
FR of Germany	n/a	83	86	77	72	66

[1] Sources differ for different countries. Comparison between countries for a given year would therefore be misleading.
Source: Booz, Allen & Hamilton.

Table 4.4

National, EC cross-frontier and international (EC + non-EC) mergers (including acquisitions of majority holdings) in the Community 1984-85, 1985-86 and 1986-87 in services

Sector	National			EC cross-frontier			International			Total		
	1984-85	1985-86	1986-87	1984-85	1985-86	1986-87	1984-85	1985-86	1986-87	1984-85	1985-86	1986-87
Distribution	30	27	40	3	6	5	1	0	4	34	33	49
Banking	10	12	22	6	4	3	2	9	10	18	25	35
Insurance	7	5	17	7	3	7	1	4	4	15	12	28
Total	47	44	79	16	13	15	4	13	18	67	70	112

Source: Seventeenth Report on Competition Policy (1988).

(ii) In insurance, the top 10 companies in the world by premium income include only one European firm alongside three Japanese and six American. This poor ranking points to a continuing fragmentation of the European industry in which European firms lag far behind their US and Japanese counterparts. The burst of merger activity in Europe is therefore not surprising.

German insurance companies have been especially active. Allianz, the largest European company, has established itself in Britain with the purchase of 100% of Cornhill Insurance (ECU 450 million) and a majority of Affiliated Legal Protection (ECU 9,5 million). Previously, Allianz had attempted to take over Eagle Star but was thwarted by BAT. In addition, Allianz owns 43,5% of the Italian company R&S Insurance and is looking for French partners. Insurance companies in France feel they lack critical mass. The merger between Compagnie du Midi and Axa is a response to this perceived need for larger size.

In the financial sector as a whole the amount of merger and acquisition activity in Europe is as great as in the USA (ECU 17 billion in 1986), but in 1986 non-EC firms were involved in only 5,6% by value of these mergers. Again the situation varies considerably from one Member State to another, with some countries whose financial market is small (France, Spain and Italy) showing a preponderance of national deals (86,6% of the total), a relatively low average value per operation (ECU 32 million as against ECU 110 million in Northern European countries) and very few cross-frontier acquisitions (Muldur U. (1988)).

Two remarks can be made about mergers and acquisitions in financial services. First, economies of scale are not important in this domain, as labour and interest costs do represent

Table 4.5

Recent bank mergers and acquisitions

Date	Acquirer	Country	Transaction	Partner	
September 1986	PK Banken	Sweden	Takeover	English trust group	UK
October 1986	Istituto Bancario San Paolo Torino	I	Acq. 6,4% shareholding	Hambros	UK
December 1986	Deutsche Bank	D	Acquisition UKL 603 million	Banca d'America e d'Italia	USA
February 1987	Paribas	F	Cooperation agreement	Banca commerciale italiana	I
July 1987	Banco de Bilbao	E	5% shareholding	Hambros	UK
November 1987	Istituto Bancario San Paolo Torino AGF	I F	49% shareholding 89% in 1989 11% shareholding	Banque Vernes	F
December 1987	Swiss Bank Corp.	Switz.	51% shareholding raised to 80%	Banque Stern	F
January 1988	Banco de Bilbao	E	Merger	Banco de Vizcaya	E
February 1988	Amsterdam Rotterdam Bank	NL	Exchange of shares	Générale de Banque	B
March 1988	Banco de Nat-West March	E	84% shareholding	Banco de Asturia	E
June 1988	Banco Central	E	Merger	Banco Espanõl	E
June 1988	Nat-West	UK	Purchase	Branches de la Banque de l'Union	F
October 1988	Royal Bank of Scotland	UK	Exchange of shares	Banco Santander	E

Source: Nomura Research Institute, 1988.

the major expenses. US banks for example, usually seem to exhaust size-related economies at a fairly low level of assets (USD 50 million). Second, mergers are far from being the easiest way for benefiting from the financial market integration. Europe's wholesale financial markets are already competitive and bank mergers will make sense only in a limited number of cases. By contrast, Europe's retail financial markets may be headed for a shake-up through new entries. These entries require a retail network of offices or agents, obtained by opening new branches or by purchasing competitors. Few financial firms are expected to follow the first route, given the importance of taking speedy strategic actions and the already overbanked nature of most European countries. But purchasing a network has its own drawbacks. Many banks are owned by federal or provincial governments. Besides, banks for sale are frequently financially weak and costly to turn around. As we have seen in the case of industry, it is difficult to efficiently digest an acquisition. Friendly alliances ranging from agreements to cross-sell products to joint ventures could then be an alternative approach (see J. Morgan, 'Financial markets in Europe: towards 1992', *World financial markets*, September 1988, No 5).

Chapter 5 — Assessment of merger trends with reference to sectoral criteria

EC competition policy will be mainly concerned with mergers between European-scale firms. It is therefore useful first to see how big a place large firms have in European industry overall. Then the section will look at the role of large firms in individual industries. Finally, we will consider recent patterns of merger activity in certain growth industries.

5.1. Concentration in manufacturing: international comparisons

Table 5.1 shows the share of the largest European firms in Community manufacturing industry and similar figures for the USA and Japan.

Table 5.1

Shares of manufacturing industry accounted for by large firms in the EC, USA and Japan — 1986

%

	Share of the n largest firms in total sales of industry[1]			
	5	10	20	40
EUR 12[2]	6,8	10,8	16,9	23,0
USA	13,5	19,6	26,5	34,6
Japan	8,0	12,6	17,5	23,7

[1] NACE sectors 1-4.
[2] For EUR 12 total industry figures are based on Commission estimates.
Source: Nouvel Economiste, (1987); calculations by EC Commission.

The table shows clearly the important part the largest firms play in European manufacturing. The top 40 firms for example account for 23% of all sales generated by manufacturing, though representing less than 0,5% of manufacturing firms.

Secondly, a comparison of the present situation in Europe with that prevailing in the USA shows that the giants of American industry are unquestionably even more significant for the US economy than their European counterparts are for the EC economy. The top 20 European companies generate 16,9% of manufacturing turnover in the Community, as against the 26,5% accounted for by the 20 largest American corporations. Compared with Japan however the significance of the largest European firms in the EC is comparable to that of the leading Japanese firms in Japan. This shows that the top European companies already operate on a Community-wide scale — another indication of the need for and importance of EC competition legislation.

However there are major differences between individual industries within the manufacturing sector and these greatly exceed the differences observed between the three blocs (Europe, the USA and Japan) for manufacturing as a whole. Table 5.2 shows the share of total sales of selected manufacturing industries accounted for by the five or three biggest European firms in the industry.

(i) In a few industries (e.g. motor vehicles, aerospace and computers), the five largest firms have a very large share — about two-thirds — of total sales. In some others (like tobacco, chemicals and electronics), the figures are over 40%. But it should be noted that the large shares of the market held by the biggest players in these industries are also partly due to the prominence of American multinationals in Europe. The prime example is IBM in computers. The share of the five largest firms in the total sales of these industries does not necessarily mean that mergers should be discouraged, especially between the smaller firms. Other factors too may argue in favour of mergers in industries dominated by a few large firms. Such factors include a market open to foreign competition, strong demand growth and the significance of R&D expenditure. In Part C we will suggest a procedure for vetting horizontal mergers in such industries which weighs the criteria of a possible reduction in competition against the possible efficiency gains.

(ii) In other industries the concentration ratios are much lower, as in textiles, printing, metal goods and food.

These findings on the significance of large firms are consistent with those obtained from other sources (Buigues, Jacquemin (1988)). In industries such as computers, electronics and basic chemicals, firms employing over 500 people account for 70% of total sales in the industry in all EC countries for which data are available (Federal Republic of Germany, France, Italy, UK and Belgium). Conversely, the industries in which the top three or five firms have a smaller share of total industry sales are also those in the Buigues/Jacquemin study in which firms employing more than 500 people are less prominent (textiles, food and drink, tobacco).

As we shall see in Part C, concentration ratios cannot be taken as the sole guide to the desirability of mergers in an industry. But they provide a necessary first indication of their impact. It is therefore clearly necessary that the Commission should have access to data allowing it to follow changes in concentration levels at a finer level of disaggregation. The NACE 3-digit level comprising 140 industries would be a first step.

Table 5.2

Share of largest firms in output of selected EC industries

%

Industry	NACE-CLIO	Share of top five firms in total output	Share of top three firms in total output
Tobacco	429	43,7	—
Textiles	431 to 439	—	6,4
Chemicals	251 to 256 + 259	41,5	—
Rubber	481 + 483	–	17,4
Construction materials	241 to 248	22,3	—
Iron and steel	221 to 224 + 311 + 313	27,5	—
Metal goods	312 + 314 à 316	6,9	—
Electronics	342 to 347	42,2	—
Motor vehicles	351 to 353	65,5	—
Aerospace	364	65,6	—
Pharmaceuticals	257	28,7	—
Computers, office equipment	330	65,3	—
Industrial and agricultural machinery	321 to 328	13,7	—
Drink	424 to 427	34,1	—
Food	411 to 423 + 428	13,5	—
Printing and publishing	473 + 474	12,1	—

Source: Commission services, DG II.

5.2. Merger activity and economic conditions in industry

The variety of situations found in different industries makes horizontal comparison difficult. But a study of merger and acquisition activity in growth and technology-intensive industries is instructive. Annex 1(d) summarizes the data available at the finest level of disaggregation possible.

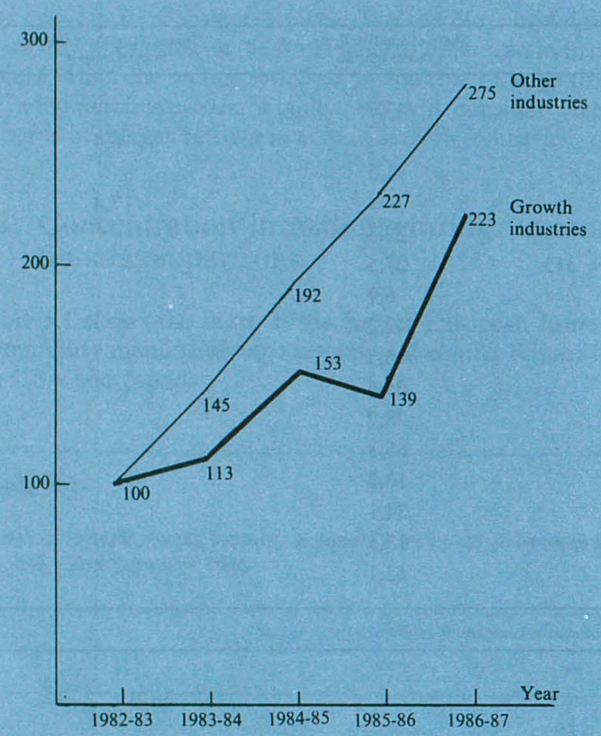
Figures for the volume of domestic demand for industries' products in the EC, the USA and Japan show that for some industries demand growth has been little affected by the cyclical fluctuations seen in industrial economies. This is the case for example in computers, electronics, telecommunications, chemicals and pharmaceuticals.

In these industries demand has continued to grow in volume terms at an average rate of 5% a year (Buigues, Goybet (1988)). But it is here that EC firms have lost the biggest share of export markets compared with other OECD countries: between 1979 and 1986 their share of export markets declined by nearly 2 percentage points, whereas that of Japanese industry went up by 7,6 points over the same period. Meanwhile, the import penetration of Community markets has been increasing: the share of EC demand supplied by imports from outside the EC rose from 13,0% in 1979 to 20,0% in 1985.

An analysis of merger activity in these industries over the period 1982-87 shows that growth industries have a number of features that set them apart from the rest of industry:

(a) First of all, the number of mergers and acquisitions of majority holdings involving firms in the top 1 000 has risen significantly less quickly in growth sectors than in the rest of industry (Figure 5.1).

FIGURE 5.1: **Index of merger and acquisition activity (1982-83 = 100)**[1]



[1] The absolute number of mergers and acquisitions in each sector (growth industries and other) would be meaningless, as it depends on the number of firms in the sample (the 1 000 largest) belonging to that sector.

Source: Competition reports.

This is at first sight surprising in that in these industries mergers often produce substantial efficiency gains. A comparison of the size of European firms with that of their American and Japanese competitors (Table 5.3) reveals that the European market leaders are smaller (for example in the aerospace, computer and consumer electronics sectors). While international comparisons of sales figures are not free of problems as they only reflect year-to-year positions at prevailing exchange rates, it is noticeable that for the same year and exchange rate European firms were among the world's largest in mature or declining industries such as steel or textiles.

As noted in Chapter 3, mergers must not automatically be rejected in growth industries. This is because:

(i) the increase in merger activity has been less in industries facing a growth in demand than in industry overall;

(ii) the European market leaders in these sectors are smaller than their international competitors;

(iii) European firms have lost market share in third country markets and on the Community market in these industries.

(b) A second observation is that it is in industries facing strong growth in demand that European firms often prefer mergers with partners from other countries.

Whereas link-ups with firms from the same country accounted for 77,1% of the mergers recorded between 1982 and 1987 in industries with weak or falling demand and 70% of those in sectors with moderate demand growth, in high-growth industries they only represented 53,5%. Necessity being the mother of invention, the more strongly the market is growing and the higher the technological sophistication of the products, the more firms are obliged to leave their national market in order to attain the necessary volume of output to produce at lowest cost or to acquire technology unobtainable on their home market.

In growth industries 32,5% of mergers involved firms from other Member States, compared with only 16,8% for industries with static demand growth, while 14% involved non-EC partners in high demand sectors and 6,1% in low.

The proportion of joint ventures involving partners from non-EC countries is higher than in the case of mergers. In 1987 non-EC firms were the partner in 50% of joint ventures in EC manufacturing industry. Of the 45 joint ventures with non-Community partners the other company was American in 22 cases and Japanese in 13.

This second fact points to the importance for a Community merger control policy of clearly distinguishing between operations in growth (and generally technology-intensive) industries and in mature or declining industries. In the former case, the Community or international scale of the market is more pronounced. Moreover, in these sectors the integrated market will make substantial restructuring necessary since potential economies of scale are particularly significant, and European industry is in a relatively vulnerable position compared with its main overseas competitors.

Table 5.3

World and European leaders

Year: 1986

Sector	Sales of world leader	World		Sales of Eur. leader	Europe		Number of companies in top n companies			
	ECU billion	Company name	Nat.	ECU billion	Company name	Nat.	EUR	USA	Japan	n
Manufacturing sector										
Aerospace	16,8	Boeing	USA	5,0	Aérospatiale	F	7	13	—	20
Food	25,8	Unilever	NL/UK	25,8	Unilever	NL/UK	4	14	—	20
Vehicles	105,8	General Motors	USA	31,0	Daimler/Benz	D	7	3	8	20
Mechanical engineering	16,4	Mitsubishi	Japan	8,2	Mannesmann	D	4	2	2	10
Electrical engineering	2,6	General Electric	USA	0,4	Philips	NL	3	3	4	10
Chemicals, pharmaceuticals	28,0	Dupont de Nemours	USA	19,3	Bayer	D	9	10	—	20
Oil	71,9	Exxon	USA	66,7	RD Shell	NL/UK	5	10	2	20
Computers	50,5	IBM	USA	4,5	Siemens	D	4	11	5	20
Photographic products	11,9	Eastman-Kodak	USA	3,3	Agfa Gevaert	D	1	2	2	5
Cosmetics	2,7	L'Oreal	F	2,7	L'Oreal	F	1	3	1	5
Toys	1,4	Hasbro	USA	—	—	—	—	5	—	5
Consumer electronics	10,3	Matsushita JVC	Japan	8,1	Philips	NL	2	0	3	5
Steel	14,2	Thyssen	D	14,2	Thyssen	D	8	4	5	20
Textiles	3,1	Courtaulds	UK	3,1	Courtaulds	UK	3	11	5	20
Services sector										
Banking	224,4	Dai-ichi Kangyo	Japan	146,5	Crédit Agricole	F	7	1	12	20
Media	4,3	Bertelsmann	D	4,3	Bertelsmann	D	2	5	2	10
Advertising[1]	0,7	Dentsu Inc.	Japan	0,5	Saatchi et Saatchi Compton	UK	1	8	1	10
Hotels	—	Holiday Inn	USA	—	Trusthouse Forte	UK	2	8	—	10
Airlines	8,8	United	USA	4,8	British Airways	UK	3	6	1	10

[1] Gross income 1986.
Source: 'La guerre mondiale des entreprises 1987', *L'Expansion*, 6/19, November 1987.

Table 5.4

Mergers by geographical type and economic conditions in industry
Total period 1982-87

%

	Strong growth	Moderate growth	Weak growth
National (same EC country)	53,5	70,0	77,1
EC (different EC countries)	32,5	19,2	16,8
International (EC + non-EC)	14,0	10,8	6,1
Total	100,0	100,0	100,0

Source: Seventeenth Report on Competition Policy and DG IV.

Part C — Analysis for the purposes of European merger control

The impact of a merger can be of three basic types: it can improve efficiency without any reduction of competition, reduce competition without any gain in efficiency, or have effects at once conducive to efficiency and harmful to competition. As the first case is wholly positive, only the second and third situations give cause for concern. The questions which arise are, first, what criteria are there to determine whether a merger or takeover will bring about a significant reduction in competition? Secondly, if a significant reduction in competition is likely, what criteria are there to estimate possible efficiency gains as a result of the operation and to determine whether these outweigh the adverse effects?

With specific reference to the proposed European merger control regulation (see text in Annex 2), Chapter 6 of Part C begins by looking at the criteria, generally accepted in competition policies, for the impact of concentration on competition in the light of the discussion in Parts A and B. On the basis of these criteria Chapter 7 goes on to examine the criteria adopted in the merger control proposal, including the turnover measure, and assesses the value of efficiency gains as a justification for mergers both in relation to the regulation and to the economic and political role that the Commission will be called upon to play in administering the European merger control system. Chapter 8 suggests the order of steps to be followed in the merger vetting process.

First of all, the complementary nature of the relationship between control of mergers at the level of competition policy and the control of takeover bids (TOB) in the field of company law must be underlined. On the one hand a regulation of TOB could ensure the publicity and transparency of large-scale mergers at Community level mainly by requiring that the acquisition of voting rights in an enterprise above a certain threshold should force the bidder to make a public purchase or exchange offer. Requirements for information about the intentions of the predator concerning the future activities of the firm involved follow the same guidelines. On the other hand we have seen in Part A that takeover bids constitute a means whereby competition is enhanced, encouraging the replacement of inefficient management. Their regulation could therefore outlaw certain defensive measures which would prevent in an abusive fashion the functioning of a free 'market for corporate control'. The recent Directive of the Commission, whose text is provided in Annex 3, conforms to this approach.

Chapter 6 — Criteria for a reduction in European competition

In the European merger control proposal the first two articles are of key importance for the economic analysis.

They state that the mergers covered by the regulation are those which have a Community dimension and that of such mergers those which create or strengthen a dominant position in the common market or a substantial part of it are to be disallowed. The criteria adopted for determining whether this is the case are (Article 2(1)):

(i) the market position and economic and financial power of the firms concerned;

(ii) the possibilities of choice of suppliers and consumers;

(iii) access to supplies or markets;

(iv) the structure of the markets affected, having regard to international competition;

(v) barriers to entry (legal or *de facto*);

(vi) the trend of supply and demand for the goods or services concerned.

It is further stated in the recitals that mergers which, on account of the small market share of the firms concerned, are unlikely to impede effective competition may be presumed to be compatible with the common market (and would therefore not be blocked), and that this presumption exists in particular where the merging firms do not have a market share of over 25% in the common market as a whole or in any substantial part of it.

To evaluate the implications of these provisions, we will examine them in the light of the criteria which economic analysis suggests should be used in assessing the competitive impact of a horizontal merger.

6.1. Criteria suggested by economic analysis

From the simple model described in Part A it is clear that it is impossible to rely on a single criterion to determine the danger of a merger's conferring or strengthening monopoly power. At the margin, in a perfectly contestable market, where among other things there is complete freedom of entry and exit, a horizontal merger that raised a firm's share of the market to 100% would still not automatically give the firm monopoly power.

In fact, to assess the competitive impact of a horizontal merger it is necessary to analyse several aspects of the structure of the market.

First of all, we have to define what the relevant market is. In this market we have to include all the goods (or services) that are close substitutes from the consumer's point of view. The definition must also determine the geographical extent of the market (local, regional or international), i.e. the area within which a purchaser can reasonably be expected to consider offers of the goods or service.

Secondly, the degree of concentration of this market must be calculated and the possible impact of the merger on the scope for collusion estimated.

Thirdly, the relative ease of entry into the market has to be assessed, whether for domestic or foreign firms or for imports.

In Part B two further very important factors from the point of view of the single European market were identified and analysed with reference to EC data. These are the rate of growth in the industry and the degree of openness to international trade. As we shall see, these factors are very important for the assessment of the three aspects mentioned above.

Competition policies consider goods (or services) as forming a market if there is effective competition between them, which implies a sufficient degree of interchangeability for the same use (see for example the European Court of Justice's judgment in *Hoffman-La Roche* (1979) in which each group of vitamins was considered to form a separate market because of their specific metabolizing functions). A theoretical way of measuring interchangeability is to calculate the cross-elasticity of demand. If this is positive and high, there is a presumption of interchangeability.[1] In practice this type of calculation is supplemented or replaced by an examination of the specific features of the various products to determine whether they can really be said to satisfy the same need. The current merger guidelines of the US Anti-trust Division[2] have adopted a new approach to this question: rather than looking to data of actual substitution, they refer to a concept of potential substitution.

[1] Cross-elasticity of demand can be expressed as:

$$Eij = \frac{\delta qi}{\delta pj} \cdot \frac{pj}{qi}$$

where qi is the quantity demanded of product i and pj is the price of product j. If a given increase in the price of product j leads to a large increase in the quantity demanded of product i, it is concluded that the two products are substitutes. Obtaining data for such changes is not easy and in addition the conclusions depend on the *ceteris paribus* assumption.

[2] US Department of Justice, *Merger guidelines*, 14 June 1982.

A market is defined as a group of products such that a hypothetical monopolist or cartel controlling all production capacity for the products could profitably increase the price by 5% above the current price for a non-transitory period. The market thus represents the businesses a producer must control in order to be able to significantly increase prices. Such a definition requires a consideration of all potential substitutions in the demand (buyers defecting to other products) and supply sides (sellers of other products switching their capacity to supply the market in which prices have been raised).[1] If prices cannot be increased by such a percentage it is because substitutability acts as a strong constraint.

The emphasis on the ability of a hypothetical monopolist to raise prices accords fairly well with the European concept of dominant position, which is characterized by the possibility of independent conduct whereby the firm is able to act without great regard to its competitors, customers or consumers (see in particular the Court of Justice's judgments in *Continental Can* (1973) and *United Brands* (1978)).

Nevertheless, the criterion raises at least two questions.

First, the equating of actual and potential competition is open to objection: not only is the evaluation of the intensity of potential competition much more subjective, but also its effects are felt over a longer time scale than those of actual competition.

Secondly, reference to the current price would be inappropriate if this already reflected monopoly power as it would lead to existing dominant positions not being identified and challenged.[2]

This suggests that in defining the relevant market for antitrust purposes we should be wary of relying exclusively on quantitative or mechanical tests which inevitably involve a degree of arbitrariness, and should include qualitative analyses that take into account the special features of each case.

The definition of the geographic market must have regard to a number of well-known criteria: the significance of transport costs, the perishability of the project, local or regional differences and consumption habits. But the crucial aspect, given the 1992 programme, is the degree of openness to international trade.

In defining the geographic market it is therefore natural to take into account the production capacity of foreign firms selling into the relevant market, national or European. If there are imports into the market, a certain rise in prices on the market is liable to produce an increase in imports or even a complete switching of foreign production to the market. Clearly, the removal of non-tariff barriers in the Community will increase such effects and reduce the danger of mergers leading to monopolization.

In Part A it was shown that imports could exert considerable competitive pressure on domestic products. The model discussed there suggests that the more foreign firms sell on a market, the less is the loss of consumer welfare on that market resulting from a merger and the more likely in fact there is to be a net social gain.

In applying Article 86 the Commission and the Court of Justice have regularly taken imports and even potential competition from abroad into account in defining the geographic market. In some cases this approach has led to the market being defined as the world market (for example *Bayer/Gist* (1976), *Commercial Solvents* (1974), *Hoffman-La Roche* (1979)).

But the role played by international competition is extremely variable. First, as we saw in Part B from a classification of industries according to their degree of openness to imports, there is wide variation in import penetration ratios (share of imports in domestic consumption) between industries.

Secondly, foreign competition is not a perfect substitute for domestic competition in that import flows are subject to extra uncertainties that do not affect domestic production. For example, economic measures such as tariffs, quotas, standards or safeguard clauses can stop the flow of imports. As we saw in Part A, this is also true of macroeconomic measures such as a devaluation of the domestic currency against that of the exporting country, which can make imports uncompetitive. In general, exchange rate volatility reduces the protection that foreign competition affords against the adverse effects of a domestic merger. Also, the intensity of competitive pressure from imports is more likely to change than that from domestic competition.

Hence it is not surprising that in a considerable number of cases, the Commission and the Court of Justice have held the relevant geographic market to be only part of the Community market, the national market of a medium-sized

1 In the *Continental Can* case (1973) the European Court of Justice held that in defining the relevant product market the Commission had failed to consider the possibility of substitution on the supply side, i.e. the ease with which cylindrical metal can producers could switch their production to making packaging in more complex shapes for meat and fish.

2 Schmalensee (1988): 'It makes sense to define a market as something that could profitably be monopolized, not as something for which price could be profitably increased over current (possibly monopolistic) levels'.

Member State, and even only part of a large Member State (*Sugar cartel* (1975)).[1]

The degree of concentration on the relevant market has hitherto been considered as the crucial criterion both on the basis of the theoretical models presented in Part A and of econometric studies establishing positive correlations between concentration ratios and profitability. The Herfindahl index is particularly illuminating in this respect.

Unlike measures based on the market shares only of the largest firms, the Herfindahl index reflects the distribution of the market shares of all firms: for a given number of firms it is higher where the distribution of market shares is very unequal and lower where the distribution is more even. Also, it is strongly influenced by the distribution of the shares of the largest firms. This aspect is important because it is reasonable to assume that collusive behaviour is more likely in the case of a more unequal distribution so that there should be a positive correlation between the concentration figure and the likelihood of collusion.

Again, use of this index in the European context requires consideration of the degree of openness to international trade. A possible approach would be to calculate market shares excluding exports out of the relevant geographic market (national or Community) and including imports into the market.[2]

The Herfindahl index has been adopted in the current US merger guidelines to determine the threshold from which a merger is considered dangerous. It is also used in some studies by the EC Commission. To obtain the index as a whole number, the squares of the market shares expressed as fractions are multiplied by 10 000. Thus in the case of a monopoly with one firm holding 100% of the market, H = 10 000. Where, on the other hand, the industry is composed of n firms of equal size,

$$H = \frac{10\,000}{n}$$

The US merger guidelines lay down the rule that in markets where the value of H is above 1 800, mergers can expect to be challenged if they increase the index by 25 points or more. An index reading of 1 800 is equivalent to 5,5 or 6 equal-sized firms, and roughly corresponds to a four-firm concentration ratio of over 70%.[3]

It is worth noting that in applying Article 86, the EC authorities have regard not to the degree of concentration, but directly to the market share of the firm concerned. The Court of Justice *(Hoffman-La Roche* (1979)) has held that barring exceptional circumstances a large market share is sufficient evidence by itself of a dominant position.

In particular a market share of 80% or over has been regarded as pointing to a dominant position without the need for further evidence while for shares of 40 or 50% further particulars would be required.

There are strong objections to such a use of concentration ratios and market share data. As we have seen, the theory tells us that concentration ratios (or market share data) alone cannot be used to prove the existence of monopoly power. In most cases high concentration and a large market share is a necessary but not a sufficient condition. Other variables must be taken into consideration, such as the elasticity of demand and entry conditions. Furthermore, recent empirical work suggests that where it exists the correlation between the degree of concentration and profitability is statistically weak and unstable. On the other hand, the correlation with price is generally positive and strong, which is an argument in favour of relating concentration to collusion (for a recent survey, see Schmalensee (1988).

These reservations about concentration and market share data — apart from the inevitable arbitrariness of the thresholds chosen — suggest that high concentration or market share should be regarded merely as indicators triggering an investigation since they are usually necessary but not sufficient conditions for the exercise of monopoly power. The investigation itself should focus on the conduct, namely whether a merger is liable to affect the interests of consumers directly or indirectly through a substantial change in market structure. Similarly, at a legal level, it is not market con-

[1] In the case of the planned sale of BSN's Dutch and German glassmaking interests to Pilkington, the Commission made it clear to the parties that the geographic market in which Pilkington had a dominant position (here the British flat glass market) could be different from the location of the abuse (here the Dutch and German markets). See *Tenth Report on Competition Policy* (1981) p. 133 *et seq.*

[2] Let Pi be the output of firm i and P the total output of all firms in the relevant market, Xi the exports of firm i and X total exports and M total imports.

$$H = \sum_{i=1}^{n} \left[(Pi - Xi)/(P - X + M)^2 \right]$$

[3] At the other extreme, for H values of less than 1 000 (equivalent to 10 firms of equal size and a four-firm concentration ratio of above 40%), the market is not considered to be concentrated and mergers are presumed acceptable.

centration as such that should be set up as a separate legal category and subject of control, but the act of merger.[1]

This position appears to be taken by the draft merger control regulation when it makes a presumption that mergers involving a market share of under 25% are compatible with the common market. However unlike the American system no reference at all is made to the concentration of the market, even only as a trigger.

In recent years entry and exit conditions to and from the relevant market have been assigned increasing importance. The famous study by Baumol, Panzar and Willig (1982) showed that, even in a monopoly, price could equal average and marginal costs in equilibrium if the market was perfectly contestable. This state requires completely free entry and exit, but is also compatible with the existence of economies of scale. If this situation of contestability were general, the role of competition policy would be very small and even large market shares would not call for intervention. In fact, it is clear that in most industries there are barriers to entry in the form of sunk costs and that even where sunk costs are quite low (compared with the variable costs of production or because only part of high fixed costs are truly irrecoverable and therefore sunk), this is sufficient to make potential competition incapable of forcing prices down to the competitive level.[2]

The question is therefore to estimate the height of such entry barriers. Among the factors to be taken into consideration are the capital cost of entry, the structure of production costs (and especially whether there are economies of scale with sunk costs necessitating entry on a large scale), and the speed at which entry is possible. The latter is largely dependent on the need to change consumer habits or to incur high expenditure on product promotion and establishing reputation. In the light of these factors it can be assumed, as we suggested in Part B, that industries experiencing strong growth in demand and relatively open to trade are, other things being equal, less protected by entry barriers. Conversely, mature industries (where competition is often nonexistent) or those relatively closed to imports are less subject to potential competition; in these cases, the analysis should focus on current concentration of the market.[3]

[1] For a legal analysis on these lines, see Vogel (1988) and the preface by B. Goldman. It should be pointed out that contrary to the view expressed by Vogel, this legal approach is not inconsistent with the economic view, as presented by a dynamic analysis of strategic conduct by firms wishing to alter over time the structure of their markets. See Jacquemin (1987).

[2] For the empirical aspect, see Baumol and Willig (1980) and for the theoretical arguments, Dasgupta and Stiglitz (1988).

[3] See Salop (1986).

Finally, in assessing whether or not entry barriers are such as to allow mergers to have anti-competitive effects the question to be asked is the same as for defining the relevant market: would new sellers find it profitable to enter the market if the merger led to a rise in prices?

Once again to answer this question it is not possible to use a simple, single measure. We must assemble a body of data with which to make a qualitative classification similar to that made by Bain (1962) into high, medium and low barriers.

6.2. Analysis of the European merger control proposal

(a) Article 2: mergers which 'create or strengthen a dominant position'

We now look at what the EC proposal has to say about the criteria for identifying the competitive effects of a merger in the light of the above discussion.

The list in Article 2 contains no reference to concentration but does mention other criteria such as 'market position', 'economic and financial power of the firms concerned' and 'structure of the markets affected'.

Market position can only be determined by reference to a number of structural features. Market structure includes distribution of market shares and entry barriers, which are mentioned separately. As for economic and financial power, this probably cannot be equated with a size or performance criterion, since the Court of Justice has explicitly rejected the relevance of these two factors for establishing the existence of a dominant position (Hoffman-La Roche (1979)). However, it could perhaps be a factor in assessing ability to prevent entry.

That leaves four criteria:

The 'possibilities of choice of suppliers and consumers' are key elements in market definition. 'Access to supplies or markets' is related to vertical integration but is also an important factor in the identification of entry barriers which are referred to separately ('legal or *de facto* barriers to entry').

The same applies to 'international competition', which must be taken into account in several connections, namely in defining the relevant market, in measuring concentration and in evaluating entry barriers.

Finally, the dynamic aspect is taken into account in the reference to the 'supply and demand trends for the relevant goods or services'. As we have seen in Part B, such trends can lead to a presumption of greater or lesser competitive pressure.

The overall impression given by Article 2 is that the list is unsystematic and needs to be fleshed out by guidelines elucidating the criteria and setting out the procedural steps that will be followed in assessing mergers.

(b) Article 1(2): the turnover criterion

As noted above, the Court of Justice has rejected a number of criteria for identifying a dominant position which are also unsupported by the economic evidence. The principal of such criterion is absolute size. Yet Article 1 uses this criterion. It states that a merger has a Community dimension and so falls under the regulation where the total worldwide sales of all the firms concerned exceed ECU 1 billion and the total sales in the Community of at least two of the firms concerned exceed ECU 100 million. However, mergers do not have a Community dimension (and fall outside the scope of the regulation) where each of the firms concerned earns more than three-quarters of its total sales within the Community in one and the same Member State.

The thinking behind this approach is explained in the preamble to the regulation. There it is said that the regulation should apply to 'structural alterations the effects of which are substantial and go beyond national borders of one Member State'. The scope of application of the regulation should therefore be 'defined according to the territory of operations of the firms concerned and be limited by quantitative thresholds in order to include only those operations which have a Community dimension'. This is the case, the preamble continues, where the aggregate turnover of all the firms concerned exceeds a given level and each of the firms involved in the merger has its sole or principal field of activities in a different Member State.[1]

Two reasons for using a sales threshold are that it reduces legal uncertainty about when the regulation applies, as sales figures can be directly calculated, and cuts down the number of cases that have to be processed. But the choice of such a threshold has major economic implications as for some industries it will be high relative to total Community output while for others it will be low.

(i) Industries in which total output is low relative to an ECU 1 billion threshold

In some industries total Community output is of the order of ECU 2-3 billion, and in a few it is under 1 billion. (While this is the figure for Community, not world, output, many of these industries are fragmented and so world output figures are not relevant.) Of the approximately 120 3-digit NACE industrial sectors, 15 have a total EC output of less than ECU 3 billion and seven an output under ECU 1,2 billion (see Table 6.1). But the 3-digit NACE sub-divisions are still quite broad categories as compared with product groups. For example NACE 453 'Manufacture of ready-made clothing and accessories' is counted as a single 3-digit sector, but it covers completely different businesses such as women's and girls' outerwear (453.1), men's outerwear (543.2), rainwear and leather clothing (453.4), underwear, corsetry and shirts (543.5), hats (453.6) etc.

Hence, an ECU 1 billion threshold could miss a large number of mergers in industries in which total EC output is itself around this figure allowing even a monopoly to fall below the threshold. Thus, the problem of mergers falling below the ECU 1 billion threshold in niche markets in which total output is low and the market shares of the merging firms very high is not tackled by the proposal. The regulation is silent about such cases, whose number it is difficult to estimate.

(ii) Industries in which EC output is very high relative to an ECU 1 billion threshold

In other industries EC output is very high relative to an ECU 1 billion threshold. There are about 15 3-digit NACE sectors in which total EC output is over or around ECU 40 billion. (See Table 6.2).

In such industries the danger posed by a firm arising out of the merger of two firms with consolidated sales of only ECU 1 billion may be very small indeed. As such, modifications of the threshold will not solve the problem.

[1] It would also be the case where although the firms concerned mainly operate in a single Member State at least one of them has substantial operations in other Member States through subsidiaries or direct sales, or where mergers by firms not having their sphere of operations in the Community are likely to have effects in the common market.

Table 6.1

Sectors in which 1985 EUR 12 output was under ECU 3 billion

232	Salts of potassium and of natural phosphates	3,0
244	Articles made of asbestos (except for articles made of asbestos-cement)	1,2
246	Grindstones and other abrasive products	1,2
319	Other metal workshop products n.e.s.	1,2
348	Assembly and installation of electrical equipment and apparatus (except work relating to the wiring of buildings)	2,4
363	Cycles, motorcycles, invalid carriages	3,0
365	Children's prams, invalid chairs, animal-drawn vehicles	0,6
374	Clocks and watches	2,4
434	Preparation and spinning of flax, hemp and ramie	1,8
435	Jute industry	1,8
455	Household linen, bedding, curtains, wall coverings and awnings, sails, flags, bags	3,0
456	Fur articles	0,6
466	Articles of cork, straw, basketware (other than furniture), brooms, brushes	1,8
492	Musical instruments	1,2
493	Products for developing and printing cinematographic and photographic films	1,2

Source: European Economy No 35 (1988), Annex C, Table 1 Dimension and structure of the internal market: production (EUR 12), 1985.

Table 6.2

Sectors in which 1985 EUR 12 output was over or around ECU 10 billion

221	Cast iron, crude steel, hot-rolled products, cold-rolled sheet, coated sheet (ECSC products)	100,8
224	Non-ferrous metals	47,1
251	Basic chemicals	129,2
257	Pharmaceutical products	37,4
316	Tools and finished metal articles, except electrical equipment	58,0
328	Other machinery and mechanical equipment	62,2
342	Electric motors, generators, transformers, switches	54,4
344	Telecommunications equipment, meters and measuring equipment, electro-medical equipment	50,1
351	Motor vehicles and engines	126,2
412	Meat, meat products, other products from slaughtered animals	59,8
413	Milk and dairy products	69,4
429	Tobacco products	44,7
467	Wood and cane furniture, mattresses	42,9
473	Printing products	54,9
483	Plastic products	48,9

Source: European Economy No 35 (1988), Annex C, Table 1 Dimension and structure of the internal market: production (EUR 12), 1985.

Chapter 7 — The efficiency defence

In Part A we presented a simple analysis of mergers by which it is theoretically possible to identify cases in which the loss of efficiency due to a restrictive effect on competition to produce output is more than offset by a positive impact on costs and prices.

It is clear however that in an economy characterized by 'non-convexity', product differentiation, incessant technological change and imperfect information, it is impossible to reduce the determinants of social welfare to a simple price-output relation at a given point in time. Welfare is in fact determined by multiple factors including product quality and durability, security of supply, the pace of technical progress and innovation. The narrow efficiency criterion is only a subset of the general concept of the interest of consumers. But once the need for this extension is recognized the analysis runs into serious problems. Many of these aspects are not measurable. Also, difficult trade-offs have to be made. How for example can one determine whether the effect of a reduction in output of a product is offset by an increase in resources devoted to R&D or a greater variety of products?

Such questions belong to the difficult area of theory of the 'second best' which can provide few general conclusions about the optimality of conduct. The situation becomes more complicated if we try to include the redistributive effects of mergers between producers and consumers and to determine whether the efficiency gains brought about by a merger are passed on to buyers.

In its proposal the Commission has clearly opted for a pragmatic approach and a broad interpretation of the efficiency concept on the lines of Article 85(3).

The pragmatic approach emerges clearly in the preamble, which states that the dismantling of non-tariff barriers will lead to major and beneficial corporate restructuring in the Community, particularly through merger. It goes on to say that such developments are to be welcomed as they will help strengthen the competitiveness of European industry. On the other hand, the restructuring should not be allowed to cause lasting damage to competition. Thus, no presumption for or against mergers is made. Rather, a neutral stance is adopted, a position justified by the theoretical and empirical analysis presented in Part A of this report.

As far as the interpretation of efficiency is concerned the proposal says that mergers will be allowed if the resulting harm to competition is more than compensated by the contribution the merger makes to the attainment of basic objectives of the Treaty, and in particular to: 'improving technical or economic progress or to improving the competitive structure within the common market, taking due account of the competitiveness of the firms concerned with regard to international competition and of the interests of consumers, provided that they do not:

(a) impose on the firms concerned restrictions which are not indispensable to the achievement of the merger; or

(b) afford the firms concerned the possibility of eliminating competition in respect of a substantial part of the goods or services concerned' (Article 2(3)).

The choice of factors reflects the Commission's concern both to have regard to dynamic as well as static economies (improvement in production or distribution, promotion of technical or economic progress) and to consider competitive conditions on the international market as well as the European domestic market (structure of competition within the common market, international competition).

With regard to the latter aspect, the analysis in Part B showed that European firms in growth and technology-intensive industries are currently in a weak position. They are losing market share and are often smaller than their American or Japanese rivals. This prevents them exploiting all the possible economies of scale. In these industries mergers may therefore enhance efficiency.

But in view of the findings of empirical research against a general presumption in favour of mergers and the fact that firms themselves are best placed to identify the efficiency gains they expect from a merger, it is reasonable to place the main burden of proof of efficiency gains on the initiator of the operation and to require the production of detailed evidence. In Fisher's (1988) words, 'such claims are easily made and .... often too easily believed'. A trap into which the Commission sometimes fell in its early application of Article 85(3) and which should be avoided now is that of being too easily satisfied with general statements about the possibilities of rationalization or synergies.[1]

As well as a reference to the interests of consumers, which might require a consideration of the redistributive and not merely allocative effects of the merger, two conditions are specified for the acceptance of an efficiency defence.

[1] Whereas in the early days of the application of Article 85 some commentators thought an exemption under Article 85(3) would be very difficult, if not impossible to obtain, it seems that in a number of early cases the Commission granted exemption mainly on the basis of the text of the agreement. See Jacquemin (1970).

First, the merger must not impose on the firms concerned restrictions not indispensable to the success of the operation. An alternative wording, consistent with Article 85(3), would have been to say that a merger will only be approved if the resulting efficiency gains probably cannot be obtained by alternative means less restrictive than the creation or strengthening of a dominant position.

We saw in Part A that the economic benefits of large scale could be attained in many alternative ways, including by internal growth and cooperation. A reasonable requirement would therefore be to show by reference to differences in transaction costs, speed, etc., that the merger route was preferable.

The second condition is that the merger does not give the merging firms the ability to eliminate competition in a substantial part of the market. This is no doubt failsafe: as in Article 85(3), it allows the Commission to block mergers without really examining the efficiency arguments.

It should be pointed out, however, that although Article 2 is concerned with the conditions for exceptions to the prohibition of mergers which establish or strengthen a dominant position, it will not be easy to distinguish in practice between the establishment or strengthening of a dominant position and acquisition of the power to eliminate competition in a substantial part of the market. Another point is that the provisions go further than Article 86, which only condemns the strengthening of dominant positions but regards the establishment of such a position as legal. This extension has required the Commission to invoke Article 235 of the Treaty which allows the Council to take action unanimously for cases in which the Treaty has not provided the necessary powers.

Finally, it should be pointed out that the criteria for assessing the benefits of a merger are (inevitably) vague and give the Commission considerable discretion.[1] As noted above, any public interest criterion transcends the purely economic and contains a substantial political element. This explains why in countries such as the Federal Republic of Germany the competition authorities only scrutinize the implications for intensity of competition and leave the question of the wider effects of the mergers to the Federal economics minister (Hopt (1982)). To confer on the Commission responsibility for scrutinizing all aspects of mergers is thought in some quarters to amount to a major transfer of sovereignty by the Member States to a European administrative body as mergers go to the heart of national restructuring processes and industrial policies.

It is natural therefore that Article 18 of the regulation should provide for consultation of an advisory committee of national government officials before any decision allowing or disallowing a merger under Article 8 or imposing fines. Depending on the background of the officials designated, the arguments put forward in the committee will probably vary widely. Article 18 merely requires that at least one of the representatives of each Member State should be an expert in restrictive practices and monopolies.

[1] On the other hand, the use of precise criteria can lead to very debatable choices. For example the new Canadian merger legislation adopted in 1986 provides in Section 68 concerning an exception on efficiency grounds that two factors should be given particular consideration: the fact that the merger will lead to a significant increase in exports or a significant substitution of imports by domestic products. This is a mercantilist view which assumes that more exports and less imports are in all circumstances desirable.

Chapter 8 — Procedure for scrutinizing mergers

The draft contains a number of provisions on the procedures for dealing with cases of mergers that have to be notified to the Commission. In particular, it lays down the periods within which the Commission must open proceedings with respect to a notified merger and within which it has to take a final decision on whether the merger can be allowed to go ahead as compatible with the common market or must be prohibited as incompatible. Figure 8.1 is a flowchart of the decision-making process. The length of the periods allowed largely determines the thoroughness of the analyses that can be made to decide whether the transaction should be investigated and whether it should be authorized or blocked. It is therefore worth attempting to work out a possible sequence of steps in the vetting of mergers on the basis of these provisions. The first stage in the screening process is decided by the obligation to notify or not to notify. As we showed in Chapter 6.2(b) a threshold is liable to allow potentially dangerous operations to slip through the net and to require the notification of quite harmless ones. After the preliminary elimination process, three stages are suggested by the draft for the subsequent examination of cases (Figure 8.2).

Stage 1, in which the Commission has one month from notification to decide whether or not to open proceedings in a case, will probably have to be limited to a check of sales figures as they alone determine whether the regulation is applicable. At best it should also be possible to verify that the transaction is in fact a merger and not a more temporary form of link.

Our approach would have been to use this stage to rapidly screen out mergers which, though above the size thresholds, clearly did not present any danger to competition. Two indicators of the need or otherwise to open proceedings in a case could be used.

First, the size of the firms relative to their principal competitors could have been looked at. Secondly, general knowledge of conditions in the industry could have been used to shed further light on the prospective merger in addition to the evidence of the absolute size criteria. For example, in Part B we proposed two criteria for assessing the danger of mergers leading to reduction of competition in an industry, namely import penetration and demand growth. Other information could also be useful, such as the market share of the n largest European firms or the size of the European market leaders compared with their US or Japanese competitors. The idea would be to have a comprehensive and up-to-date body of data on industries, albeit at a fairly crude level of disaggregation (for example the 120 3-digit industrial sectors in the NACE classification), and to organize this data in such a way as to give a typology of industries that could be used in the quick preliminary assessment of mergers.

Under the present system, even innocuous cases that exceeded the sales threshold would not be disposed of at stage 1, but would have to be taken through to the stage of a formal decision.

Stage 2 will be concerned with the cases not eliminated at stage 1, in which the Commission has decided to open proceedings. It will have to analyse the effects of the merger on competition by looking at the market shares of the firms concerned in relation to existing products and competitors and to the possibilities of entry. It is here that the criteria for determining whether the merger would create or reinforce a dominant position and the presumption that the merger is unobjectionable where the firms do not have a market share of over 25% would be applied. How market shares are to be calculated is defined in the regulation.

At this second stage more detailed data involving a full economic analysis of the firms' markets and products would be required. The criteria used to describe the general conditions in the industry would also come in, but this time at firm level. Throughout this report, we have tried to show the value of a battery of indicators not only of firms' size and market shares but also on the stage in product life cycles and the competitive pressure of imports. The Commission would have one month to carry out this analysis and to clear mergers that did not create or strengthen a dominant position.

The last stage would look at efficiency arguments in justification of mergers that created or strengthened a dominant position in order to determine whether or not these outweighed adverse effects so that the merger could be allowed to go ahead or should be blocked. The Commission would have four months to make up its mind. At this stage, arguments such as those referred to in Part B concerning potential scale economies and R&D efforts should be considered. It is reasonable to place the burden of proof on the defenders of the merger; they should be required to make out a strong case that the potential gains are genuine, that they could not be achieved by less restrictive alternatives, and that they will benefit consumers.

FIGURE 8.1: **Stages in the merger vetting process**

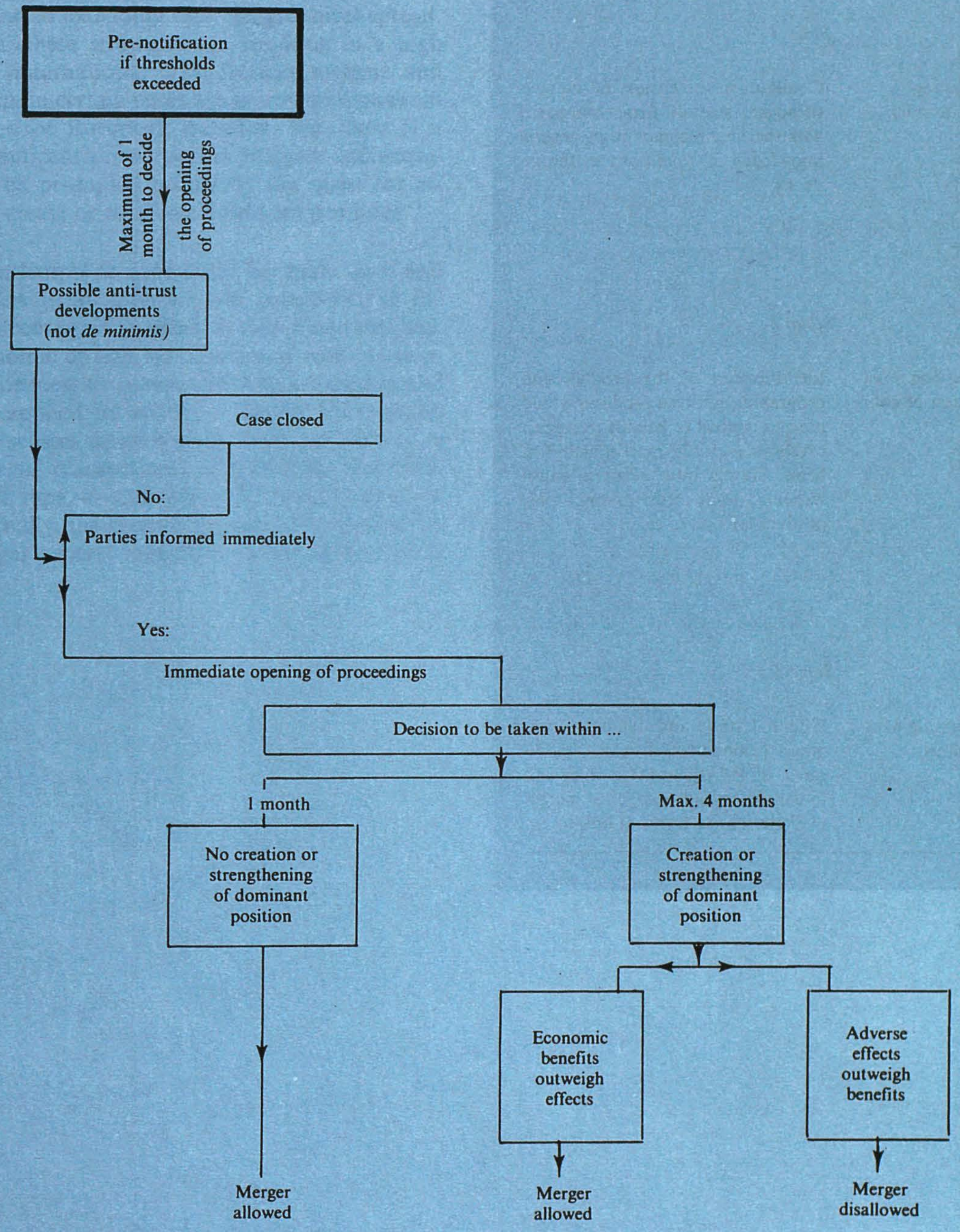


FIGURE 8.2: **Order of proceeding in the scrutiny of horizontal mergers**

	Stage 1
Factors determining whether or not to start proceedings	Community dimension of merger: turnover; size of firms compared with their main competitors; general knowledge of conditions in the industry
	Stage 2
Criteria for assessing possibility of reduction of competition	Identification of the product and geographic market a producer would need to control to be able to significantly raise prices; market shares of firms taking into account international trade, entry conditions, product life cycles, etc.
	Stage 3
Criteria for assessing possible efficiency gains	Potential static and dynamic economies (economies of scale, significance of R&D); transfer of benefit to consumers; advantages of merger over alternative forms of link-up

Conclusions

The potential benefits of the internal market programme will not be fully realized unless business adopts new strategies and government implements credible common policies that support such strategies. As 1992 approaches many firms in Europe are engaged in restructuring, in refocusing on their core businesses and in extending their geographical spread. As we have seen, these strategies are resulting in a high level of EC and international cross-frontier mergers and acquisitions, which in certain cases are an essential phase in the modernization of European industry. But there is a danger that a significant proportion of mergers and acquisitions may not be prompted purely by the quest for efficiency and may create or reinforce dominant positions.

This report first attempts to summarize the main costs and benefits of mergers in an international perspective in the light of the latest economic research. It then illustrates how some of the economic criteria (economies of scale, technological change, openness to international trade and demand growth) can be applied in order to classify Community industries, and discusses recent trends in merger activity in the EC (number of transactions, size of firms involved, and geographical type — domestic, EC cross-frontier or international). Finally, the report discusses the proposal for a European merger control regulation in the light of these factors.

There are still some problems with the practical application of the regulation. First of all, the turnover criterion in spite of its ease of use by firms is not always sufficient to identify the mergers that could have an effect of reducing competition especially in industries whose total sales are in the region of ECU 1 billion, the threshold for notification. Without the possibility of prior vetting of mergers in these industries, it would be essential to use Article 86 of the Treaty as a back-up.

Secondly, in the procedure both before and after the decision to open proceedings in a given case it would be worthwhile deciding the steps to be followed and defining the most appropriate criteria to use at each step. At the various stages in the merger-vetting process it is useful to have a battery of criteria to throw light on the various factors affecting competition and to assess the probability of a reduction in it.

The comments made in this report are intended to help flesh out the Community legislation in later Commission implementing regulations. The provisions of the basic regulation itself are capable of ensuring effective Community control of mergers and are relatively well suited to the pragmatic approach that is desired.

Annexes

Annex 1

Annex 1(a)

Definitions of indicators

Demand growth: in each industry domestic demand is calculated for EUR 9 (D + DK + F + I + IRL + NL + B/L + UK). Domestic demand is defined as: production + imports − exports. The growth of demand is calculated in real terms over the period 1980-85. Demand growth helps to determine the stage in the life-cycle of the industry.

Import penetration ratio: the proportion of domestic demand supplied by imports indicates the degree of openness of a market to penetration by foreign products. On average the import penetration ratio in Community (EUR 9) industry is 35% for intra-EC and non-EC imports combined, 20,9% for intra-EC imports and 14,1% for non-EC imports. Prima facie the danger of a reduction of competition is less in industries open to the penetration of imports, whether these come from other Member States or non-EC countries, i.e. in those in which total intra-EC *or* non-EC import penetration is above average. Conversely, the danger of a reduction of competition is greater in industries relatively closed to imports, i.e. in those in which total intra-EC *and* non-EC import penetration is below average.

The potential economies of scale in an industry are the additional unit costs borne by firms operating at below 50% of the optimal scale. The data are drawn mainly from a survey of recent research into economies of scale (see Pratten (1988)). Industries in which potential economies of scale are substantial include transport equipment (motor vehicles, locomotives and aircraft), computers, electrical and telecommunications equipment and some sectors of the chemicals and food industries.

Technology content: several criteria can be used to identify high-technology sectors: the intensity of R&D, the proportion of scientists employed, the speed of obsolescence of products and processes, the amount of high-risk investment, etc. The main source here is the classification suggested by the OECD which uses the ratio of R&D expenditure to output for each industry in the OECD area (see OECD (1986)). The same criterion is adopted by de Woot (1988), who considers it to be the most stringent. De Woot identifies four major technologies of the future (information technology, biotechnology, opto-electronics and advanced materials) and six high-tech industries in which the ratio of R&D expenditure to sales is at least double the average for industry (pharmaceuticals, office automation and computers, telecommunications, electronic components, aircraft and aircraft components and rockets and spacecraft). Other sources drawn on in addition include: Cardiff (1983) quoted in NEI (1983), Querette (1987), and Archibugi *et al.* (1987). They distinguish around 20 high-technology industries, which are listed below.

High-technology industries

NACE code	*Industry*
247	Glass
248	Ceramics
251	Basic chemicals
256	Biotechnology
257	Pharmaceuticals
259	Other chemicals
260	Man-made fibres
322	Machine tools
330	Computers and office automation
341	Electric cables and wire
342	Electrical plant and machinery
343	Electrical equipment, batteries
344	Telecommunications
345	Electronic appliances, radio, TV
346	Domestic electrical appliances
347	Lighting equipment
351	Motor vehicles
362	Railway rolling stock
364	Aircraft
371	Precision instruments
372	Medical and surgical equipment
373	Optical instruments and photographic equipment
374	Clocks and watches

Annex 1(b)

Identification of industries in which there is a danger of monopolization[1]

Demand growth	Import penetration: Below EC average[2] — NACE code	Industry	Total IP	Import penetration: Above EC average[3] — NACE code	Industry	Total IP
	241	Bricks	4,1	221	Iron and crude steel	27,2
	242	Cement, lime and plaster	4,3	224	Non-ferrous metals	70,7
	243	Cement, lime and plaster products	2,9	231	Construction materials	33,6
	244	Asbestos products	25,5	247	Glass	30,0
	311	Iron castings	9,3	248	Ceramics	36,7
	312	Metal forgings	18,4	322	Machine tools	46,6
	315	Boilermaking	7,2	323	Textile machinery	88,1
	420	Sugar	16,3	327	Wood, paper and leather machinery	60,9
	424	Alcohol distilling	15,1	363	Cycles and motorcycles	37,3
Weak	463	Wooden structures and components	8,7	374	Clocks and watches	66,2
	464	Wooden containers	3,6	438	Carpets and linoleum	57,9
	467	Wooden furniture	22,6	451	Footwear	57,7
				456	Fur articles	:
				461	Sawn or planed wood	57,5
				462	Plywood and hardboard	42,4
				465	Wood manufactures (except furniture)	36,0
				466	Cork and basketware articles, brushes	54,3
				482	Retreaded tyres	60,5
				491	Gold and jewellery	:
				494	Toys and games	59,0
	245	Working of stone and of non-metallic mineral products	22,5	222	Steel pipes and tubes	44,8
				223	Drawn wire and other drawn products	35,9
	255	Paints and varnishes	9,1	232	Potash and phosphates	25,5
	313	Secondary processing of metals	10,4	259	Other chemicals	67,1
	314	Metal fabrication	11,1	260	Man-made fibres	72,2
	316	Tools and finished metal goods	21,3	324	Food processing and chemical plant	46,5
	325	Mining and metallurgical plant	28,4	326	Mechanical transmissions	40,8
	342	Electrical plant and machinery	20,0	328	Other machinery and mechanical equipment	47,0
	352	Motor vehicle bodies, trailers, caravans	11,6			
	361	Shipbuilding	12,2	346	Domestic electrical appliances	33,0
	362	Railway rolling stock	8,7	347	Lighting equipment	54,9
	413	Milk and dairy products	14,9	364	Aircraft	58,9
Moderate	416	Grain milling	15,8	371	Precision instruments	41,5
	417	Pasta	10,7	372	Medical and surgical equipment	63,9
	419	Bread and flour confectionery	7,6	373	Optical and photographic equipment	:
	421	Cocoa, chocolate and sugar products	18,0	411	Vegetables and animal fats	51,0
	422	Animal feedingstuffs	6,9	412	Meat and meat products	31,0
	423	Other food products	18,0	431	Woollen goods	52,4
	425	Wine, sparkling wine	22,3	432	Cotton goods	64,2
	427	Brewing and malting	3,9	436	Knitwear	61,5
	472	Pulp, paper and board	21,4	439	Other textile products	54,9
	473	Printing	9,9	442	Leather goods	55,0
	481	Rubber goods	27,8	453	Clothing	42,4
				455	Household linen	56,0
				471	Pulp, paper and board	52,3
				483	Plastic goods	30,6
				492	Musical instruments	70,4

Demand growth	Import penetration: Below EC average[2] NACE code	Industry	Total IP	Import penetration: Above EC average[3] NACE code	Industry	Total IP
Strong	257	Pharmaceuticals	18,7	256	Other chemical products for industrial and agricultural purposes	54,4
	258	Soap and detergents	12,4	321	Agricultural machinery	28,3
	341	Electrical cables and wire	12,0	330	Computers and office automation	67,7
	418	Starch products	25,0	344	Telecommunications	45,1
	428	Mineral water and soft drinks	4,2	345	Electronic appliances, radio, TV	43,9
	429	Tobacco products	6,4	351	Motor vehicles, engines	43,1
				353	Automotive components and accessories	56,5
				415	Preserved fish	25,7
				441	Leather	60,8

[1] Industries in which value-added in EUR 12 represents at least 0,01% of total industry.
[2] Total IP < 35, intra-IP < 20, and extra-IP < 15.
[3] Total IP ≥ 35, intra-IP ≥ 20, or extra-IP ≥ 15.

Annex 1(c)

Identification of industries in which mergers could lead to efficiency gains

Technological content	Economies of scale (EOS)[1]					
	Insignificant			Modest or substantial		
	NACE code	Industry	EOS	NACE code	Industry	EOS
Low to medium	223	Drawn wire and other drawn products	1	221	Iron and crude steel	8
	243	Cement, lime and plaster products	1	222	Steel pipes and tubes	8
	255	Paints and varnishes	3	224	Non-ferrous metals	8
	258	Soap and detergents	3	241	Bricks	20
	323	Textile machinery	4	242	Cement, lime and plaster	15
	324	Food processing and chemical plant	4	311	Iron castings	10
	325	Mining and metallurgical plant	4	315	Boilermaking	20
	326	Mechanical transmissions	5	321	Agricultural machinery	7
	327	Wood working, paper and leather machinery	4	361	Shipbuilding	8
				411	Vegetable and animal oils and fats	9
	328	Other machinery and mechanical equipment	4	412	Meat and meat products	9
				416	Grain milling	20
	363	Cycles and motorcycles	4	419	Bread and flour confectionery	12
	413	Milk and dairy products	3	420	Sugar	14
	429	Tobacco products	2	421	Cocoa, chocolate and sugar confectionery	14
	431	Woollen goods	2	422	Animal feedingstuffs	14
	432	Cotton goods	2	427	Brewing and malting	8
	436	Knitwear	2	438	Carpets and linoleum	10
	439	Other textile products	2	471	Pulp, paper and board	10
	441	Leather	2	473	Printing	20
	442	Leather goods	2			
	451	Footwear	2			
	453	Clothing	2			
	455	Household linen	2			
	456	Fur goods	2			
	461	Sawn or planed wood	2			
	462	Plywood and hardboard	2			
	463	Wooden structures and components	2			
	464	Wooden containers	2			
	465	Wood manufactures (except furniture)	2			
	466	Cork and basketware articles, brushes	2			
	467	Wooden furniture	2			
	481	Rubber goods	5			
High	259	Other chemicals	3	247	Glass	7
	322	Machine tools	4	248	Ceramics	6
	343	Electrical equipment, batteries	3	251	Basic chemicals	10
				256	Other chemical products for industrial or agricultural purposes	10
				257	Pharmaceuticals	6
				260	Man-made fibres	10
				330	Computers and office automation	9
				342	Electrical plant and machinery	12
				344	Telecommunications	12
				345	Electronic appliances, radio, TV	9
				346	Domestic electrical appliances	6
				351	Motor vehicles, engines	9
				362	Railway rolling stock	20
				364	Aerospace	20
				371	Precision instruments	9
				372	Medical and surgical equipment	9
				373	Optical and photographic equipment	9

[1] Percentage cost penalty for operating at half optimum scale.

Annex 1 (d)

Merger activity and economic conditions in industry

	NACE code	Demand growth[1]	Openness of market[2] Import penetration 1986			Market share of five largest firms[3]	Number of mergers involving top 1 000 firms Total	
			EC	non-EC	total		1982-87	1986-87
Mining and extractive industries	21+23	W	54,8	18,4	73,2	—	43	9
Manufacture and primary processing of metals	22+31	W	12,5	17,8	30,3	18,0	72	19
Construction materials	24	W	4,3	12,5	16,8	22,3	75	19
Chemicals, fibres, glass, ceramics, rubber	25+26+247+ 248+48	S	10,0	24,5	34,5	21,0	252	71
Machine tools and precision instruments	32+37	M	19,0	27,6	46,6	12,5	133	31
Office equipment	33	S	33,7	34,1	67,8	65,3	6	2
Electrical equipment and electronics	34	S	16,6	18,2	34,8	40,4	104	41
Motor vehicles and other transport equipment	35+36	M	11,2	24,5	35,7	51,0	54	21
Food and drink	41+42−429	M	5,7	11,9	17,6	12,6	122	52
Textiles, leather, clothing	43+44+45	W	22,1	27,2	49,3	3,7	36	6
Wood, furniture, paper	46+47− 473-474	M	15,0	11,9	26,9	4,3	92	25

[1] Percentage of total sales of industry:
S = strong demand growth.
M = moderate demand growth.
W = weak demand growth.
[2] Proportion of total domestic demand supplied by intra-Community (EC import penetration) and non-EC (non-EC import penetration) imports.
[3] Percentage of total sales of industry.

Source: EC, Reports on competition policy and other Commission departments.

Annex 2

Amended proposal for a Council Regulation (EEC)

on the control of concentrations between undertakings

(submitted by the Commission pursuant to Article 149(3) of the EEC Treaty)

The Council of the European Communities,

Having regard to the Treaty establishing the European Economic Community, and in particular Articles 87 and 235 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion ot the Economic and Social Committee,

(1) Whereas, for the achievement of the aims of the Treaty establishing the European Economic Community, Article 3(f) requires the Community to institute 'a system ensuring that competition in the common market is not distorted';

(2) Whereas this system is essential for the achievement of the internal market by 1992;

(3) Whereas the dismantling of internal frontiers can be expected to result in major corporate reorganizations in the Community, particularly in the form of concentrations;

(4) Whereas such a development must be welcomed as being in line with the requirements of dynamic competition and liable to strengthen the competitiveness of European industry, to improve the conditions of growth and to raise the standard of living in the Community;

(5) Whereas, however, it must be ensured that the process of reorganization does not give rise to lasting damage to competition; whereas the system of undistorted competition must therefore include provisions governing those concentrations which may impede effective competition in the common market;

(6) Whereas, pursuant to Articles 85 and 86, anticompetitive agreements, decisions and practices, which may affect trade between Member States, are prohibited, provided that their impact on competition and trade is appreciable;

(7) Whereas the principles laid down in Articles 85 and 86 apply also to arrangements which alter the competitive structure of the market and whereas provisions for the implementation of those principles must take due account of the specific context of market structure;

(8) Whereas those provisions should apply to significant structural changes, whose impact on the market goes beyond the national borders of one Member State;

(9) Whereas the scope of application of this Regulation should therefore be defined according to the territory of operations of the undertakings concerned and be limited by quantitative thresholds in order to include only those operations of concentration which have a Community dimension;

(10) Whereas this is the case where the aggregate turnover of all the undertakings concerned exceeds a given level and where at least two of the undertakings concerned have their sole or principal field of activities in a different Member State or where, although the undertakings in question act mainly in one and the same Member State, at least one of them has substantial operations in at least one other Member State through subsidiaries or direct sales; whereas this is also the case where the concentrations effected by undertakings which do not have their principal field of activities in the Community are such as to have an effect within the common market;

(11) Whereas the existing competition rules and in particular Article 87 provide a legal basis for the control of certain forms and types of concentration;

(12) Whereas it is necessary, however, to create a legal framework which makes it possible to treat in a comprehensive way all concentrations having the same impact on the competitive structure of the common market or a substantial part thereof;

(13) Whereas, pursuant to Article 235 the Community may, by way of Regulation, give itself the additional powers of action necessary for the attainment of this objective, and in particular with regard to concentrations on the markets for products listed in Annex II to the Treaty;

(14) Whereas the Regulation should establish the principle that concentrations which create or strengthen a position as a result of which the maintenance or development of effective competition is impeded in the common market or in a substantial part thereof are to be declared incompatible with the common market;

(15) Whereas concentrations which, by reason of the limited market share of the undertakings concerned, are not

liable to impede effective competition may be presumed to be compatible with the common market; whereas, in particular, this may be presumed where the market share of the undertakings concerned does not exceed 25% either in the common market or in a substantial part thereof;

(16) Whereas authorization should be available in respect of concentrations which, although they impede effective competition, contribute to the attainment of the basic objectives of the Treaty in such a way that, on balance, their economic benefits prevail over the damage they cause to competition;

(17) Whereas the Regulation should also provide that decisions of compatibility and authorizations may be made subject to conditions and obligations to be determined case by case in order to ensure that conditions of effective competition are maintained;

(18) Whereas the Commission should have the task of taking all the decisions necessary to establish whether or not concentrations which fall within the scope of application of the Regulation are compatible with the common market, as well as decisions designed to restore and maintain conditions of effective competition;

(19) Whereas, to ensure effective supervision, prior notification and the suspension of concentrations should be made obligatory;

(20) Whereas a period within which the Commission must initiate a proceeding in respect of a concentration notified to it and a period within which it must give a final decision on the compatibility or incompatibility with the common market of a notified concentration should be laid down;

(21) Whereas undertakings concerned must be accorded the right to be heard by the Commission as soon as a proceeding has been initiated, and third parties showing a legitimate interest must be given the opportunity to submit their comments;

(22) Whereas the Commission should act in close and constant liaison with the competent authorities of the Member States and should obtain the views of those most directly concerned by a concentration;

(23) Whereas, for the purposes of this Regulation, the Commission must be afforded the assistance of the Member States and must also be empowered to require information to be given and to carry out the necessary investigations in order to appraise concentrations;

(24) Whereas compliance with this Regulation must be enforceable by means of fines and periodic penalty payments: whereas the Court of Justice should be given unlimited jurisdiction in that regard pursuant to Article 172;

(25) Whereas it is appropriate to define the concept of concentration in such a manner as to cover operations bringing about a change in the structure of the undertakings concerned; whereas it is therefore necessary to exclude from the scope of application of this Regulation those operations which have as their object or effect the coordination of the competitive behaviour of independent undertakings, since such operations fall to be examined under the provisions of other regulations implementing Article 85 or Article 86;

(26) Whereas the Commission should be given exclusive competence to apply this Regulation, subject to review by the Court of Justice; whereas it should also be stipulated that the provisions of this Regulation apply to all concentrations with a Community dimension, whether or not they fall within the scope of Article 85 or Article 86;

(27) Whereas the Member States may not apply their national legislation on competition to concentrations having a Community dimension, unless expressly empowered to do so by the Commission;

(28) Whereas, however, this principle does not prevent Member States from taking appropriate measures in so far as is necessary to protect legitimate interests other than those pursued by this Regulation, provided that such interests are sufficiently defined and protected by domestic law and that such measures are compatible with the other provisions of Community law,

Has adopted this Regulation:

Article 1

Scope of application

1. This Regulation shall apply to all concentrations having a Community dimension as defined in paragraph 2, whether or not they fall within the scope of Article 85 or Article 86.

2. For the purposes of this Regulation, a concentration has a Community dimension where:

   (a) the aggregate worldwide turnover of all the undertakings concerned is more than ECU 1 000 million, and

(b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than ECU 100 million,

unless each of the undertakings concerned achieves more than three quarters of its aggregate Community-wide turnover within one and the same Member State.

Article 2

Appraisal of concentrations

1. Concentrations falling within the scope of this Regulation shall be appraised with a view to establishing whether or not they are compatible with the common market, by reference in particular to the market position of the undertakings concerned and to their economic and financial power, to opportunities of choice available to suppliers and users, to their access to supplies or markets, to the structure of the markets affected taking account of international competition, to legal and factual barriers to entry, and to supply and demand trends for the relevant goods or services.

2. Concentrations which do not create or strengthen a position as a result of which the maintenance or development of effective competition would be impeded in the common market or in a substantial part thereof shall be declared compatible with the common market.

3. Concentrations which create or strengthen a position as a result of which the maintenance or development of effective competition is impeded in the common market or in a substantial part thereof shall be declared incompatible with the common market unless authorized on the ground that their contribution to improving production and distribution, to promoting technical or economic progress or to improving the competitive structure within the common market outweighs the damage to competition. In this respect, the competitiveness of the sectors concerned with regard to international competition and the interests of consumers shall be taken into account.

   Concentrations shall be authorized on account of their compatibility with the common market only in so far as they do not:

   (a) impose on the undertakings concerned restrictions which are not indispensable to the implementation of the concentration; and

   (b) afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services concerned.

Article 3

Definition of concentration

1. A concentration shall be deemed to occur where:

   (a) two or more undertakings merge; or

   (b) (i) one or more persons already controlling at least one undertaking, or

   (ii) one or more undertakings

   acquire, whether by purchase of shares or assets, by contract or by any other means, direct or indirect control of the whole or parts of one or more undertakings.

2. Operations which have as their object or effect the coordination of the competitive behaviour of independent undertakings shall be deemed not to give rise to a concentration within the meaning of paragraph 1(b).

   The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity, which does not have as its object or effect the coordination of the competitive behaviour of the undertakings concerned, shall be deemed to be a concentration within the meaning of paragraph 1(b).

3. Control is constituted by rights or contracts which, either separately or jointly, and having regard to the considerations of fact or law involved, make it possible to determine how an undertaking shall operate, and in particular by:

   (a) ownership or the right to use all or part of the assets of an undertaking;

   (b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking;

   (c) rights or contracts which make it possible to manage the business of an undertaking;

   (d) contracts made with an undertaking concerning the computation or appropriation of its profits;

   (e) any other means conferring decisive influence on the activity of an undertaking.

4. Control is acquired by persons, undertakings or groups of persons or undertakings which:

   (a) are holders of the rights or entitled to rights under the contracts concerned;

   (b) while not being holders of such rights or entitled to rights under such contracts, have power to exercise the rights deriving therefrom;

   (c) in a fiduciary capacity derived from a private law contract, hold assets of an undertaking or shares in an undertaking, and have power to exercise the rights attaching thereto, unless that power may be revoked at any time or unless they are bound by special instructions from their principals.

5. Control of an undertaking is not constituted where banks or financial institutions acquire shares in an undertaking with a view to selling them, provided that they do not exercise voting rights in respect of those shares with a view to determining the competitive behaviour of that undertaking.

Article 4

Prior notification of concentrations

1. Concentrations as referred to by this Regulation, whether or not they form the subject-matter of an agreement, shall be notified to the Commission before they are put into effect.

2. Concentrations within the meaning of Article 3(1)(a) shall be notified jointly by the parties concerned. In the cases referred to in Article 3(1)(b), the notification shall be made by the party or parties seeking to acquire control of the whole or parts of one or more undertakings.

3. Where the Commission finds that a concentration falls within the scope of application of this Regulation, it shall immediately publish the main contents of the notification. The publication shall contain the names of the parties, the nature of the concentration and the economic sectors involved. It shall take account of the legitimate interest of undertakings in the protection of their business secrets.

Article 5

Calculation of turnover

1. Aggregate turnover within the meaning of Article 1 shall be calculated by adding together the pre-tax turnover of the undertakings concerned for all goods and services in the last financial year. Turnover deriving from internal operations within a group shall not be included in this calculation.

2. By way of derogation from paragraph 1, where the concentration consists in the acquisition of parts, whether or not constituted as legal entities, of one or more undertakings or of a group of undertakings, only the turnover relating to the parts which are the subject of the operation shall be taken into account with regard to the seller or sellers.

3. In place of turnover the following shall be used:

   (a) for banking and financial institutions: as regards Article 1(2)(a) and (b), one tenth of their assets; as regards the final part of Article 1(2), operations with clients from their own and from other Member States;

   (b) for insurance companies: the value of premiums received.

4. Without prejudice to the provisions of paragraph 2, the relevant turnover for each of the undertakings concerned shall be calculated by adding together the respective turnovers of all undertakings belonging to the same group.

   In this respect the following undertakings shall be taken into account:

   (a) those which take part directly in the concentration;

   (b) those in which a party to the concentration, directly or indirectly,

      (i) owns at least half the capital or business assets, or

      (ii) has the power to exercise at least half the voting rights, or

      (iii) has the power to appoint at least half the members of the supervisory board, board of management or bodies legally representing the undertakings, or

      (iv) has the right to manage the undertaking's affairs;

   (c) those which directly or indirectly have, in or over a party to the concentration, rights or powers as listed in (b);

   (d) those in or over which an undertaking as referred to in (c) directly or indirectly has rights or powers as listed in (b).

Undertakings in which several undertakings as referred to in (a) to (d) jointly have, directly or indirectly, rights or powers as set out in (b) shall also be considered to be undertakings concerned.

Article 6

Initiation of proceedings

1. Where the Commission finds that a concentration falls within the scope of application of this Regulation, it shall immediately initiate a proceeding with a view to establishing whether or not that concentration is compatible with the common market. It shall so inform the undertakings concerned and the competent authorities of the Member States without delay.

2. Where the Commission finds that a notified concentration does not fall within the scope of application of this Regulation, it shall immediately so inform the undertakings concerned and the competent authorities of the Member States.

3. As regards notified concentrations, decisions pursuant to paragraphs 1 and 2 shall be taken within a period not exceeding one month, unless the undertakings concerned agree to extend that period. The period of one month shall commence on the day following the date of receipt of the notification, or if the information to be supplied with the notification is incomplete, on the day following the date of receipt of the complete information.

4. The Commission may initiate a proceeding after the expiry of the period provided for in paragraph 3 where the information supplied by the undertakings in the notification or thereafter is false or misleading.

Article 7

Suspension of the concentration

1. Undertakings shall suspend the implementation of a concentration which falls within the scope of application of this Regulation until the Commission has decided on initiation of a proceeding pursuant to Article 6.

2. In order to ensure conditions of effective competition, the Commission may decide, when it initiates a proceeding pursuant to Article 6(1), that the suspension of the implementation of a concentration should be extended until it takes a final decision pursuant to Article 8.

3. The provisions of paragraphs 1 and 2 shall not impede the implementation of a public takeover or exchange bid which has been notified to the Commission by the date of its announcement, provided that the acquirer does not exercise the voting rights attached to the shares in question.

4. The Commission may, on request, waive the provisions of paragraphs 1 and 2 or the proviso contained in paragraph 3 in order to prevent serious damage to one or more undertakings concerned by a concentration; the waiver may be subject to conditions and obligations in order to ensure conditions of effective competition.

Article 8

Powers of decision of the Commission

1. For each proceeding initiated pursuant to Article 6 and concerning a notified concentration, the Commission shall establish by decision whether or not that concentration is compatible with the common market.

2. Where the Commission finds that a notified concentration fulfils the conditions of compatibility laid down in Article 2(2), it shall issue a decision declaring the concentration compatible with the common market; conditions and obligations may be attached thereto in order to ensure conditions of effective competition. In such a case, the Commission may also empower Member States which are directly concerned by the concentration to apply their national legislation on competition in order to ensure conditions of effective competition in local markets within their respective territories.

3. Where the Commission finds that a notified concentration fulfils all the conditions laid down in Article 2(3), it shall issue a decision authorizing the concentration as being compatible with the common market; conditions and obligations may be attached thereto in order to ensure conditions of effective competition. The decision granting the authorization shall also cover additional restrictions reasonably ancillary to the implementation of the concentration.

4. Where the Commission finds that a concentration fulfils the conditions of incompatibility laid down in Article 2(3) but does not fulfil the conditions for an authorization laid down therein, it shall issue a decision refusing the authorization and declaring the concentration incompatible with the common market.

5. Where a concentration has already been implemented, the Commission may require in a decision pursuant to paragraph 1 or by separate decision, the undertakings or assets grouped together to be separated or the cessation of common control or any other action that may be appropriate in order to restore conditions of effective competition.

6. The Commission may revoke its decision pursuant to paragraph 2 or paragraph 3 where the decision is based on incorrect information for which one of the undertakings involved in the concentration is responsible or where the decision has been obtained by deceit.

   It may also revoke its decision pursuant to paragraph 2 or paragraph 3 where the undertakings concerned commit a breach of an obligation attached to the decision.

7. Authorizations of concentrations by the Commission shall in no way alter collective workers' rights in force in the undertakings concerned.

Article 9

Time limits for decisions

1. Decisions pursuant to Article 8(2) concerning notified concentrations shall be taken within one month following the date of initiation of the proceeding, unless the undertakings concerned agree to an extension of that period.

2. Decisions pursuant to Article 8(3) and (4) concerning notified concentrations shall be taken within four months following the date of initiation of the proceeding, unless the undertakings concerned agree to an extension of that period.

3. By way of exception, the periods of one and four months set respectively by paragraphs 1 and 2 shall be suspended where the Commission, owing to circumstances for which one of the undertakings involved in the concentration is responsible, has had to request information by decision pursuant to Article 10 or to order an investigation by decision pursuant to Article 12.

Article 10

Requests for information

1. In carrying out the duties assigned to it by this Regulation, the Commission may obtain all necessary information from the governments and competent authorities of the Member States and from persons, undertakings and associations of undertakings.

2. When sending a request for information to a person, an undertaking or an association of undertakings, the Commission shall at the same time forward a copy of the request to the competent authority of the Member State in whose territory the residence of the person or the seat of the undertaking or association of undertakings is situated.

3. In its request the Commission shall state the legal basis and the purpose of the request and also the penalties provided for in Article 13(1)(b) for supplying incorrect information.

4. The information requested shall be supplied, in the case of undertakings, by their owners or their representatives and, in the case of legal persons, companies or firms, or of associations having no legal personality, by the persons authorized to represent them by law or by their statutes.

5. Where a person, an undertaking or an association of undertakings does not supply the information requested within the period fixed by the Commission, or supplies incomplete information, the Commission shall by decision require the information to be supplied. The decision shall specify what information is required, fix an appropriate period within which it is to be supplied and mention the penalties provided for in Article 13(1)(b) and Article 14(1)(a) and the right to have the decision reviewed by the Court of Justice.

6. The Commission shall at the same time forward a copy of its decision to the competent authority of the Member State in whose territory the residence of the person or the seat of the undertaking or association of undertakings is situated.

Article 11

Investigations by the authorities of the Member States

1. At the request of the Commission, the competent authorities of the Member States shall undertake the investigations which the Commission considers to be necessary under Article 12(1), or which it has ordered by decision pursuant to Article 12(3). The officials of the competent authorities of the Member States responsible for conducting these investigations shall exercise their powers upon production of an authorization in writing issued by the competent authority of the Member State in whose territory the investigation is to be made. Such authorization shall specify the subject matter and purpose of the investigation.

2. If so requested by the Commission or by the competent authority of the Member State in whose territory the investigation is to be made, officials of the Commission may assist the officials of such authority in carrying out their duties.

Article 12

Investigating powers of the Commission

1. In carrying out the duties assigned to it by this Regulation, the Commission may undertake all necessary investigations into undertakings and associations of undertakings.

   To this end the officials authorized by the Commission are empowered:

   (a) to examine the books and other business records;

   (b) to take or demand copies of or extracts from the books and business records;

   (c) to ask for oral explanations on the spot;

   (d) to enter any premises, land and means of transport of undertakings.

2. The officials of the Commission authorized to carry out the investigations shall exercise their powers upon production of an authorization in writing specifying the subject-matter and purpose of the investigation and the penalties provided for in Article 13(1)(c) in cases where production of the required books or other business records is incomplete. In good time before the investigation, the Commission shall inform the competent authority of the Member State in whose territory the investigation is to be made of the investigation and of the identity of the authorized officials.

3. Undertakings and associations of undertakings shall submit to investigations ordered by decision of the Commission. The decision shall specify the subject matter and purpose of the investigation, appoint the date on which it is to begin and indicate the penalties provided for in Article 13(1)(c) and 14(1)(b) and the right to have the decision reviewed by the Court of Justice.

4. The Commission shall inform the competent authority of the Member State in whose territory the investigation is to be made in good time of its intention to take a decision pursuant to paragraph 3. It shall hear the competent authority before taking its decision.

5. Officials of the competent authority of the Member State in whose territory the investigation is to be made may, at the request of such authority or of the Commission, assist the officials of the Commission in carrying out their duties.

6. Where an undertaking opposes an investigation ordered pursuant to this Article, the Member State concerned shall afford the necessary assistance to the officials authorized by the Commission to enable them to make their investigation. Member States shall, after consultation with the Commission, take the necessary measures to this end before ... .

Article 13

Fines

1. The Commission may by decision impose on persons, undertakings or associations of undertakings fines of from ECU 1 000 to 100 000 where intentionally or negligently:

   (a) they supply incorrect or misleading information in a notification pursuant to Article 4;

   (b) they supply incorrect information in response to a request made pursuant to Article 10 or fail to supply information within the period fixed by a decision taken pursuant to Article 10;

   (c) they produce the required books or other business records in incomplete form during investigations under Article 11 or Article 12, or refuse to submit to an investigation ordered by decision taken pursuant to Article 12.

2. The Commission may by decision impose fines not exceeding 10% of the aggregate turnover of the undertakings concerned within the meaning of Article 5 where the persons or undertakings concerned, either intentionally or negligently:

   (a) breach an obligation imposed pursuant to Article 7 or Article 8;

   or

   (b) implement a concentration in breach of the provisions of this Regulation.

3. In setting the amount of the fine, regard shall be had to the gravity of the infringement.

4. Decisions taken pursuant to paragraphs 1 and 2 shall not be of a criminal law nature.

Article 14

Periodic penalty payments

1. The Commission may by decision impose on persons, undertakings or associations of undertakings periodic penalty payments of up to ECU 50 000 for each day of the delay calculated from the date appointed by the decision, in order to compel them:

   (a) to supply complete and correct information which it has requested by decision taken pursuant to Article 10;

   (b) to submit to an investigation which it has ordered by decision taken pursuant to Article 12.

2. The Commission may by decision impose on persons or undertakings periodic penalty payments of up to ECU 100 000 for each day of the delay, calculated from the day appointed by the decision, in order to compel them to apply the measures resulting from a decision taken pursuant to Article 8(5).

3. Where persons, undertakings or associations of undertakings have satisfied the obligation which it was the purpose of the periodic penalty payment to enforce, the Commission may set the total amount of the periodic penalty payment at a lower figure than that which would arise under the original decision.

Article 15

Review by the Court of Justice

The Court of Justice shall have unlimited jurisdiction within the meaning of Article 172 of the Treaty to review decisions whereby the Commission has fixed a fine or periodic penalty payment; it may cancel, reduce or increase the fine or periodic penalty payment imposed.

Article 16

Professional secrecy

1. Information acquired as a result of the application of Articles 10, 11 and 12 shall be used only for the purposes of the relevant request or investigation.

2. Without prejudice to the provisions of Article 19, the Commission and the competent authorities of the Member States, their officials and other servants shall not disclose information acquired by them as a result of the application of this Regulation and of the kind covered by the obligation of professional secrecy.

3. The provisions of paragraphs 1 and 2 shall not prevent publication of general information or surveys which do not contain information relating to particular undertakings or associations of undertakings.

Article 17

Hearing of the parties and third parties

1. Before taking decisions provided for in Article 8, paragraph 2, where conditions and obligations are attached thereto, and in Article 8, paragraphs 3 to 6, as well as in Articles 13 and 14, the Commission shall give the parties the opportunity of being heard on the matters to which the Commission has taken objection.

2. The Commission may also, on application or on its own initiative, hear other natural or legal persons and associations.

3. Natural or legal persons or associations showing a legitimate interest shall be entitled to make such applications.

4. Applications to be heard on the part of members of the administrative or management organs and the acknowledged employees' representatives from the undertakings concerned, shall in all cases be granted.

Article 18

Liaison with the authorities of the Member States

1. The Commission shall transmit forthwith to the competent authorities of the Member States copies of notifications and of the most important documents lodged with or issued by the Commission pursuant to this Regulation.

2. The Commission shall carry out the procedures set out in this Regulation in close and constant liaison with the competent authorities of the Member States, which may express their views upon those procedures. It shall obtain the views of the competent authorities of the Member States which show that they are directly concerned by the concentration, in particular with a view to the application of Article 8(2).

3. An Advisory Committee on Concentrations shall be consulted prior to the taking of any decision pursuant to Article 8, paragraphs 3 to 6, as well as Articles 13 and 14, or of implementing provisions pursuant to Article 22.

4. The Advisory Committee shall consist of officials of the Member States. Each Member State shall appoint two officials to represent it; if prevented from attending, they may be replaced by other officials. At least one of the representatives of a Member State shall be competent in the matter of restrictive practices and dominant positions.

5. Consultation shall take place at a joint meeting convened at the invitation of and chaired by the Commission. A summary of the facts, together with the most important documents and a preliminary draft of the decision to be taken, shall be sent with the invitation. The meeting shall take place no earlier than 14 days after the invitation has been sent. The Commission may, however, shorten this period in order to avoid serious harm to one or more of the undertakings concerned by a concentration.

6. The Advisory Committee shall deliver an opinion on the Commission's draft decision, if necessary by taking a vote. The Advisory Committee may deliver an opinion even if some members are absent and unrepresented. The opinion shall be delivered in writing and appended to the draft decision. It shall not be made public.

7. The Commission shall take the utmost account of the opinion delivered by the Committee. It shall inform the Committee of the manner in which its opinion has been taken into account.

Article 19

Publication of decisions

1. The Commission shall publish the decisions which it takes pursuant to Article 8(2), where conditions and obligations are attached thereto, and to Article 8(3) to (6) in the *Official Journal of the European Communities.*

2. The publication shall state the names of the parties and the main content of the decision; it shall have regard to the legitimate interest of undertakings in the protection of their business secrets.

Article 20

Jurisdiction

1. Subject to review by the Court of Justice, the Commission shall have sole competence to take the decisions provided for in this Regulation.

2. Member States shall not apply their national legislation on competition to concentrations having a Community dimension, unless expressly empowered to do so by the Commission in accordance with the provisions of the last sentence of Article 8(2).

3. Notwithstanding the provisions of paragraphs 1 and 2, Member States may take appropriate measures where necessary to protect legitimate interests other than those pursued by this Regulation, provided that such interests are sufficiently defined and protected in domestic law and that such measures are compatible with other provisions of Community law.

Article 21

Exclusive application of this Regulation

Regulation No 17 and Regulations (EEC) No 1017/68, No 4056/86 and No 3975/87 shall not apply to concentrations falling within the scope of this Regulation.

Article 22

Implementing provisions

The Commission shall have power to adopt implementing provisions concerning the form, content and other details of notifications pursuant to Article 4, time limits pursuant to Articles 6 and 9, as well as hearings pursuant to Article 17.

Article 23

Entry into force

This Regulation shall enter into force ... .

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at ... For the Council

Annex 3

Proposal for a 13th Council Directive

on company law concerning takeover and other general bids

(presented by the Commission)

Explanatory memorandum

I. Introduction

1. In its White Paper programme for removing all remaining internal barriers in the common market by 1992, the Commission saw a need for harmonizing Member States' law on takeover bids and announced that it would be bringing forward a proposal for a directive on this subject.

2. Takeovers are one of the areas yet to be covered in the programme of company law coordination directives under Article 54 of the EEC Treaty. The aim of the coordination is to afford shareholders and other interested parties equivalent standards of protection before the law in all Member States. To date the harmonization has covered requirements relating to disclosure,[1] formation and capital,[2] accounts[3] and consolidated accounts,[4] the qualifications of auditors,[5] and two types of reconstruction or amalgamation, namely mergers[6] (strictly speaking, 'legal mergers' or 'assets mergers') and 'divisions'.[7]

3. Takeovers, or 'share mergers', are however also a common type of reconstruction or amalgamation of companies. It is therefore unsatisfactory that the harmonization legislation should not yet cover this type of financial operation, which is quite different from legal mergers and divisions.

4. In a legal merger, all the assets and liabilities of a company are transferred to another company and the company being taken over is dissolved, without going through the liquidation procedure, and its shareholders issued with shares in the acquiring company. Alternatively, the assets and liabilities of two or more existing companies are transferred to a newly-formed company and both the original companies dissolved.[8]

5. A division differs from a legal merger in that the assets and liabilities of an existing company, which is subsequently dissolved, are transferred to several other companies. Otherwise, the two operations are largely the same.

6. A takeover or 'shares merger' although often commercially and economically the equivalent of a legal or assets merger, is legally quite different. It does not involve the dissolution of one of the companies or the transfer of its assets or liabilities to the acquiring company. The company whose shares are acquired remains in existence.

7. Legal mergers between companies from different Member States are not covered by Directive 78/855/EEC, but only intra-State ones. A proposal for a 10th company law Directive to facilitate inter-State legal mergers was sent to the Council on 14 January 1985,[9] and is currently before Parliament. Takeover bids for companies in other Member States can already be mounted without difficulty.

8. Unlike assets mergers, which in most European countries have been taking place since the 1930s, if not before, mergers by takeover are a phenomenon which has only emerged in the last 25 years and which varies greatly in frequency from country to country. This explains why some Member States have established very detailed rules on the subject while others have made no specific provision at all. Takeovers have nevertheless become an increasingly widely used technique throughout the Community, and one whose importance is growing with the gradual liberalization of capital markets.

9. A takeover bid is generally understood to mean an offer made to the holders of securities carrying voting rights in a company or convertible into securities carrying such rights (i.e., shares, convertible bonds, subscription rights, options and warrants) to acquire their securities for a consideration in cash or other securities, the purpose of

1 Directive 68/151/EEC, OJ L 65, 14.3.1968.
2 Directive 77/91/EEC, OJ L 26, 31.1.1977.
3 Directive 78/660/EEC, OJ L 222, 14.8.1978.
4 Directive 83/349/EEC, OJ L 193, 18.7.1983.
5 Directive 84/253/EEC, OJ L 126, 12.5.1984.
6 Directive 78/855/EEC, OJ L 295, 20.10.1978.
7 Directive 82/891/EEC, OJ L 378, 31.12.1982.

8 Articles 3 and 4 of Directive 78/855/EEC.
9 OJ C 23, 25.1.1985, p. 11.

the offer usually being to acquire control of the company or consolidate the offeror's existing control, and the offer being made conditional upon sufficient offerees accepting it to achieve the offeror's objective

To guarantee the equal treatment of all shareholders, the directive fixes a threshold at which there is an obligation to launch a takeover bid. Besides, in order to protect minority shareholders and to avoid purely speculative partial bids the directive ensures that the offeror must make a bid concerning all the shares of the company.

10. To enable the addressees of a takeover or other general bid to make a properly informed assessment before deciding whether to accept, the offeror must be required to draw up and bring to their notice an offer document setting out all the terms of the bid. The Directive must also specify the circumstances in which an offer, once formally made to shareholders in this way, can be withdrawn. Another essential feature of a takeover bid is the setting of a closing date for acceptances, which should not, however, preclude revisions of the initial offer within certain limits.

As well as the offer document drawn up by the offeror, provision should also be made for shareholders to receive a report giving the view of the offeree company's board on the offer.

11. Rules to protect the interests of those affected by takeover bids are unlikely to be effective unless they are policed by an official regulatory body independent of the parties. The Directive requires Member States to designate such a supervisory authority or authorities. How this regulatory system is organized is left to the Member States, provided the authorities have the power to effectively police the takeover rules. The Directive also lays down a rule for determining the supervisory authority responsible in cases where bids are launched simultaneously in several Member States and in such cases requires the mutual recognition of offer documents.

12. The Directive secures the protection of shareholders, by, *inter alia*, ensuring that they receive full and substantiated information on the offer, and by imposing the respect of the fundamental principle of equality of treatment of those to whom the offer is addressed. Such persons, especially when resident in a different Member State than the target company, should be properly informed of what is going on during a bid and appreciate the importance of the various steps in the bid procedure. Such shareholders often have only a small portfolio of shares and little information to go on apart from the annual accounts of their company and possibly the current stock exchange price of their shares. The company making the bid is usually better informed about the situation of the target company and the value of its shares than the company's shareholders, because it has taken the initiative.

The Directive ensures a basic level of protection for the addressees of takeover bids throughout the Community. This does not affect Member States' rights to maintain or introduce more far-reaching or detailed provisions in their law.

13. Certain recent events have raised the question whether the Directive should introduce a reciprocity clause towards bidders from third countries.

The need for such a clause has been emphasized by those who say that in general it is easier for a company from a third country to take control of a Community company than the opposite.

The situation within the Community is not as open as one may think. Indeed, company law in several Member States also allows companies to adopt a range of defensive measures to ensure that control of the company remains in the hands of friendly shareholders. These defensive measures are very widely used in some Member States. As a consequence the conditions in which a takeover bid is carried out vary considerably between Member States.

Against this background, and given the lacunae which exist within the Community, it would be premature to introduce a reciprocity clause now at Community level. For the time being and until subsequent harmonization, Member States may introduce such a clause into their national law, bearing in mind their international commitments.

II. Article-by-article commentary

Article 1

The scope of the Directive as regards the types of companies covered is defined by reference to the company whose shares are the subject of the general bid.

Only the public companies limited by shares are covered.

The public companies need not be quoted; to restrict the rules to quoted companies would discriminate between the shareholders of quoted and unquoted companies by according a higher standard of protection to the former. However, a number of special rules are laid down for those cases where the securities of quoted companies are offered to the shareholders of the offeree company to reflect capital market regulatory requirements.

Thus the obligation to make a bid for all the shares of a company once a certain threshold of participation is reached does not depend for application on whether the target company is quoted on the Stock Exchange or not. The rules of the Directive apply to obligatory bids and also to cases where someone decides voluntarily to make a bid for the shares of a small or medium-sized company not quoted on the Stock Exchange.

Because there are restrictions in many Member States on the transfer of shares of private limited companies, the Directive does not apply to bids for such companies.

The characteristic feature of a general bid is that the offer is made on the same terms to all the holders of voting stock of the company, or instruments convertible into voting stock, or of a particular class or classes of voting stock.

Article 2

The definition of 'securities' includes instruments carrying potential voting rights such as convertible bonds, subscription rights, options and warrants.

Any person or company who launches a bid either on the basis of Article 4 or on a voluntary basis is considered to be an 'offeror'. It goes without saying that if the members of the board of the target company decide to launch a bid they are to be considered as offerors too. They are subject to all obligations imposed by this Directive.

The term 'parties to the bid' is used in the requirement for an expert's report in certain cases where the consideration offered includes securities (Article 14(2)). The parties to the bid are the offeror and its agent, the addressees of the bid and the directors of the offeree company. The offeror may be a company or an individual. If it is a company, its directors are also parties to the bid.

Account must be taken of the fact that in a takeover bid the offeror often does not act alone but in concert with others. 'Persons acting in concert' are defined as persons who, pursuant to an agreement, cooperate with one another to acquire a company's securities.

Article 3

The Directive lays down in this article a fundamental principle of company law, that of equal treatment of shareholders who are in the same position. The text also contains provisions which apply this principle to individual situations, for example Article 4 (obligation to make a bid), and Article 16 (automatic revision).

Article 4

So that the principle of equal treatment of shareholders cited in Article 3 may be respected, the Directive requires an offer to be made by persons wishing to acquire shares, which, when added to any existing holdings, give them a percentage of voting rights which Member States may not fix at less than one third.

To avoid purely speculative partial bids, the Directive obliges the offeror to make a bid concerning all the shares in the company. This also has the aim of preventing shareholders suffering a loss caused by the reduction in value of the shares they continue to own after a partial bid.

For the purpose of the obligation imposed by this Article, the voting rights held by certain persons connected with the offeror must be added to those held by the offeror himself. These are on the one hand persons acting in their own name but on behalf of the offeror and on the other hand persons acting in concert with the offeror. Where the offeror is a company the voting rights held by companies belonging to the same group of companies as the offeror within the meaning of Article 1 of Directive 83/349/EEC on consolidated accounts and those held by the members of the management body of these companies must also be taken into account.

The threshold of one third is that from which the offeror may exercise a blocking minority. Indeed, numerous important decisions which, within a company, must be taken by the general meeting of shareholders, require at least a majority of two-thirds of the votes attached to the securities represented. This is the level used in Community legislation to limit or suppress the right of preferential subscription for cases of increase of capital, for the reduction of capital, for the total or partial writing-off of capital[1] and for operations such as mergers[2] or scissions.[3]

In certain cases the obligation to launch a bid as set out in paragraph 1 of this Article could lead to undesirable results.

For example, it would be exaggerated to impose this obligation on those who reach the required threshold in an

[1] Article 40 of Directive 77/91/EEC.
[2] Article 7 of Directive 78/855/EEC.
[3] Article 5 of Directive 82/891/EEC.

accidental manner (from donations, inheritance, etc.). A bid could be incompatible with the interests of shareholders or even with the objectives of the Directive. That is why the supervisory authority may grant exemptions to this obligation. It must give the reasons for its decision and adopt all measures necessary to ensure equal treatment of all shareholders.

Article 5

The obligation described in Article 4 could have excessive results if the company concerned is small or medium-sized. These are normally companies for which the obligations imposed by the offeror could lead to disproportionate costs by reference to the size and the value of the target company. Thus, when this company is small or medium-sized as defined in Article 27 of Directive 78/660/EEC on annual accounts or when it belongs to a group of undertakings which do not exceed the limits established by that article, and it is not quoted on the Stock Exchange, the offeror is exempt from the requirement to make a bid. If the offeror decides to make a bid anyway, it must be made in accordance with the requirements of the Directive.

Article 6

Member States are required to designate a supervisory authority or authorities to monitor compliance with the rules by all bid parties and must inform the Commission of their arrangements, including the division of responsibilities between the authorities if several bodies have regulatory functions in the area.

The Directive leaves it to Member States whether a public or private or a nationally or regionally organized body is designated and how the authority operates, provided it has the necessary powers to effectively police the system and see that the Directive is respected. In this respect, the authority (or authorities) must have in every case either the power to forbid the publication of an offer document which is incomplete by reference to the requirements of the Directive, or the power to oblige the offeror to revise such a document at a later date.

It is necessary to specify which Member State's authority is responsible for policing cross-frontier bids. This responsibility (in particular, for supervising the content and notification to shareholders of the offer document) is assigned to the authority of the Member State in which the offeree company has its registered office. Where a bid is launched simultaneously in several Member States, the Directive requires authorities to recognize offer documents drawn up under each other's supervision, as in the rules on listing particulars.[1]

After the offer document has been published or otherwise brought to the notice of shareholders, the authorities of the various Member States concerned are required to assist one another in performing their duties and for this purpose to supply one another with all necessary information.

To avoid the creation of false markets in securities concerned in takeover bids, it is provided that all current or former officers or servants of supervisory authorities must be bound to strict confidentiality regarding information coming to their knowledge in the course of their professional duties and must not disclose such information to any person or body not legally entitled to receive it.

The liability position of supervisory authorities is to be governed by their national law.

Article 7

Article 7 is based on the principle that information capable of having an influence on the market in the securities concerned should be made public as soon as possible to reduce the scope for insider dealing. Hence, as soon as the offeror decides to make the bid, even though the details might not have been fully worked out, it must announce its intention to all the intended addressees by one of the means provided for by the Directive for notifying the offer document to them (Article 11). It must then immediately prepare an offer document meeting the requirements of Article 10 in order to inform the addressees of the exact terms of the offer.

However the offeror must take certain steps before the publication of the offer document. He must forward the offer document to the supervisory authority and to the board of the offeree company.

Article 8

The administrative or management body of the offeree company must at all times act in the interests of the company. Unless the general meeting authorizes it to do so, therefore, it would be prohibited from impeding the bid by issuing new securities carrying voting rights in the offeree company, or deciding to engage in operations of an exceptional nature which might cause a substantial loss of the company's assets. In this connection, operations of an exceptional nature are

[1] Directive 87/345/EEC, OJ L 185, 4.7.1987, p. 81.

considered to be those which are not carried out in the normal course of the company's business or not in conformity with normal market practice.

This ban would take effect when the offeror informs the administrative or management body of the offeree company that he intends to make a bid (Article 7(1)), and would last until the period for acceptance has expired.

Article 9

To ensure that offerors fully comply with the rules, they are required to be represented by a licensed dealer in securities or a financial institution authorized to act within the Community, which are subject to codes of practice in their activities as advisers in takeover bids and will thus help to ensure that the rules are observed and that shareholders are properly protected.

Article 10

This Article sets out the minimum content of the offer document.

The document must first identify the offeree company and the offeror and its agent.

It must also state the securities or class or classes of securities for which the bid is made and the holdings of such securities already in the possession of the offeror or its associates and the voting rights attached to the securities already held. The associates whose holdings must be disclosed are persons acting in their own name but for the account of the offeror, persons acting in concert with the offeror, and, where the offeror is a company, its directors and any companies belonging to the same group for the purposes of Article 1 of the consolidated accounts Directive 83/349/EEC. The date and price (or other considerations) at which such shareholdings were acquired must also be stated in the offer document. Where the offeror is a company, any stakes held by the offeree company in the offeror must be similarly disclosed.

The offer document must state the consideration offered for each security and the basis of the valuation used in calculating it and, where the offer is for cash or includes a cash element, provide guarantees of the offeror's ability to meet the financial obligations resulting from the bid. If the offeror finances the bid by any means that might cause debts to the target company he has to state this clearly in the offer and specify the importance of this future indebtedness.

In the case of a share (or mixed cash and share) offer, the document must also state from what date the shares offered will become entitled to a dividend.

The offer may be made subject to conditions approved by the responsible supervisory authority. These, too, must be stated in the offer document.

The closing date for acceptances must be given within the limits laid down in Article 12.

The offeror must say what steps have to be taken by shareholders wishing to accept the bid in order to signify their acceptance and to receive the offeror's consideration for the shares they transfer to it.

In the interest of all parties to the bid and taking into account the social policy of the Commission, it seems indispensable to make clear in the offer document the intentions of the offeror concerning the future of the offeree company, especially as regards its activities, including the use of its assets but also as regards its management and staff.

The offeror must also disclose any special advantages it intends to grant to the directors of the offeree company and any agreements concerning exercise of the voting rights attached to the shares of the offeree company.

Finally, the offer document must identify all the offeror's associates and persons acting in concert with it in the bid, as specified above.

The Directive will not prevent regulatory authorities requiring additional items of information to be included in the offer document where it is necessary in the particular circumstances of the case that shareholders should be made aware of them.

The Directive requires that, where the offer includes newly issued securities for which an official stock exchange listing has been applied for, the offer document must be accompanied by the listing particulars required by Council Directive 80/390/EEC.[1] Thus the recipients of the offer will receive full disclosure concerning the shares which are being offered to them.

With the same objective in mind, where no official stock exchange listing has yet been applied for securities offered in exchange, the Directive seeks to guarantee offerees adequate information by requiring that the offer document must put

[1] OJ L 100, 17.4.1980, p. 1.

the offerees in possession of all facts necessary to make an informed judgment of the issuer's assets and liabilities, financial position, record and prospects.

Article 11

Shareholders must be given an opportunity to acquaint themselves with the bid terms.

The offer document, and if appropriate the listing particulars or equivalent of securities offered in exchange, therefore need to be brought to their attention.

This may be done in a number of ways. The offer document and any accompanying documents may be published in full in one or more national mass-circulation newspapers and in the official gazette designated under Article 3(4) of Directive 68/151/EEC. Alternatively, the offeror may announce in the newspapers and the official gazette, or in some other medium approved by the supervisory authority, that the documents are available at stated addresses.

Where all the securities comprised in the bid are registered, the offeror may also circulate the offer document and any accompanying documents to all the addressees individually.

The offeror is required to file a copy of the documents with the supervisory authority so that it can carry out its duties with regard to the takeover rules.

Article 12

The Directive sets out time-limits within which the offeror may fix the period for accepting the offer which may not be less than 4 weeks or more than 10, from the date of publication of the offer document.

On one hand, the period should be sufficiently long to allow offerees to obtain information concerning the conditions of the offer and to consult the report of the board of the offeree company. On the other hand, taking into account the limitations imposed by Article 8, the target company should not be prevented from carrying out its normal activities for too long a period.

Unless authorization on the basis of a reasoned decision is given by the supervisory authority, the acceptance delay may not be changed unless a rival bid is launched.

Article 13

To allow the offeror to withdraw a bid once the offer document has been brought to the notice of the shareholders by one of the means provided for in the Directive would be to sanction abuse of the takeover process. The offeree company and its shareholders must be protected against bids made for purposes other than the acquisition of control or a significant proportion of the voting rights in the company.

There are several other circumstances in which withdrawal is permitted. First, the bid may be withdrawn in accordance with Article 20(4) if a competing bid is made.

Withdrawal of the bid is also permitted if the approval of the general meeting of the offeror company is not obtained for the issue of new securities offered in exchange for the securities bid for or if the securities offered in exchange fail to obtain an official stock exchange listing as the offeror intended.

Another case in which a bid may be withdrawn is where the requisite judicial or administrative authorization for acquisition of the shareholding is refused. A typical example would be prohibition of the operation by the merger control authorities.

The offeror may also withdraw the bid if a condition of the bid approved by the supervisory authority is not met.

In wholly exceptional cases, when the offer cannot be made for reasons of *force majeure* the supervisory authority may authorize the withdrawal of that offer on the basis of a reasoned decision.

The withdrawal of the bid must be notified to the original addressees by the same means as the offer document and to the supervisory authority.

Article 14

The board of the offeree company, is required to give its view of the bid in a report setting out, in particular, the arguments for and against acceptance.

Takeover bids are not always contested by the target company's management; indeed in many cases the latter has negotiated the takeover and its terms with the offeror. In the case of friendly takeovers of this kind, such matters should not be concealed from shareholders but should be made clear in the report of the target company's board. The report should also specify any agreements between the offeree company's management and the offeror on the exercise of voting rights attached to the target company's shares.

In drawing up its report, the board is of course under a duty to act in the best interests of the offeree company.

Where the consideration offered in the bid includes securities for which at the time of the bid no official stock exchange listing has been applied for, the board's report is required to be accompanied by the report of an expert independent of the bid parties appointed or approved by the supervisory authority. In his report the expert must state whether, in his opinion, the consideration offered is fair and reasonable and give his views on the basis of the valuation used to determine the consideration. The purpose is to give the target company's shareholders an independent assessment of the share exchange ratio proposed, as in the experts' reports on the proposed terms of assets mergers under Article 10 of Directive 78/855/EEC.

The report of the target company's board and the expert's report, if required, must be notified to the addressees of the bid by the same means as the offer document before the expiry of the period for acceptance and filed with the supervisory authority. Where the bid is 'friendly', there is no objection to the offer document and the report of the offeree company's board being published or otherwise notified to shareholders together.

Where there are competing bids or revised bids it is clear that the management of the target company should give its reaction to them and accordingly they are subject to the same rules as original bids.

Article 15

The Directive allows the offeror to revise the terms of the bid any time up to one week before the expiry of the period for acceptance. This limitation is necessary to maintain an orderly market in the shares and to ensure that the addressees are informed of the revised terms in time. Indeed, the offeror may not revise the offer during the last week of the acceptance period unless he is authorized to do so by the supervisory authority on the basis of a reasoned opinion. To give addressees enough time to consider the new terms of the offer, however, it is provided that the initial period for acceptance must be extended by one week in that case. This can be modified by the supervisory authority on the basis of a reasoned decision.

No definition of 'revision' is given. Consequently, a revision does not necessarily have to raise the cash price or share exchange ratio. Determining whether the terms of a new offer are better than those of the original one is often more difficult than comparing absolute prices or ratios, especially for share exchange or mixed cash and share offers.

As with the initial offer, the offeror must be required to make an immediate public announcement of its intention and then to notify shareholders of the new terms. The view of the offeree company's board on the amended offer must be similarly publicized and the revised bid terms and the board's report filed with the supervisory authority.

The principle of equality of treatment of all addressees of the bid must be upheld by requiring that all shareholders who have already accepted the previous offer may accept the revised bid instead.

Article 16

An irrefutable presumption of revision of the offer takes place in all cases where the offeror, persons acting in concert with him or persons acting in their own name but on behalf of the offeror buy during the acceptance period shares which are the subject of the offer at a higher price than that laid down in the offer document or one of its revisions. The effect of these acquisitions is the increase of the consideration for offers already accepted. In this way, once again, the principle of equality of treatment is respected.

Article 17

This Article is intended to ensure that the regulatory authorities are kept informed of the progress of the bid so that they can exercise their supervisory functions.

Throughout the period for acceptance of the bid the offeror should be required to inform the supervisory authority at any time, on request, of the number of acceptances received to date.

Furthermore, from the time the bid is publicly announced the supervisory authority should be informed of all further acquisitions of securities concerned in the bid by holders of 1% or more of the voting rights in the companies concerned or persons acting in concert with them or for their account, and the price at which the securities were acquired. The obligation laid down in this paragraph is particularly important because it permits the presumption of a revision laid down in Article 16 to operate.

Article 18

All parties should be properly informed of the outcome of the bid. For this purpose it is required that the result should be brought to the notice of the shareholders to whom the bid was addressed by one of the means required for notification of the offer document and should be communicated to the supervisory authority. In this way the offeror will have to make public such information as the number of acceptances, the voting rights attached to the securities transferred to it by acceptors, and whether the objective of the bid was achieved or the bid was withdrawn.

Article 19

One of the fundamental objectives of this Directive is to inform those chiefly concerned by the operation of its consequences. Among the persons mainly concerned are the employees of the target company for whom the operation may have serious repercussions. This article imposes on the administrative or management body of the target company the obligation to communicate to employees' representatives the documents concerning the bid. These representatives thus have access to the offer document and to the documents foreseen in Article 10(3) and (4) for takeover bids where shares are offered in consideration as well as to the report of the management of the target company and, where appropriate, to the experts' report foreseen in Article 14(2).

Article 20

The takeover rules should not stand in the way of competing bids, which are in the interest of the target company's shareholders.

All bids in competition with a bid already made must comply with the same rules as the initial bid as regards procedure, the content and notification to shareholders of the offer document and the report of the offeree company's board, the period for acceptance and revision of the bid.

To maintain an orderly market in the shares and to ensure that shareholders are informed in time, the competing offeror must be required to notify its offer document to the addressees before the period for acceptance of the initial bid expires.

The Directive does not allow competing bids from persons acting in concert with the original offeror or acting in their own name but for its account, except with the permission of the supervisory authority. This provision is intended to avoid a proliferation of bids that are competitive in name only, while allowing the supervisory authority to depart from this principle where the shareholders' interests require.

The original offeror may withdraw his bid in the face of a competing one. If it does not, the period for acceptance of its bid is extended to the date of expiry of that of the competing bid. The extension must be notified to shareholders in the usual way and to the supervisory authority.

Article 21

The policing of the takeover rules by regulatory authorities in different Member States, and the possible delegation of some functions to other bodies, may give rise to problems. For this reason it is proposed to set up a contact committee to advise the Commission in three areas: firstly, uniform application of the rules, for which regular consultations will be held; secondly, to bring together the strategies followed by Member States seeking to obtain reciprocity of treatment for Community companies and nationals as regards the purchase of shares of a company by means of a takeover bid; thirdly, changes in the rules. The committee formula is modelled on that in the accounts Directive 78/660/EEC.[1]

The Council of the European Communities,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 54 thereof,

Having regard to the proposal from the Commission,

In cooperation with the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas it is necessary to coordinate certain safeguards which Member States require of companies and firms within the meaning of the second paragraph of Article 58 of the Treaty for the protection of members and others, in order to make such safeguards equivalent throughout the Community;

Whereas it is necessary to protect the interests of the shareholders of public companies limited by shares when these are the subject of a takeover or other general bid;

Whereas shareholders who are in the same position should be treated equally;

Whereas this equality of treatment requires that the obligation to make a bid is imposed on persons wishing to attain a certain level of participation in a company and in order

[1] Article 52 of Directive 78/660/EEC.

to ensure the protection of minority shareholders and to avoid purely speculative partial bids, it is necessary to require that these persons make a bid for all the shares of that company;

Whereas each Member State should designate a supervisory authority or authorities to ensure that parties to a takeover or other general bid fulfil their obligations; and whereas it is necessary to determine which authority has territorial jurisdiction in the case of cross-frontier bids and to provide for the mutual recognition of offer documents within the Community; whereas the different authorities must cooperate with one another and their present or former officers and servants should be bound to preserve confidentiality;

Whereas to reduce the scope for insider dealing offerors should be required to announce their intention of launching a bid as soon as possible and to inform the supervisory authority and the offeree company's board of the precise terms of the bid before they are made public;

Whereas to avoid operations which frustrate the bid it is necessary to limit the powers of the board of directors of the offeree company to engage in operations of an exceptional nature;

Whereas to help ensure compliance with the obligations resulting from the Directive it should be compulsory for offerors to be represented by a person or credit institution licensed to deal on the financial markets;

Whereas the addressees of a takeover or other general bid should be properly informed of the terms of the bid by means of an offer document and, where the consideration offered includes securities, should be provided with certain additional information about the company issuing those securities;

Whereas the offeror should be required to bring the offer document to the attention of all addressees of the bid and where the offer document contains insufficient information to clarify the real intentions of the offeror, the supervisory authority should be able either to forbid the publication of the offer document or to make the offeror publish a revised document;

Whereas it is necessary to set a time-limit for takeover bids;

Whereas, in the interests of the offeree company and the addressees of the bid, it should be provided that once an offer document has been made public the bid may not be withdrawn except in certain specified circumstances;

Whereas the board of the offeree company should be required to report in writing to its shareholders its view of the bid, and whereas where the consideration offered in the bid includes securities for which at the time the bid is made no official stock exchange listing has been applied for it should also be required to obtain and make available to all addressees of the bid an additional report by an independent expert;

Whereas offerors are entitled to revise their bids; whereas limits should be placed on that right in order to maintain an orderly market in the shares and it should be ensured that the addressees of the bid are informed in time; whereas it is necessary that the offeror draw up and make public a fresh document setting out the amendments to the original bid and whereas addressees who have already accepted the bid should be entitled to accept the revised bid;

Whereas in order to ensure equal treatment of addressees of the bid, any acquisition by the offeror, or by certain persons associated with him, of shares which are the subject of the bid at a higher price than that laid down in the offer document or one of its revisions, must itself be considered as a revision;

Whereas to be able to perform their functions satisfactorily, supervisory authorities need to be able to find out at any time how many acceptances have been received to date and whereas, from the time the intention to make a bid is announced by the offeror, any dealing in the securities concerned must be made public by any person already having a significant shareholding;

Whereas the result of the bid must be made public and notified to the supervisory authority;

Whereas taking into account the social policy of the Community, it is necessary that representatives of the employees of the offeree company be informed with regard to the bid and that they should receive all the documents concerning that bid;

Whereas competing bids for the securities of a company are necessarily to the advantage of its shareholders; whereas all such bids should be subject to the same rules as the original bid and the original offeror should be entitled to withdraw his bid in such a case;

Whereas this Directive does not until subsequent coordination affect the capacity of Member States to forbid a takeover or other general bid where the offeror is either a national or a company from a third country, in particular where Community nationals and companies do not benefit from reciprocal treatment as regards the acquisition of shares by means of such a bid in a company governed by the law of that third country,

Has adopted this Directive:

Article 1

(Scope)

The coordination measures prescribed by this Directive shall apply to the laws, regulations and administrative provisions of the Member States relating to takeover and other general bids addressed, on the same terms, to all holders of the securities, or the securities of a particular class or classes, of any of the following types of company:

(a) in Germany:
die Aktiengesellschaft, die Kommanditgesellschaft auf Aktien;

(b) in Belgium:
la société anonyme/de naamloze vennootschap, la société en commandite par actions/ de commanditaire vennootschap op aandelen;

(c) in Denmark:
aktieselskaber, kommanditaktieselskaber;

(d) in Spain:
la sociedad anonima, la sociedad en comandita por acciones;

(e) in France:
la société anonyme, la société en commandite par actions;

(f) in Greece:
Η ανώνυμη εταιρία, η ετερόρρυθμη κατά μετοχές εταιρία;

(g) in Ireland:
the public company limited by shares;

(h) in Italy:
la società per azioni, la società in accomandita per azioni;

(i) in Luxembourg:
la société anonyme, la société en commandite par actions;

(j) in the Netherlands:
de naamloze vennootschap;

(k) in Portugal:
sociedade anonima, sociedade em comandita por accoes;

(l) in the United Kingdom:
the public company limited by shares.

Article 2

(Definitions)

1. For the purposes of this Directive, 'offeree company' shall mean a company whose securities are the subject of a takeover or other general bid (hereinafter referred to as 'a bid').

2. For the purposes of this Directive, 'offeror' shall mean any person or company including, where appropriate, the directors of the offeree company, who launches a bid in accordance with the obligation set out in Article 4 or on a voluntary basis.

3. For the purposes of this Directive, 'securities' shall mean securities carrying voting rights in a company or which can be converted into securities carrying such rights.

4. For the purposes of this Directive, 'parties to the bid' shall mean the offeror, the representative of the offeror within the meaning of Article 9, the directors of the offeror, if the latter is a company, the addressees of the bid and the directors of the offeree company.

5. For the purposes of this Directive, 'persons acting in concert' shall mean persons who, pursuant to an agreement, cooperate with one another with the aim of acquiring the securities of a company.

Article 3

(Equal treatment)

Shareholders who are in the same position shall be treated equally.

Article 4

(Obligation to make a bid)

1. Any person aiming to acquire a number or percentage of securities, which, added to any existing holdings, gives him a percentage of the voting rights in a company which may not be fixed at more than 33 1/3 %, shall be obliged to make a bid to acquire all the securities of that company.

2. To calculate the threshold referred to in paragraph 1, the following must be added to the voting rights held by the offeror:

   (a) voting rights held by persons acting in their own name but on behalf of the offeror;

   (b) where appropriate, voting rights held by companies belonging with the offeror to the same group of undertakings within the meaning of Article 1 of Council Directive 83/349/EEC;[1]

   (c) voting rights held by persons acting in concert with the offeror;

   (d) where appropriate, voting rights held by directors of the offeror company.

3. The supervisory authority may grant exemptions to the rule laid down in paragraph 1, giving reasons for its decision and adopting all measures necessary to ensure equal treatment of all shareholders.

Article 5

(Exemptions on the basis of size of the offeree company)

Article 4 shall not apply:

(a) where the securities of the offeree company have not been admitted to official stock exchange listing or have not been the subject of a request for such admission at the moment when the bid is announced in accordance with Article 7; and

(b) where the offeree company, or, where appropriate, the group of undertakings within the meaning of Article 1 of Directive 83/349/EEC to which the company belongs, do not exceed, at the balance-sheet date, the amounts of two of the three criteria laid down in Article 27 of Council Directive 78/660/EEC.[2]

Article 6

(Supervisory authority)

1. Member States shall designate the authority or authorities which must discharge the functions specified in this Directive. The authorities thus designated may delegate all or part of their powers to other authorities or to associations or private bodies. Member States shall inform the Commission of these designations and of any delegation of powers and shall specify all divisions of functions that may be made.

2. The authorities and, where appropriate, the associations or private bodies referred to in paragraph 1 must have all the necessary powers to ensure that this Directive is put into effect and, in any case, either the power to forbid the publication of an offer document which is incomplete by reference to the requirements of this Directive or the power to oblige the offeror to correct an inadequate offer document and to make it public by the means set out in Article 11(1).

3. The authority competent for supervising the drawing-up and publication of the offer document shall be that of the Member State in which the offeree company has its registered office. Where the bid is made in several Member States simultaneously, the offer document as prepared under the supervision of the national authority responsible shall be accepted in the other Member States, without their supervisory authorities having the right to require the inclusion of any additional particulars in the document.

4. After an offer document has been made public in accordance with Article 11(1), the competent authorities of the Member States shall give each other any cooperation required for the performance of their duties and for this purpose shall supply each other with any information that may be necessary.

5. All present or former officers or servants of supervisory authorities shall be bound by the rules of professional secrecy. Information that has come to their knowledge in the course of performing their professional duties shall not be disclosed to any person or body not legally entitled to receive it.

6. This Directive shall not affect the legislation of Member States concerning the liability of competent authorities.

Article 7

(Procedure prior to publication of the offer document)

1. As soon as it decides to make a bid, the offeror shall make public its intention of doing so by one of the means provided for in Article 11(1). It shall inform the competent supervisory authority accordingly.

[1] OJ L 193, 18.7.1983, p. 1.
[2] OJ L 222, 14.8.1978, p. 11.

2. The offeror shall then immediately draw up an offer document in accordance with Article 10 and make it public in accordance with Article 11(1).

3. Before the offer document is made public, the offeror shall communicate it to the competent supervisory authority and to the board of the offeree company.

Article 8

(Restriction of the powers of the board of the offeree company)

After receiving the information referred to in Article 7(1) and until the expiry of the period for accepting the bid, the board of the offeree company shall not, without the authorization of the general meeting of shareholders, decide:

(a) to issue securities carrying voting rights or which may be converted into such securities;

(b) to engage in transactions which do not have the character of current operations concluded under normal conditions unless the competent supervisory authority has authorized them, giving its reasons for such authorization.

Article 9

(Representative of the offeror)

The offeror shall be represented either by a qualified person authorized to deal on the Community financial markets or by a credit institution authorized within the Community.

Article 10

(Offer document)

1. The offeror shall draw up an offer document in respect of the bid stating at least:

    (a) the type, name and registered office of the offeree company;

    (b) the name and address of the offeror or, where the offeror is a company, the type, name and registered office of that company;

    (c) the name and address or, where appropriate, name and registered office of the representative of the offeror referred to in Article 9;

    (d) the securities or class or classes of securities for which the bid is made;

    (e) the securities, or the securities of the relevant class or classes, already held by:

        (i) the offeror,

        (ii) other persons for the account of the offeror,

        (iii) companies belonging with the offeror to the same group of undertakings within the meaning of Article 1 of Directive 83/349/EEC,

        (iv) persons acting in concert with the offeror,

        (v) where the offeror is a company, its directors,

        and the voting rights attached to those securities and the date and the price at which they were acquired;

    (f) where the offeror is a company, the securities, or the securities of a particular class or classes, of the offeror held by the offeree company, and the voting rights attached to them and the date and the price at which they were acquired;

    (g) the consideration offered for each security and the basis of the valuation used in determining it and, in the case of a cash consideration, the guarantees provided by the offeror regarding payment of that consideration, and, where appropriate, a statement concerning any future indebtedness of the offeree company to finance the bid;

    (h) where the consideration comprises securities, the date from which those securities will entitle their holders to a share in the profits and any special conditions affecting that entitlement;

    (i) any condition authorized by the competent supervisory authority which the offeror places on the bid;

    (j) the latest date on which the bid may be accepted;

    (k) the steps to be taken by the addressees of the bid in order to signify their acceptance and to receive the consideration for the securities which they transfer to the offeror;

    (l) the intentions of the offeror, explicitly expressed, regarding the continuation of the business of the offeree company, including the use of its assets, the composition of its board and its employees;

    (m) any special advantages which the offeror intends to grant to the directors of the offeree company;

    (n) all agreements concerning the exercise of the voting rights attached to the securities of the offeree company.

2. In addition, the offer document shall identify:

(a) any person for whose account the offeror is acting;

(b) any companies belonging with the offeror to the same group of undertakings within the meaning of Article 1 of Directive 83/349/EEC;

(c) any person acting in concert with the offeror.

3. Where the consideration offered includes newly-issued securities for which at the time of the bid an official stock exchange listing has been applied for, the offer document shall be accompanied by the listing particulars required by Council Directive 80/390/EEC.[1]

4. Where the consideration offered includes securities for which at the time of the bid no official stock exchange listing has been applied for, the offer document shall contain all the facts necessary to enable the addressees of the bid to form an informed judgment as to the assets and liabilities, financial position, record and prospects of the issuer.

Article 11

(Publication of the offer document)

1. The offer document and, where appropriate, the documents required by Article 10(3) or (4) shall be either:

(a) published in full in one or more national or mass-circulation newspapers and in the national gazette designated under Article 3(4) of Council Directive 68/151/EEC;[2] or

(b) made available to the addressees of the bid at addresses announced in notices in the newspapers and the gazette referred to at (a) or by equivalent means approved by the competent supervisory authority; or

(c) where all the securities comprised in the bid are registered, circulated to all addressees of the bid.

2. The offer document and, where appropriate, the documents referred to in Article 10(3) and (4) shall also be filed with the competent supervisory authority.

Article 12

(Period for acceptance)

1. The period for accepting the bid indicated in the offer document in accordance with Article 10(1)(j) may not be less than four weeks or more than 10 weeks from the date of publication of the document in accordance with Article 11(1).

2. The period may not be modified without the authorization of the supervisory authority, giving its reasons, without prejudice to Article 20.

Article 13

(Withdrawal of bids)

1. Once a bid has been made public by the means provided for in Article 11(1), it may be withdrawn only in the following circumstances:

(a) where there are competing bids and the offeror decides to withdraw his bid in accordance with Article 20(4);

(b) in a bid in which new securities are offered in exchange for the securities bid for, where the approval of the general meeting of the offeror company is not obtained for the issue of the new securities;

(c) in a bid in which securities are offered in exchange for the securities bid for, where the securities fail to obtain an official stock exchange listing as the offeror intended;

(d) where the necessary judicial or administrative authorization is not obtained for the acquisition of the securities for which the bid is made, and in particular in the event of lack of authorization of the acquisition by the merger control authorities;

(e) where a condition of the bid announced in the offer document in accordance with Article 10(1)(i) and approved by the competent supervisory authority is not fulfilled;

(f) in exceptional circumstances and with the authorization of the supervisory authority, giving reasons, where the bid cannot be put into effect for reasons beyond the control of the parties to the bid.

2. The withdrawal of the bid shall be made public by the means provided for in Article 11(1) and communicated to the competent supervisory authority.

Article 14

(Report of board of offeree company)

1. The board of the offeree company shall draw up a detailed report giving its views on the bid and setting out

[1] OJ L 100, 17.4.1980, p. 1.
[2] OJ L 65, 14.3.1968, p. 8.

the arguments for and against acceptance. The report shall state whether the board is in agreement with the offeror on the bid and specify any agreements on the exercise of the voting rights attached to the securities of the offeree company.

2. Where the consideration offered comprises securities for which at the time of the bid no official stock exchange listing has been applied for, the board's report shall be accompanied by the report of an expert independent of the parties to the bid appointed or approved by the competent supervisory authority. This report shall in all cases state whether, in the expert's opinion, the consideration offered is fair and reasonable and shall give the expert's views on the basis of valuation used to determine the consideration.

3. The reports shall, in good time before the expiry of the period for acceptance, be made public by the means provided for in Article 11(1) and filed with the competent supervisory authority.

4. Where the board of the offeree company is in agreement with the offeror, the board's report, accompanied, where appropriate, by the expert's report as referred to in paragraph 2, may be attached to the offer document provided for in Article 10.

5. The provisions of this Article shall also apply to revisions of the bid and to competing bids.

Article 15

(Revision of bids)

1. At any time before the last week of the period for acceptance announced in accordance with Article 10(1) (j), the offeror may revise the terms of the bid. Article 7(1) shall apply as regards the public announcement of the offeror's intention to revise the bid.

2. Where a bid is revised, the previous period for acceptance shall be automatically extended by one week.

3. The offeror shall draw up a document setting out the amendments to the offer document and making it public by the means provided for in Article 11(1).

4. Member States shall ensure that persons who have already accepted the previous bid by the offeror may accept the revised bid.

5. The periods provided for in paragraphs 1 and 2 may be modified with the authorization of the competent supervisory authority, which must set out the reasons on which it is based.

Article 16

(Automatic revision)

The acquisition by the offeror, by persons acting in concert with him or by persons acting in their own name but on behalf of the offeror, during the acceptance period, of securities in respect of which the bid is made at a price higher than that established in the offer document or one of its revisions, will itself be considered as a revision of the bid and have the effect of increasing the consideration offered to those who have accepted previously.

Article 17

(Provision of information to the supervisory authority)

1. Throughout the period for acceptance of the bid the offeror shall provide the competent supervisory authority at any time on request with information as to the number of acceptances received to date.

2. From the time a bid is publicly announced in accordance with Article 7(1), the offeror or any holder of 1% or more of the voting rights of the offeree company, of the offeror company if the offeror is a company, or of any other company whose securities are offered by way of consideration, shall declare to the competent supervisory authority all acquisitions of securities of the said companies by the offeror or the holder, persons acting in concert with them or persons acting in their own name but for their account, and the purchase price of such securities.

Article 18

(Publication of result of bid)

Once the period for acceptance has expired, the result of the bid shall be made public by the means provided for in Article 11(1) and shall be communicated to the competent supervisory authority by the offeror.

Article 19

(Information for representatives of employees of the target company)

The board of the offeree company shall communicate to its workers' representatives, as designated by national legislation or customary practice in Member States, the offer document and, where appropriate, the documents referred to in Article 10(3) and (4), as well as its own report as referred to in Article 14 and, if appropriate, the expert's report as referred to in Article 14(2).

Article 20

(Competing bids)

1. Where competing bids are made for the securities of the offeree company, this Directive shall apply to each such bid.

2. Competing bids shall be publicly announced in accordance with Article 7(1). The offeror shall draw up an offer document in accordance with Article 10 and shall make it public by the means provided for in Article 11(1) before the period for acceptance of the initial bid expires.

3. Except with the authorization of the competent supervisory authority, which must set out the reasons on which it is based, persons acting in concert with the offeror or acting in their own name but for the account of the offeror may not make a bid competing with the initial bid.

4. Where there are competing bids and the initial offeror does not withdraw its bid, the period for acceptance of the initial bid shall be extended automatically to the date of expiry of the period for acceptance of the competing bid. The extension shall be made public by the means provided for in Article 11(1) and communicated to the competent supervisory authority.

Article 21

(Contact Committee)

1. A Contact Committee shall be set up under the auspices of the Commission. Its function shall be:

   (a) without prejudice to the provisions of Articles 169 and 170 of the Treaty, to facilitate the uniform application of this Directive through regular consultations on, in particular, practical problems arising in its implementation;

   (b) to ensure concerted action upon the policies followed by the Member States in order to obtain reciprocal treatment for Community nationals and companies as regards the acquisition of securities of a company by means of a takeover bid;

   (c) to advise the Commission, if necessary, on additions or amendments to this Directive.

2. The Contact Committee shall be composed of representatives of the Member States and representatives of the Commission. The Chairman shall be a representative of the Commission. Secretarial services shall be provided by the Commission.

3. The Committee shall be convened by the Chairman either on his own initiative or at the request of one of its members.

Article 22

(Transposition of the Directive)

1. Member States shall adopt before .... the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith inform the Commission thereof.

2. Member States shall fix the date of entry into force of these provisions in any case at the latest by ....

3. Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered by this Directive.

Article 23

(Addressees of the Directive)

This Directive is addressed to the Member States.

Done at Brussels — For the Council

Fiche d'impact sur la compétitivité et l'emploi[1]

I. Quelle est la justification principale de la mesure?

1. Assurer que les actionnaires d'une société qui fait l'objet d'une offre publique d'achat ou d'échange (OPA) soient traités de façon égale.

2. Assurer que ces mêmes destinataires d'une OPA aient toute l'information dont ils ont besoin pour évaluer l'offre ainsi que le temps nécessaire pour décider s'ils l'acceptent ou pas.

II. Caractéristiques des entreprises concernées

En particulier:

(a) Y a-t-il un grand nombre de PME?

La directive prévoit une exemption lorsque la société visée est une PME non cotée (voir III ci-dessous), pour tenir compte de la spécificité des opérations impliquant ces sociétés.

(b) Note-t-on des concentrations dans des régions?
I. Éligibles aux aides régionales des États membres?
II. Éligibles au Feder?
Non.

III. Quelles sont les obligations imposées directement aux entreprises?

Les mesures proposées imposent une série d'obligations aux personnes et aux sociétés voulant acquérir le contrôle d'une société en vue de garantir les objectifs mentionnés sous 1. ci-dessus. Il s'agit notamment de l'obligation de lancer une OPA à partir d'un certain seuil de participation dans une société, de l'obligation d'accorder un traitement égal aux actionnaires de la société visée se trouvant dans des conditions identiques, ainsi que de l'obligation d'informer les destinataires de l'offre en établissant un document contenant les conditions de celle-ci. Ce document doit également être publié. Toutefois, en ce qui concerne l'obligation de lancer une offre, la directive prévoit une exemption lorsque la société visée est une PME non cotée.

[1] English text not available.

IV. Quelles sont les obligations susceptibles d'être imposées indirectement aux entreprises via les autorités locales?

Nulles.

Les autorités locales peuvent accorder des exceptions aux obligations décrites ci-dessus visant à alléger les obligations imposées par la directive lorsque celles-ci résulteraient en des charges excessives.

V. Y a-t-il des mesures spéciales pour les PME? Lesquelles?

Voir II (a) ci-dessus.

VI. Quel est l'effet prévisible?

(a) Sur la compétitivité des entreprises?

Effet positif. Les OPA constituent en général un moyen très sain d'assurer le renouvellement des équipes dirigeantes des entreprises européennes par le remplacement d'administrations peu efficaces ou non innovatrices. Cela provoque une sélection par le marché des entreprises plus compétitives et une restructuration des entreprises européennes qui est indispensable pour faire face à la concurrence internationale.

Dans la mesure où une OPA risquerait de provoquer une concentration excessive dans un secteur déterminé, cela pourrait être évité par l'utilisation des pouvoirs de la Commission en matière de libre concurrence.

(b) Sur l'emploi?

Pas d'effet direct.

VII. Les partenaires sociaux ont-ils été consultés? Quels sont leurs avis?

Le texte a été établi après consultation d'un groupe d'experts des États membres en matière de droit des sociétés et des principaux partenaires sociaux. Les avis des milieux concernés ont été pris en considération pour l'élaboration de la présente proposition de directive.

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