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Strategic Management, Firm Behavior and the Law of Potential Competition

Shilpi Bhattacharya*

ABSTRACT

Considerable cross-jurisdictional scholarship has highlighted the limitations of antitrust law in the digital age. Merger review has been a particular target of these calls for reform. As antitrust law comes under the scanner, it is time to explore whether it may be energized by the injection of new theories and ideas outside the dominant paradigm of neoclassical economics. Management or business studies is a discipline that has direct relevance to antitrust law as a field that studies firm behavior in competitive and strategic situations. This paper explores how the view of the firm as strategic and boundedly rational can contribute to merger analysis in antitrust law. For instance, rather than focusing solely on incentives and ability of firms, antitrust law should make allowances for errors and biases in firm decision-making arising from managerial hubris, overconfidence bias, availability bias, strategic momentum, escalation of commitment, risk aversion etc. Through two detailed case studies, this paper argues that antitrust law should consider management practices of firms during merger review. Moreover, it is time for antitrust law to recognize that beyond profit maximization, achieving competitive advantage is a key motivator of firm decision-making. This paper adds to the growing literature calling for reforms in the law of potential competition in digital markets.

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INTRODUCTION

Economic models simplify the world through assumptions in order to make clear predictions. This has definite advantages, but also carries the danger of missing the forest for the trees.[1] These models carry the risk of depicting a reality that is over-simplified by relying on assumptions that do not represent real-world behavior, such as the foundational assumption of rational decision-making.[2] Moreover, the simplifications involve 'cognitive representations' of real-world behavior, which may carry human biases and limitations.[3] Acknowledging that creators of theoretical models have bounded cognition means that there can be more than one way of understanding and viewing systems and the danger of theoretical traditions becoming dogmatic is real.

Evolutionary learnings from a variety of disciplines have cautioned against over-dependence on dominant theoretical paradigms. This note of caution should also apply to the use of neoclassical economics as the predominant theoretical bases of antitrust law. Neoclassical economics has influenced the questions asked, lines of inquiry developed, and data gathered to assess antitrust enforcement.[4] For instance, when it comes to merger review, the 2010 U.S. Horizontal Merger Guidelines state that the focus is "primarily on how the merger affects conduct that would be most profitable for the firm."[5] Profit maximization is considered the best guide to understanding firm behavior and the best predictor of the competitive effects of a merger.[6] The assumption of firm rationality and profit maximization is a key aspect of neoclassical economic theory.

Over-reliance on neoclassical economic theory in anti-trust law is a source of concern. Theoretical models based on neoclassical economics have been used in antitrust law for their conclusive and clear predictions of market outcomes. On the other hand, encouraging different theoretical traditions to co-exist may sacrifice certainty but allows for more growth and evolution of thought in

1. A similar metaphor was used by physicist M. Mitchell Waldrop when describing a presentation of models made by economists at the Santa Fe Institute, "It seemed as if [the economists] were dazzling themselves with fancy mathematics, until they couldn't see the forest for the trees . . . In a lot of cases what was required was just common sense." As quoted in ARUN MAIRA, *Over-simplified Models: Complex Social Systems*, THE HINDU Oct. 19, 2021 (quoting M. MITCHELL WALDROP, COMPLEXITY: THE EMERGING SCIENCE AT THE EDGE OF ORDER AND CHAOS (1992)).

2. *See* Daniel A. Levinthal, *A Behavioral Approach to Strategy: What's the Alternative*, 32 STRATEGIC MGMT. J. 1517, 1520 (2011) (arguing that the dichotomy between rational and behavioral approaches is a false one as rationality has an inherent behavioral component because rationality involves making choices which are made using behavioral mechanisms).

3. *Id.* at 1519.

4. *See* Felix Oberholzer-Gee & Dennis A. Yao, *Antitrust: What Role for Strategic Management Expertise*, 90 B.U. L. REV. 1457, 1464 (2010).

5. U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines, § 1, (2010) [hereinafter U.S. Merger Guidelines], available at http://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

6. *See* Interview by Elizabeth M. Bailey with Joseph Farrell, Dir., Bureau of Economics, FTC & Carl Shapiro, Deputy Assistant Attorney General for Economic Analysis, DOJ Antitrust Division (Feb. 2010).

antitrust. In fact, some literature suggests that antitrust enforcement based on traditional paradigms has not succeeded in achieving objectives like increasing consumer welfare.[7] This may be because for instance, contrary to the predictions of neoclassical economic theory, M&A has been found to reduce social welfare.[8] Accordingly, learning about firm behavior from disciplines other than neoclassical economics can strengthen the theoretical foundations of antitrust law by providing a more nuanced understanding of firm behavior and its impact on markets.

Today, antitrust law encounters a multitude of challenges globally, including critical divisiveness, disputes over its normative framework, new regulations, and calls for increased enforcement. This has come at a time when digital markets are ascendant, big tech firms are occupying prominent positions in multiple markets and COVID-19 has created systemic shocks. Under attack, the weakness of antitrust law also reflects weaknesses in the theory underlying antitrust enforcement. This suggests that there is a case for moving beyond a paradigm that is solely based on neoclassical economics.

A recent challenge confronted by antitrust law is that digital markets have incentivized firms to act in ways that may have been previously categorized as 'maverick.'[9] Therefore, what was previously considered the behavior of outliers in the market is now becoming commonplace market behavior. In particular, businesses have taken more aggressive competitive positions in digital markets. However, this has not necessarily resulted in more competitive markets. Competition in digital markets is strategic, and firm rivalry is tuned to achieving goals that are different from the optimizing behavior presumed in traditional economic models. Business models in digital markets involve sacrificing short-term goals for long-term goals and interests that may never be realized. Short-term survival and long-term growth are thus, key objectives in digital markets.

The strategic nature of digital markets is humorously depicted in the following dialogue from the popular television series on HBO called Silicon

7. *See* Orley Ashenfelter, Daniel Hosken & Matthew Weinberg, *Did Robert Bork Understate the Competitive Impact of Mergers? Evidence from Consummated Mergers*, 57 J.L. & ECON. S67, S96 (Aug. 2014); Robert W. Crandall & Clifford Winston, *Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence*, 17(4) J. ECON. PERSPECTIVES 3 (2003).

8. *See* Dennis C. Mueller & B. Burcin Yartoglu, *Efficiency vs. Market Power through Mergers*, *in* THE INTERNATIONAL HANDBOOK OF COMPETITION 57, 81 (Manfred Neumann & Jürgen Weigand eds., 2d ed., Edward Elgar Publishing Limited, 2013) (finding that for every merger that increases social welfare there are two mergers that reduce social welfare, where social welfare is defined as increasing efficiency and/or increasing profits or sales).

9. A maverick firm in antitrust law is one that plays a disruptive role in markets by generally favoring different strategic choices from their competitors. For instance, a firm that refuses to cooperate with industry norms or that insists on pricing aggressively may be considered a maverick. Merger guidelines in Europe and the U.S. explain the concept of a maverick firm. *See* U.S. Merger Guidelines, § 2; Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings, Council Regulation (EC) No. 139/2004, 2004/C 31/03, §20, §42, (Feb. 2004), http://eur-lex.europa.eu/legal- content/EN/TXT/PDF/ [hereinafter EC Merger Guidelines].

Valley, which is a parody of the business practices of Silicon Valley companies.[10] In the dialogue below, Hanneman, an investor, is advising Hendricks, the inexperienced new CEO of a start-up digital company, that having a profitable business is not the goal he should aspire to as it is not a winning strategy.

> Hanneman: No one wants to see revenue.
>
> Hendricks: Oh, uh I just thought that mainly the goal of companies is to make money.
>
> Hanneman: . . .That's not how it works. . . if you show revenue, people will ask how much, and it will never be enough. But if you have no revenue, you can say you're pre-revenue. You're a potential pure play. . . It's not about how much you earn but what you're worth. . .and who is worth the most? Companies that lose money.[11]

The static models of price theory are ill-equipped to explain firm conduct in situations of dynamic change and uncertainty that are a common feature of digital markets.[12] Further, scholars such as Levinthal have argued that the focus on rational decision-making has limited the understanding of how firms behave in market contexts, as there is a presumption that rationality provides the only true way of viewing the market rather than as one of many ways to do so.[13] The notion of the firm as a 'maximizer' has mathematical utility, but is inherently contradictory to human decision-making. Markets are complex systems created by human actors who are boundedly rational.[14] The significance of the limitations of human decision-making to economic behavior was recognized in the award of the Nobel Memorial Prize in Economic Sciences to Daniel Kahneman for his work in behavioral economics.

Yet the implications of bounded rationality have not been sufficiently studied in antitrust law. Bounded rationality refers to cognitive constraints in decision-making caused by human biases and limitations.[15] As managers of firms are boundedly rational, they do not maximize expected utility, but instead make decisions using other tools such as rules of thumb or heuristics.[16] Firms can be boundedly rational due to constraints in internal processes for decision-making, institutional structures such as organizational routines, or difficulties in learning

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10. Farhad Manjoo, *'Silicon Valley' Recap: It's Not About How Much You Earn*, N.Y. TIMES (Apr. 26, 2015), http://artsbeat.blogs.nytimes.com/2015/04/26/silicon-valley-recap-season-2-russ-hanneman/.

11. *Silicon Valley: Bad Money* (HBO Entertainment, Apr. 26, 2015).

12. *See* Marina Lao, *Reimagining Merger Law to Include Intent*, 77 EMORY L.J. 1035, 1037 (2022) (discussing the limitations of economic tools in assessing non-price, dynamic, future effects of a merger).

13. *See id.* at 1519.

14. For an overview and critique of the literature on boundedly rational actors in markets, see Shilpi Bhattacharya & Roger Van den Bergh, *The Contribution of Management Studies to Understanding Firm Behaviour and Antitrust Law*, 37(4) WORLD COMPETITION 517 (2014).

15. Reinhard Selten, *Bounded Rationality*, 146(4) J. INST. & THEORETICAL ECON. 649, 649 (1990).

16. Mie Augier, *Bounded Rationality*, THE PALGRAVE ENCYCLOPEDIA OF STRATEGIC MANAGEMENT (Mie Augier & David J. Teece eds., Palgrave Macmilan, 2016), 118, 120 https://link.springer.com/referenceworkentry/10.1057/978-1-349-94848-2_533-1.

and adapting to the environment, among other factors.[17] The Carnegie School[18] developed the concept of firm bounded rationality by drawing on scholarship inspired from the work of Cyert and March on the Behavioral Theory of the Firm.[19] Different fields within management studies such as strategic management apply concepts of firm bounded rationality to understand the real world behavior of firms.[20] For instance, competitive advantage is considered by certain scholars of strategic management to be a dominant motivator of firm decisions.

This paper explores how the review of mergers in U.S. and EU competition law may be enriched by moving beyond the strict confines of neoclassical economics to theoretical traditions drawn from behavioral views of the firm.[21] Merger review is an area where behavioral literature may be particularly useful.[22] Unlike other decisions of firms, these are often not profit maximizing[23] as acquisitions may be characterized as individual decisions of managers that are affected by managerial biases.[24] Moreover, acquisitions are common in digital markets and thus, the discussion in this paper will be of relevance to competition law in digital markets.

Existing literature in behavioral antitrust also notes that merger review is particularly conducive to behavioral insights.[25] For instance, Tor has probed the predictions of entry in neoclassical economic models and the role of efficiencies in merger analysis.[26] With respect to entry, Tor argued that neoclassical economic models can underestimate the likelihood of entry, or in some cases, magnify the pro-competitive effects of entry in overcoming the exercise of market power.[27] The existence of merger efficiencies has also been questioned.[28] This paper extends previous studies within behavioral antitrust by focusing on certain aspects of firm decision-making from the perspective of bounded rationality.

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17. *See* Bhattacharya & Van den Bergh, *supra* note 14.

18. For a perspective on The Carnegie School and its influence on transaction cost economics see Mie Augier, *Cyert, March and The Carnegie School*, THE ELGAR COMPANION TO TRANSACTION COST ECONOMICS (Peter G. Klein & Michael E. Sykuta eds., Edward Elgar, 2010).

19. One of the most influential works that inspired The Carnegie School was RICHARD M. CYERT & JAMES G. MARCH, A BEHAVIORAL THEORY OF THE FIRM (Prentice Hall, 1963).

20. *See* Thomas C. Powell, Dan Lovallo & Craig R. Fox, *Behavioral Strategy*, 32(13) STRATEGIC MGMT. J. 1369 (2011) (for an overview of the field that applies behavioral theory to business strategy).

21. *See* Bhattacharya & Van den Bergh, *supra* note 14 (discussing an overview of how the contributions of management studies and behavioral theories of the firm can strengthen competition law).

22. *See* Gregory J. Werden, Luke M. Froeb & Mikhael Shor, *Behavioral Antitrust and Merger Control*, 167(1) J. INST. & THEORETICAL ECON. 126 (Mar. 2011).

23. *Id.* at 199.

24. *See* Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59(2) J. BUS. 197, 199 (1986).

25. *See* Amanda P. Reeves & Maurice E. Stucke, *Behavioral Antitrust*, 86 IND. L.J. 1527, 1581 (2011).

26. Avishalom Tor, *Understanding Behavioral Antitrust*, 92 TEX. L. REV. 573, 602–05 (2013).

27. *See id.* at 603–05.

28. *See id.* at 602.

Within the context of merger review, this paper will focus on the law of potential competition. Potential competition has come under scrutiny in digital markets, and has behavioral implications. A potential competitor is one who intends to enter the market in the future, or is on the 'fringes' of the market and exerts a pro-competitive influence on firms in the relevant market merely by its presence on the fringes of the market.[29] The theory of actual potential competition addresses the competitive impact of an acquisition from the removal of future competition between the parties. The theory of perceived potential competition addresses the reduced competition because the present constraining influence of a firm on the fringes of a market is lost through the acquisition.[30] The U.S. Supreme Court has recognized that acquisitions that eliminate perceived potential competitors can have a negative effect on competition in the market.[31] Comparatively, the EC Merger Guidelines require that the potential competitor should exert a "significant constraining influence" or there should be a "significant likelihood" of the entities succeeding in exerting a competitive influence. The EC Merger Guidelines also state that "evidence that a potential competitor has plans to enter a market in a significant way could help the Commission to reach such a conclusion."[32] Competition agencies generally use economic theory to assess if firms have the ability and incentives to enter a market, but may also rely on reliable evidence of a firm's actual behavior.

The law of potential competition requires a strategic view of the firm as a responder to market potentialities. Furthermore, the law of potential competition suggests that how individual firms respond to market potentialities affects market outcomes. Thus, this is an area of antitrust law that is particularly conducive to the application of behavioral insights. For these reasons, this paper studies mergers where the potential competition doctrine was applied or should have been applied. This is done through two case studies. The first case study is an old one in the beer industry – the classic potential competition case of Falstaff's acquisition of Narragansett. The second one is a more recent and much-discussed case – Facebook's acquisition of WhatsApp.

These cases examine the firm's acquisition decisions in-depth, along with the view taken by courts and agencies of those decisions and questions whether neoclassical economics provided an accurate theoretical framework to assess these decisions. Case studies are a method for understanding firm behavior and were popularly used by The Carnegie School due to their unique ability to study

29. *See* Henry S. Klimowicz, *Reinvigorating the Perceived Potential Competition Theory: An Analysis of the Perceived Potential Competition Doctrine and FTC v. Steris Corp.*, 49 SETON HALL L. REV. 173, 177 (2018) (describing the difference between the actual and perceived potential competition doctrine as protecting future and present competition, respectively).

30. *See id.* at 177.

31. *Id.* at 175 (describing the adoption of the doctrine of potential competition in U.S. law). *See* FTC v. Proctor & Gamble Co., 386 U.S. 568, 578 (1967).

32. EC Merger Guidelines, *supra* note 9, at § 60.

firms while recognizing their heterogeneity. The case study method used in this paper is also an ode to the relevance of this method for behavioral studies.

The rest of this paper is divided as follows: Section I reviews the literature from behavioral studies and strategic management that pertains to firms' decisions to merge. Section II studies Falstaff's acquisition of Narragansett. Section III examines Facebook's acquisition of WhatsApp. The last section concludes.

I. BEHAVIORAL AND STRATEGIC VIEW OF MERGERS

Strategic management is concerned with understanding strategic behavior of firms, why some firms outperform others, and suggest ways by which firm performance can be improved.[33] Within this, the field of behavioral strategy develops on the premise that decision-making within a firm is constrained by the complexity of the environment in which a manager is located[34] as well as the manager's cognitive limitations. Since managerial decision-making is cognitively limited, the complexity and uncertainty of strategic environments make behavioral insights relevant to business strategy. As Levinthal explains while cautioning against the dominant application of neoclassical economic theory in this field, "all approaches to strategic decision making operate in the world of second best" and one approach should not be treated as superior to another.[35]

This section describes some of the vast behaviorally motivated literature on M&A within management studies to generally develop a behavioral and strategic view of M&A. The following discussion first describes the theory of bounded rationality of firms, then discusses theoretical as well as empirical studies on M&A decisions that use a behavioral perspective. Finally, it examines broader literature from strategic management that is relevant to understanding M&A.

A. M&A as a Behavioral Decision

Selten clarified that motivation, adaptation, and cognition are three aspects of human behavior which produce limits to rationality.[36] Motivation represents the objectives of human behavior.[37] Adaptation refers to routine learning

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33. *See* PHILIP BROMILEY, THE BEHAVIORAL FOUNDATIONS OF STRATEGIC MANAGEMENT 12 (Blackwell 2005).

34. *See* Christina Fang, *Behavioral Strategy*, *in* THE PALGRAVE ENCYCLOPEDIA OF STRATEGIC MANAGEMENT (Mie Augier & David J. Teece eds., Palgrave Macmilan, 2016), https://link.springer.com/referenceworkentry/10.1057/978-1-349-94848-2_15-1.

35. Levinthal, *supra* note 2, at 1522.

36. Reinhard Selten, *Features of Experimentally Observed Bounded Rationality*, 42 EUR. ECON. REV. 413, 414 (1998).

37. *Id.*

behavior without the use of reasoning.[38] This builds a connection between the actions of individuals and what they learn from their everyday experiences. Finally, cognition describes all conscious and unconscious reasoning processes of the human mind.[39] Cognitive limitations are often cited as the primary reason for bounded rationality.

Using empirical studies, members of 'The Carnegie School' have produced scholarship that has questioned the assumption in neoclassical economics that firms engage in maximizing behavior. Their work describes how decision-making in firms is compromised by internal conflicts, organizational structures, and decision processes. Firms employ a range of tools, including heuristics (rules of thumb), in their decision-making that cause bounded rationality.[40]

A substantial amount of literature describes how M&A decisions are boundedly rational. Acquisition decisions involve numerous considerations such as whether and why to undertake M&A, which of all possible companies are the most appropriate to acquire, how to structure and value the transaction, and how much to pay for targets.[41] Managers consider many possibilities and process vast amounts of information to make these decisions. To simplify the processing of all the variables and data involved in an acquisition decision, managers use perceptual processes or heuristics. This can make acquisition decisions subject to managerial biases.[42]

Managerial objectives play an important role in decisions to merge.[43] Managers might be more concerned with power, prestige, income, publicity, or career opportunities than firm profitability.[44] Roll was the first to propose managerial hubris as a factor behind acquisition decisions. There is now a wealth of literature that supports this view. Hubris occurs when managers are convinced that their valuations of a firm are correct, and that a decision to merge will lead to gains for the acquiring firm, even when there is little evidence to support these beliefs.[45] Hubris can cause managers to overestimate their own abilities, performance, and probability of success.[46] These effects are more prevalent for managers that have previously executed acquisitions successfully.[47] Hubris can

38. *Id.*

39. *Id.*

40. For instance, Cisco's acquisition strategy followed a simple rule that they would only acquire companies with fewer than 75 employees, 75% of whom were engineers.

41. *See* Irene M. Duhaime & Charles R. Schwenk, *Conjectures on Cognitive Simplification in Acquisition and Divestment Decision-Making*, 10(2) ACAD. MGMT. REV. 287 (Apr. 1985).

42. *See* Duhaime & Schwenk, *id.* at 288.

43. Randall Morck, Andrei Shleifer & Robert Vishny, *Do Managerial Objectives Drive Bad Acquisitions?* 45(1) J. FIN. 31 (1990).

44. Oliver Budzinski & Jürgen-Peter Kretschmer, *Implications of Unprofitable Horizontal Mergers*, 10(1) CONTEMP. ECON. 13, 14–15 (2016).

45. Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59(2) J. BUS. 197, 213 (1986).

46. Pasquale M Picone, Giovanni B Dagnino & Anna Minà, *A Multidisciplinary Appraisal of the Hubris Hypothesis and Proposed Research Agenda*, 28(4) ACAD. MGMT. PERSP. 447, 454 (2014).

47. *See id.* at 458.

lead managers to believe that market value does not represent the full value of the firm and should be disregarded in favor of managers' own valuations.[48] Hubris can also affect the performance of the firm post-acquisition as attempts to achieve efficiencies may not be realized.[49] It may also result in managers paying too much for an acquisition because they are likely to overestimate their ability to positively integrate and extract value from it.[50] An empirical examination of mergers measuring the distribution of gains and losses across the acquiring and acquired firms found that there was little empirical evidence to support the hypothesis that mergers are carried out to achieve efficiencies, and there was more empirical evidence to show that mergers are carried out because of managerial discretion and hubris.[51] Even though managers with hubris are aware that mergers are risky and on average cause losses to the acquiring firm, they still proceed with mergers because hubris leads them to believe that they are better than other managers at identifying and operationalizing mergers.

Managers may also be biased because of overconfidence and overestimate efficiencies and underestimate problems associated with mergers.[52] Overconfident CEOs are more likely to undertake value-reducing mergers.[53] In addition to overconfidence, CEO dominance also contributes to excessive merger activity as dominance increases the likelihood that a CEO can impose their overconfident views on the company.[54] Managers have also been documented to overestimate the extent to which they can control the outcome of an acquisition.[55] This results in managers not thoroughly evaluating acquisition candidates before deciding to acquire them.

Another bias associated with M&A is 'escalation of commitment.' This occurs when managers continue an M&A transaction, even if they realize it is no longer in the firm's best interest, because they feel they have already invested significant time and resources on the transaction.[56]

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48. *See* Roll, *supra* note 45, at 199.

49. *See* Picone, *supra* note 46, at 458.

50. *See* THOMAS STRAUB, REASONS FOR FREQUENT FAILURE IN MERGERS AND ACQUISITIONS: A COMPREHENSIVE ANALYSIS 48 (Ph.D. Dissertation, Deutscher Universitätsverlag, Gabler Edition Wissenschaft, Jul. 2007); Mathew L.A. Hayward & Donald C. Hambrick, *Explaining the Premiums Paid for Large Acquisitions: Evidence of CEO Hubris*, 42(1) ADMIN. SCI. Q.J. 103 (1997).

51. *See* Dennis C. Mueller & Mark L. Sirower, *The Causes of Mergers: Tests Based on the Gains to Acquiring Firms' Shareholders and the Size of Premia*, 24 MANAGERIAL DECISION ECON. 373 (2003).

52. *See* Jonathan B. Baker & Carl Shapiro, *Reinvigorating Horizontal Merger Enforcement*, *in*, HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST 235, 256 (Robert Pitofsky ed., Oxford University Press, 2009).

53. *See* Ulrike Malmendier & Geoffrey Tate, *Who Makes Acquisitions? CEO Overconfidence and the Market's Reaction*, 60(6) J. FIN. ECON. 20 (2008).

54. *See* Rayna Brown & Neal Sarma, *CEO Overconfidence, CEO Dominance and Corporate Acquisitions*, 59 J. ECON. & BUS. 358 (2007).

55. *See* Duhaime & Schwenk, *supra* note 41, at 289.

56. *See* Mario Schijven & Michael A. Hitt, *The Vicarious Wisdom of Crowds: Towards a Behavioral Perspective on Investor Reactions to Acquisition Announcements*, 33 STRATEGIC MGMT. J. 1247, 1252 (2012).

Empire building may also motivate M&A. Acquisitions and the legacy attached to them, whether a success or failure, can have a weighty impact on a manager's career. This can also explain why managers acquire companies despite past failures and predicted difficulties in undertaking M&A transactions.[57] According to Marris, "managements are likely to see the growth of their own organization as one of the best methods for satisfying personal needs and ambitions, an attitude which is reinforced by psychological tendencies to identify the ego with the organization."[58] For instance, the former CEO of Daimler-Benz used M&A as a tool for his ambition to make the company a global car manufacturer.[59] Another example of managerial egos being responsible for mergers is in the merger of Holcim and Lafarge, the two largest cement manufacturers in the world. The chairman of Holcim was about to retire and "wanted to end [his career] on a high" with a successful merger.[60] Even though the merger of Holcim and Lafarge was to be a merger of equals, personality and ego clashes between the top management of both companies ruffled feathers to such an extent that the success of the merger itself was threatened.[61]

Managerial biases are also reflected in the premiums paid for acquisitions. Acquisition premiums can represent the acquiring firm's view of the potential for efficiencies from the transaction. Higher premiums are used in economics as a signal for greater efficiencies from the acquisition.[62] However, one study found that managers' expectations of efficiencies from a merger did not correlate with the amount of premium paid by an acquiring firm, suggesting that efficiencies may be a means to get shareholder consent, while managers have other reasons for taking the decision.[63] There is also empirical evidence that managers consistently overpay for acquisitions for reasons described above: managerial hubris, escalation of commitment, cognitive biases, or agency considerations such as empire-building.[64] It is also argued that mergers that are financed by payments in stock rather than cash are more likely to be caused by managerial hubris or agency-related motives.[65] Managers use overvalued firm stock to undertake acquisitions that further personal goals.[66] Mergers motivated by

57. *See* STRAUB, *supra* note 50, at 48.

58. Robin Marris, *A Model of the "Managerial" Enterprise*, 77(2) Q.J. ECON.185, 187–82 (May, 1963).

59. *See Divorce Puts Paid to Car-making Dream*, FIN. TIMES (May 14, 2007).

60. *See* Sarah Gordon and Arash Massoudi, *Holcim & Lafarge: A Merger of Egos*, FIN. TIMES (Mar. 23, 2015),

61. *See id*.

62. *See* Schijven & Hitt, *supra* note 56, at 1251.

63. *See* Ahmed Ismail, *Does the Management's Forecast of Merger Synergies Explain the Premium Paid, the Method of Payment and Merger Motives?*, 40(4) FIN. MGMT. 879 (2011).

64. *See* Schijven & Hitt, *supra* note 56, at 1252.

65. *See* Hien Thu Nguyen et al., *Motives for Mergers and Acquisitions: Ex-Post Market Evidence from the US*, 39 J. BUS. FIN. & ACCT. 1357, 1369 (2012).

66. *See id*. at 1372.

empire-building are also said to more substantially reduce the long-term value of firms.[67]

Jemison and Sitkin describe M&A decisions in firms as negotiated results of decision-making processes, rather than as outcomes of rational choices.[68] Formal and informal processes, organizational routines, political interests, and the managers' former experiences can all affect decision-making within firms.[69] Sub-units within a firm can have different and conflicting goals, resources, and time horizons. In many cases, decisions can only be taken by resolving these differences through coalition building, bargaining, and conflict resolution.[70] Deeper issues with an acquisition may arise due to differences between and within firms.[71] Further, if both firms have different organizational cultures and routines, extracting value from M&A can be costly. For instance, in innovation mergers, M&A may reduce innovation when integration becomes very costly.[72]

Drawing on literature from organizational routines and managerial cognition, Amburgey and Miner argue that mergers are affected by a firm's strategic inertia, also referred to as strategic momentum.[73] This is a firm's tendency to repeat its previous strategic decisions in its responses to environmental changes, regardless of whether they were previously successful. Every time a firm undertakes an M&A transaction, they develop improved competencies in M&A, which further encourages this activity.[74] Amburgey and Miner found that strategic momentum does impact certain M&A decisions. A firm is likely to make repeated M&A decisions, particularly for product extension and horizontal mergers.[75]

In summary, decisions to merge are taken for a combination of reasons outlined above, such as managerial self-interest, market timing, efficiency, and hubris.[76] Ngyuyen, Yung and Sun helpfully classify the large variety of merger motives into value-increasing and value -decreasing motives.[77] The former is motivated by efficiencies, and the latter by agency considerations, managerial hubris, and timing.[78] The variability and complexity of merger motives suggests

67. *See id.* at 1369.

68. *See* David B. Jemison & Sim B. Sitkin, *Corporate Acquisitions: A Process Perspective*, 11(1) ACAD. MGMT. REV. 145 (1986).

69. *See* STRAUB, *supra* note 50, at 50–51.

70. *See* Thomas C. Powell et al., *Behavioral Strategy*, 32 STRATEGIC MGMT. J. 1369, 1375 (2011).

71. *See* PHILIPPE C. HASPESLAGH & DAVID B. JEMISON, MANAGING ACQUISITIONS: CREATING VALUE THROUGH CORPORATE RENEWAL (The Free Press ed. 1991).

72. Jaideep Anand & Yeolan Lee, *Acquisition Strategy*, *in*, THE PALGRAVE ENCYCLOPAEDIA OF STRATEGIC MGMT. (M. Augier & David Teece eds. 2016).

73. *See* Terrey L. Amburgey & Anne S. Miner, *Strategic Momentum: The Effects of Repetitive, Positional and Contextual Momentum on Merger Activity*, 13(5) STRATEGIC MGMT. J. 335 (1992).

74. *See id.* at 336.

75. *See id.* at 345.

76. *See* Nguyen et al., *supra* note 65, at 1372.

77. *See id.* at 1359.

78. *Id.*

that the presumption of a merger being profit maximizing for a firm is overly simplistic and carries weak presumptive power in determining firm behavior.

B. Strategic Management and Antitrust Law

The discussion in this sub-section highlights relevant literature from the broader (non-behavioral) field of strategic management as it relates to M&A and suggests how it may be useful to antitrust law.

M&A can be a firms' strategic decision or competitive tactic. Many acquisitions in digital markets, including 'killer acquisitions,' would fall within this category. Budzinski and Kretschmer argue that pre-emptive and defensive mergers, or mergers that are taken to pre-empt competitive threats, are rational even when unprofitable because they are less unprofitable for a firm than the consequences that would arise from the merger not occurring.[79] Haspeslagh and Jemison highlight that acquisitions are made to further a firm's strategic objectives.[80] Traditionally, these are size, growth and profitability. Another reason for M&A is to achieve greater market power.[81] Acquisitions may be a response to an emerging competitive threat, or a means to enter a new market and exploit market opportunities or to spread risks across industries.[82] In digital markets, M&A can occur in order to shift operations from core business into different markets or to protect against uncertainty in the competitive landscape. In industries with intense competitive rivalry, firms may engage in acquisitions to lessen their dependence on one or more products or markets.[83]

From a strategic management perspective, firms constantly search for opportunities to obtain a sustainable competitive advantage, and M&A is one such tool in the hands of managers to obtain an advantage over competitors. A firm has a competitive advantage when it implements a strategy which competitors are unable to duplicate or find it too costly to imitate.[84] However, no competitive advantage is permanent, and the question is of how long a competitive advantage will last.[85] Temporary advantages may play an important role in a firm's strategic decisions as managers value relief from competition, even when it is short-term. Thus, strategic M&A may not be profit-maximizing or value enhancing, but a means of survival or competitive posturing. This perspective of M&A activity as a way of obtaining competitive advantage can be useful to antitrust law as it suggests that authorities should give weight to

79. *See* Budzinski & Kretschmer, *supra* note 44, at 14–15.

80. *See* Haspeslagh & Jemison, *supra* note 71.

81. *See* Michael A. Hitt, R. Duane Ireland & Robert E. Hoskisson, *Strategic Management Concepts: Competitiveness and Globalization* 184 (8th ed., Southwestern Cengage Learning, 2009).

82. *See id.* at 183.

83. *See id.* at 190.

84. *See id.* at 5.

85. *See id.*

motives other than profit maximization in assessing the competitive impact of mergers.

Strategic management acknowledges the key role of firm management in making and guiding the strategic decisions of firms, including M&A decisions.[86] Managers in strategically managed companies commit to the firm's future and set ambitious goals which, if successful, have the potential to create a sustained competitive advantage for the firm.[87] Both planning and execution are key components of strategic management. The best plans are of no use if they are not effectively executed. Different managerial skills are required for making and executing plans. Antitrust law focuses much more on a firm's theoretical incentives to act rather than on its ability and willingness to successfully operationalize such acts. However, some case law does recognize the need to assess the means at the disposal of a firm to execute strategic entry decisions.[88] Furthermore, in dynamic markets, where market environments change quickly and significantly, the luxury of planning in order to make well-reasoned and informed decisions is often absent. Managers may also feel that time spent in planning decisions in these markets is waisted as market environments change in the time it takes to collect data and formulate plans.[89] Thus, antitrust law should consider placing weight on the likelihood of successful execution of M&A decisions in assessing the competitive impact of M&A.

A firm's strategy and behavior may be impacted by its CEO's feelings about time, both the focus on time and the urgency of time.[90] Managers' attitudes towards time have been linked to a firm's decisions to introduce new products, competitive aggressiveness, and corporate entrepreneurship.[91] This may be useful in understanding the urgency of some M&A decisions and the acquisition of nascent competitors. This suggests that it may be relevant for antitrust law to acknowledge that time may be viewed differently by firms based on managerial cognition or focus on time and that a firm's subjective view of time can play an important role in M&A decisions.

The literature on competitive dynamics (CD) and the resource based view (RBV) provide insight on mergers where firm decisions are based on the need to expand, integrate, re-evaluate or extend their existing resources and capabilities.[92] For instance, multi-market contact between firms in product

86. *See* Frederick W. Gluck, Stephen P. Kaufman & A. Steven Walleck, *Strategic Management for Competitive Advantage*, HARV. BUS. REV. (July 1980), https://hbr.org/1980/07/strategic-management-for-competitive-advantage.

87. *Id.*

88. *See* United States v. Crocker-Anglo Nat'l Bank, 277 F. Supp. 133, 184 (N.D. Cal. 1967).

89. *See* Gluck, Kaufman & Walleck, *supra* note 86.

90. Jianhong Chen & Sucheta Nandkarni, *It's about Time!: CEO's Temporal Dispositions, Temporal Leadership and Corporate Entrepreneurship*, 62 ADMIN. SCI. Q. 31, 31 (2017).

91. Ming-Jer Chen, John G. Michel & Wenchen Lin, *World's Apart?: Connecting Competitive Dynamics and the Resource Based View of the Firm*, 47(7) J. MGMT. 1820, 1834 (2021).

92. *See id.* at 1826.

markets reduces the rivalry or degree to which firms compete.[93] A firm's awareness and motivation to engage in competitive actions are affected by the extent to which a firm depends on a revenue stream and market overlaps with rivals.[94] This suggests viewing mergers with some degree of skepticism when a firm is entering new or allied markets where it is facing the same competitors that it faces in other markets. CD literature takes a firm specific view of competition that moves beyond a market specific analysis by examining the relationships between firms.[95] This literature may prove valuable to antitrust law as markets become increasingly fluid and less amenable to precise definition in digital contexts. The CD literature provides a valuable broader context to understand firm motivations and conduct.[96]

RBV shows how firm decisions are often based on the need to expand, integrate, re-evaluate, or extend their existing resources and capabilities.[97] For example, some firms engage in M&A to acquire new capabilities.[98] RBV may be particularly useful in understanding vertical and conglomerate mergers that are now coming under greater competition scrutiny. Acquiring firms with different skills and capabilities helps the acquiring firm access new knowledge and remain competitively relevant.

In summary, behavioral and strategic views of the firm show that greater attention must be paid within antitrust law to how firms are managed and their motivations for M&A. This should move beyond managerial experience to managerial culture, ethos, style, biases, and hubris. This understanding could enrich antitrust law in a number of ways. For instance, it may be possible to more accurately predict whether projected efficiencies or innovations will be achieved through M&A by examining the past and present managerial culture and ethos of the transacting firms. In addition, competition agencies should examine the likelihood of firms successfully executing decisions by considering operational management of firms. Agencies may also examine strategic momentum or inertia as another explanation for M&A behavior that departs from rationality. Managerial hubris and overconfidence may be assessed to determine whether claimed outcomes from M&A are likely to be achieved. Hubris may be present when deal values are at a premium. The timing of M&A and how they are financed may also play a role in assessing whether mergers are likely to be anticompetitive or whether efficiencies are likely to be achieved. Finally, and most importantly, competition agencies should consider that the ultimate objective of strategic firms is achieving sustained competitive advantage rather

93. *See id.* at 1832.
94. *Id.* at 1831.
95. *See id.* at 1835.
96. *See id.*
97. See *id.* at 1826.
98. *See* Philip M. Rosenzweig, *Managing Acquisitions: Creating Value through Corporate Renewal*, 18(2) ACAD. MGMT. REV. 370, 371 (Apr. 1993) (book review).

than profit maximization.[99] Managers concerned about the survival or growth of their firms may be willing to go to great lengths to ensure their safety and security in markets where threats are perceived. This can provide insights on a variety of firm behaviors, such as entry into markets despite high barriers to entry.

II. THE FALSTAFF CASE

This case study reveals that the law of potential competition should not solely rely on objective economic evidence of incentives and ability to enter. It should also assess a firm's subjective statements through a behavioral framework to determine whether a firm is a potential competitor. The law of potential competition is a unique area of antitrust law where a firm's decisions are relevant to the law and need to be assessed to determine if the firm is a potential competitor in a market. However, the law of potential competition is reluctant to take the firm's actual decisions into account[100] in predicting its likely actions. This is because of the view that the internal operations of a firm are a 'black box,' that cannot be comprehended. Furthermore, evidence collected from a firm may be self-serving.[101] However, with the development of the discipline of strategic management as well as behavioral studies of the firm, there is much better insight into when and how to account for a firm's subjective decisions and less reason for the law to disregard subjective firm decision-making as undecipherable.

In this context, the Falstaff case is interesting because it reveals the juxtaposition between objective and subjective views of the firm in antitrust law. In Falstaff, the Supreme Court clearly stated that firms would be viewed as rational, profit maximizers rather than as strategic, behaviorally-induced actors. In the words of Justice Marshall, who delivered a concurring opinion in the case:

> [I]n a case where the objective evidence strongly favors entry *de novo*, a firm which asks us to believe that it does not intend to enter *de novo* by implication asks us to believe that it does not intend to act in its own economic self-interest. But corporations are, after all, profit-making institutions, and, absent special circumstances, they can be expected to follow courses of action most likely to maximize profits.[102]

By examining Falstaff's decisions from the perspective of business strategy, the following discussion questions Justice Marshall's statement on firm behavior. This discussion begins with a background of the case, then follows

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99. *See* Chen et al., *supra* note 91, at 1826.

100. *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 533 (1973) ("The specific question . . . is not what Falstaff's internal company decisions were. . . .") [hereinafter Falstaff].

101. *See, e.g.*, Joseph F. Brodley, *Oligopoly Power Under the Sherman and Clayton Acts From Economic Theory to Legal Policy*, 19 STAN. L. REV. 285, 357–58 (1967).

102. *See* Falstaff, *supra* note 100, at 568.

with examining its factual context, and concludes by offering alternative theoretical explanations of Falstaff's behavior.

The government challenged the acquisition by Falstaff, the fourth largest beer producer in the U.S., of Narragansett, the largest beer seller in the New England area, on the theory that Falstaff's acquisition violated section 7 of the Clayton Act of 1914 because Falstaff was a potential entrant into the New England market and the acquisition eliminated competition that would have existed had Falstaff entered the market *de novo*.[103] The District Court rejected this argument and held that Falstaff was not a potential competitor since the evidence showed that Falstaff would never have entered the market other than through the present acquisition.[104] This lead to the U.S. Supreme Court's judgment in *United States v. Falstaff Brewing Corp* discussed here.[105] The Supreme Court disagreed with the District Court and held that it should have examined whether Falstaff was a potential competitor and exerted a competitive effect in the market by virtue of its presence on the fringes of the market.[106]

This case study focuses on aspects of the Supreme Court's judgment where it differed from the District Court with respect to whether Falstaff would have entered the market *de novo*. It does not address in much detail the court's assessment of Falstaff's influence over firms in the New England market due to its position on the fringes of the market.[107] The actual potential competitor doctrine examines Falstaff's entry *de novo* and the perceived potential competitor doctrine examines the competitive influence exerted by Falstaff by virtue of its presence on the fringes of the market.

Falstaff wanted to enter the New England market so that it could position itself as a national player in the brewing industry to more effectively compete against national companies.[108] The position as a national player held certain competitive advantages for Falstaff in terms of greater prestige, improved ability to advertise, and less exposure to local problems.[109] Falstaff had publicly expressed its desire to become a national player, which the court felt made Falstaff's intentions to enter the New England market known to its competitors,

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103. *See id.* at 530; *Legality of Brewery Purchase Remains Undecided*, 59 ABA J. 529.

104. *United States v. Falstaff Brewing Corp.* 332 F. Supp. 970 (D.R.I. 971) (1971).

105. *See* Falstaff, *supra* note 100, at 526.

106. *See id.* at 532–534.

107. Elzinga & Swisher note that the court ignored other more important issues in assessing the merger and if these issues had been examined the merger would have been allowed because the court would have found that it did not raise any concerns for competition. For instance, agencies would have used scanner data from retail sales to construct simulation models and measure the intensity of competition between Falstaff and Narragansett and would have found that the two companies were not selling products that were close substitutes of each other. *See* Kenneth G. Elzinga & Anthony W. Swisher, *The Supreme Court & Beer Mergers: From Pabst/Blatz to the DOJ-FTC Merger Guidelines*, 26(3) REV. INDUSTRIAL ORG. 245, 263 n.92 (May 2005).

108. *See* Falstaff, *supra* note 100, at 529.

109. *See id.* at 529.

who, as rational entities, would assume Falstaff to be a potential competitor in this market.[110]

Under the potential competition doctrine, the Supreme Court considered objective evidence such as Falstaff's incentives and ability to enter the market. The New England market was growing, Falstaff was one of the few companies with the ability to enter as a significant competitor, and it had substantial economic incentives to expand.[111] Given its incentives and ability to enter, the court felt that Falstaff could have rationally entered *de novo* or by means of 'toehold' acquisition (by acquiring a small brewery and expanding it).[112] As the following discussion shows, the court's view that "in most cases, subjective [managerial] statements contrary to objective evidence simply should not be believed"[113] ignored the larger managerial context in which the decisions were being made.

Prior to acquiring Narragansett, Falstaff commissioned Arthur D. Little to advise it on its business decisions. The Little Report recommended that Falstaff should enter several markets in which it was not operating, including New England, Chicago and Detroit. Furthermore, based on a review of cost estimates and the ratio of earnings to net worth, the Little Report advised that Falstaff should enter the Northeast by building a new brewery rather than by buying one.[114] The Little Report's recommendation that Falstaff should build a brewery was also based on evidence that Falstaff more profitably sold beer through its own branches.[115] All these factors provided a rational basis for entry *de novo*. Yet, despite its greater profitability, Falstaff sold very little of its beer through its own distribution channels. Falstaff's reluctance to use its own distribution channels despite the larger profits is a sign that factors other than profitability were governing decisions at Falstaff.

Accordingly, despite the recommendations of the Little Report, Falstaff's management insisted that acquiring a brewery was essential for a successful entry in New England.[116] Falstaff also reasoned that it could not estimate what sales it would achieve in New England so as to justify obtaining financing for building a brewery.[117] The basis for this reasoning is unclear, as Falstaff had hired an expert for the very purpose of providing it with this kind of market information

110. *See id.* at 533–36.

111. Brief of the United States before the Supreme Court of the United States in *USA v. Falstaff Brewing Corp.* 27 (1971) [hereinafter U.S.'s Falstaff brief].

112. *See id.* at 37–38.

113. Falstaff, *supra* note 100, at 569 ("in most cases subjective statements contrary to objective evidence simply should not be believed").

114. *See id.* at 529, 553.

115. *See* U.S.'s Falstaff brief, *supra* note 111, at 38.

116. *See* Falstaff, *supra* note 100, at 571.

117. Brief on behalf of Falstaff Brewing Corp. before the Supreme Court of United States in the matter of USA v. Falstaff Brewing Corp. 13, n.10 (1971) [hereinafter Company's Falstaff brief].

and also should have known the expected sales prior to deciding to buy a brewery.

The Little Report had previously recommended that Falstaff enter markets in Chicago and Detroit *de novo*. Falstaff followed these recommendations and attempted entry, which it described as "disastrous."[118] Falstaff's management felt that following the Little Report's recommendations did not work because it did not have strong distributorships to make *de novo* entry successful in those markets.[119] Falstaff's management was thus strongly influenced by its recent bad experiences of entering *de novo* in markets where it did not have established distributorships. The recent failures were amplified in the minds of Falstaff's management, making them unable to rationally assess the benefits of entering *de novo*.[120] This is called the availability heuristic.[121] Moreover, managers are selective processors of information, and their interpretation of it is affected by cognitive limitations and biases.[122] Confirmation bias postulates that individuals process information in a way that confirms their previously formed beliefs. Organizational frames of reference such as past outcomes may also impact an organization's ability to evaluate information and take decisions.[123] Therefore, Falstaff management's assessment of the Little Report may have been colored by the failure of recent entry decisions where it had relied on the recommendations of the Little report. This is evident from Falstaff management's statements highlighting these past bad experiences[124] and its subsequent conduct in looking for a brewery to acquire in New England.

Many New England breweries that were interested in being acquired had approached Falstaff between 1960 and 1964, but Falstaff rejected all these offers because it believed that each of these breweries lacked an effective distributorship and consequently, did not provide a meaningful prospect of entry into New England.[125] Falstaff's overt concern that the target must have a strong distributorship was also evident from the testimony of its President, who stated that the reason for the acquisition was "the distributorship purely and simply."[126] As stated in its Annual Report:

118. *Id*. at 16 n. 13.

119. *See id*. at 16.

120. *See* Company's Falstaff brief, *supra* note 117, at 20 (highlighting that Falstaff's management was conscious of recent failures in entering markets *de novo* and wanted to prevent those failures from re-occurring).

121. The availability heuristic shows that when evaluating decisions people rely on the most immediate instance of that decision that comes to mind.

122. *See* Ross Stagner, *Corporate Decision Making: An Empirical Study*, 53 J. APPLIED PSYCHOL. 1, 11–12 (1969).

123. Paul Shrivastava & Susan Schneider, *Organizational Frames of Reference*, 37 HUM. RELAT. 795 (1984).

124. *See* Company's Falstaff brief, *supra* note 117, at 20.

125. Company's Falstaff brief, *supra* note 117, at 12.

126. *Id*. at 13 n.10.

> The long-range principle benefits of this [Narragansett] acquisition are many, principally the acquisition of a large, modern plant and a strong marketing and *distributor organization* which can provide a springboard for the introduction of Falstaff beer into New England as a companion brand to the Narragansett products in that area.[127]

On the other hand, the government argued that entering *de novo* or by acquiring a small brewery was a rational business proposition because Falstaff had significant experience with buying smaller breweries and enlarging and modernizing them.[128] Falstaff and the government also differed in their views on the role of advertising in generating sales. The government argued that, based on Falstaff's past conduct, it could have generated enough sales to enter *de novo* if it invested in advertising. Here, Falstaff again pointed to its failure to establish itself in Detroit and Chicago to show that advertising did not always generate enough sales.[129] The losses incurred by entering into the markets in Detroit and Chicago had a deep impact on Falstaff, perhaps because this was its first big failure. In the 1950s, Falstaff had engaged in an aggressive campaign of growth through numerous acquisitions. Falstaff's annual reports showed that its managers were confident in the success of the various acquisitions as they expected these to follow the path of previously undertaken successful acquisitions.[130] However, Falstaff's tremendous growth through acquisitions peaked prior to the acquisition of Narragansett, after which its market position and sales declined dramatically.[131] The failures in Detroit and Chicago were not carefully examined by management.

This managerial behavior may not appear alien to students of behavioral theory. Management may have been reluctant to enter *de novo* if the risks involved in that decision were framed in their minds through the context of past failures in pursuing such entry. It is well established that the framing of risks as a gain or a loss affects decision-making and that decision-makers react differently to risk in the face of prior gains or losses.[132] In the case of high-risk managerial decisions such as M&A, literature has identified risk-taking in these decisions as more of a subjective assessment than an economic calculus.[133]

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127. FALSTAFF BREWING CORP., ANNUAL REPORT TO SHAREHOLDERS (1965) [hereinafter Falstaff Annual Report] (emphasis added).

128. *See* U.S.'s Falstaff brief, *supra* note 111, at 36.

129. *See* Company's Falstaff brief, *supra* note 117, at 40.

130. *See* Falstaff Annual Report, *supra* note 127.

131. *See id*.

132. Arijit Chatterjee & Donald C. Hambrick, *Executive Personality, Capability Cues & Risk Taking: How Narcissistic CEOs React to their Successes and Stumbles*, 56(2) ADMIN. SCI. Q. 202, 203 (2011) (citing a number of studies including Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice* 211 SCI. 453 (1981) and Richard Thaler & Eric Johnson, *Gambling with the House Money and Trying to Break Even: The Effects of Prior Outcomes on Risky Choice*, 36 MGMT. SCI. 643 (1990)).

133. *Id*. (surveying the literature).

Managerial confidence and optimism plays a key role in risk assessments.[134] Recent performance influences managerial expectations. For example, recent poor performance makes managers less willing to take risks.[135] Managers that exhibit risk-averse behavior may be more likely to prefer acquisitions to *de novo* entry due to the perceived additional risk and longer time frame needed to develop capabilities for entry internally within a firm.[136] Further, past managerial success can create destructive strategic persistence or the tendency to continue to take the same decisions that created past successes.[137] In this case, the past success achieved via acquisitions would amplify the benefits of continuing with a similar strategy. This would occur even when it is not in a firm's best interests to do so and prevents it from adapting to environmental changes.[138] In this case, Falstaff's management would be more reluctant to take on what they perceived to be the more risky and uncertain decision of *de novo* entry if the decision was framed in their mind in context to the prior losses of similar entry in other markets, thus diminishing their confidence in their ability to execute the Little Report's recommendations. This would be reinforced by the comfort of strategic persistence or falling back on what had worked in the past i.e. entry via acquisitions.

If the court had asked why Falstaff's management was so committed against entry *de novo* that they disregarded their own expert's advice, they may have found the reasons described above to be a "compelling demonstration" that Falstaff would not pursue its objective economic self-interest in this case.[139] Assuming that entry *de novo* was a more profitable option, as one commentator noted, potential profitability may not be the main cause for a firm's decision to enter a new market - other factors could play a role such as increasing sales, prestige, advertising costs.[140] It was clear in this case that a number of factors were taken into consideration in making this decision.

Many would agree that entry and acquisition are decisions made under uncertainty and therefore, are subject to errors. Even Justice Marshall conceded that managers can make mistakes in their assessment of objective market conditions since economic predictions are difficult and different people might reach different conclusions from the same data.[141] Moreover, an entrant's

134. *Id.*

135. *Id.* at 207, 225.

136. Amy L. Pablo, Sim B. Sitkin & David B Jemison, *Acquisition Decision Making Processes: The Central Role of Risk*, 22(5) J. MGMT. 723, 733 (1996).

137. *See* Pino G Audia, Edwin A Locke & Ken G Smith, *The Paradox of Success: An Archival and a Laboratory Study of Strategic Persistence Following Radical Environmental Change*, 43(5) ACAD. MGMT. J. 837 (2000).

138. *See id.*

139. Falstaff, *supra* note 100, at 525, 548.

140. *See* United States v. Falstaff Brewing Corporation: Potential Competition Re-examined, 72(4) MICH. L. REV. 837, 849 (Mar. 1974) [hereinafter Falstaff Case Review].

141. *See* Falstaff, *supra* note 100, at 3 n.19.

behavior cannot always be accurately predicted based on objective or subjective evidence.[142] This is evident from the fact that, even given a figure of projected profits, the experts in this case could not agree about if it was sufficient to induce *de novo* entry.[143] In the present case, economic evidence was interpreted quite differently by the management of Falstaff, the agency commissioned by Falstaff to study the market, and ultimately by the government and the courts with no consensus between them about whether entry by acquisition or entry *de novo* was more profitable.

Falstaff introduced substantial evidence during the trial to show that entry by acquisition would be more profitable for it in New England than entry *de novo*.[144] An independent economist testifying for Falstaff called the expected return on *de novo* entry as "a very, very poor investment indeed."[145] Further, as Falstaff argued, the government provided no evidence that entering *de novo* would provide an acceptable level of profit.[146] The majority opinion of the Supreme Court steered clear of this issue by sticking to the objective evidence - the financial condition of Falstaff and the characteristics of the New England market, which made it reasonable to consider Falstaff a potential entrant into that market.[147] Falstaff's own view of the market and the evidence it introduced was termed "subjective."[148]

Everyday observations of firm behavior confirms that managers of different firms can take very different decisions when faced with similar kinds of evidence about market conditions. The *Falstaff* dissent rejected the distinction between subjective and objective economic evidence, observing that economic decisions are all largely subjective.[149] In the words of Justice Rehnquist:

> In the instant case, Falstaff sought to prove why it was not in the 'economic self-interest' of that firm to enter a new geographic market without an established distribution system. Its explanation is as 'objective' as any of the evidence offered by the Government to show why a hypothetical Falstaff should enter the market.[150]

Notwithstanding Falstaff's fortunes, market conditions favored national breweries at that time and smaller firms like Falstaff felt the need to consolidate to remain competitive.[151] Yet, Falstaff's expansion was unsuccessful; its market share fell substantially in the years following the acquisition, while national

142. *See* Falstaff Case Review, *supra* note 140, at 859.
143. *See id.*
144. *See* Falstaff, *supra* note 100, at 554, 571.
145. Falstaff case review, *supra* note 140, at 857.
146. Company's Falstaff brief, *supra* note 117, at 13, 17.
147. *See* Falstaff, *supra* note 100, at 533.
148. *See id.* at 566.
149. *See id.* at 575.
150. *Id.* at 575–76.
151. *See Falstaff is Crying in Narragansett's Beer*, 59 ABA J. 105–57 (1973).

breweries gained market share.[152] Entry *de novo* may have caused Falstaff even greater losses in cost and demand conditions with low profit margins which required operating as closely as possible at optimal scale.[153] In fact, The reason that many New England breweries, including Narragansett, approached Falstaff to be acquired was so that they could achieve larger operational scale.[154] Paradoxically, the Falstaff decision was considered to be "zealous" merger enforcement aimed at protecting smaller firms and halting the trend towards concentration.[155] Yet, the Court's decision did not help to stop the trend toward concentration in the beer industry.[156]

In summary, this case study examined the dichotomy between objective and subjective evidence of firm decisions and whether the law's preference for objective evidence through the incentives and ability to enter are an accurate predictor of a firm's decisions. The court should not have presumed that Falstaff was a potential competitor because it was in Falstaff's economic interest to enter. Managers are guided by a number of factors, including behavioral biases which simplify decision-making under uncertainty. However, these biases may prevent managers from assessing what may otherwise be considered objectively the most profitable course of action. In this case, the disregard of the Little Report indicated the complexity of the decisions being made within Falstaff. Specifically, behavioral approaches show that management's subjective statements about future courses of action can be properly assessed within a definite theoretical context which includes the history of a firm's decisions, managerial risk and time perceptions, framing of decisions and strategic inertia. They can thus be incorporated into merger review rather than disregarded as untenable.

III. FACEBOOK'S (NOW META) ACQUISITION OF WHATSAPP

Gavin Belson [CEO of fictional Google-type company Hooli]: Let me acquire you.

Richard Hendricks [CEO of fictional start-up company Pied Piper]: What? No way.

Gavin Belson:. . .It's the perfect fit. You get my infrastructure, I get your speed, and I get it today rather than in a month or two. What's the downside?

Richard Hendricks: The downside is that everything I'm building becomes the property of your giant, soulless corporation.

Gavin Belson: And what exactly do you think you're building? You're out there

152. *See* Falstaff, *supra* note 100, at 530.

153. *See* Company's Falstaff brief, *supra* note 117, at 18; Falstaff case review, *supra* note 140, at 845.

154. *See* Company's Falstaff brief, *supra* note 117. at 5.

155. *See* Elzinga & Swisher, *supra* note 109, at 250, 261.

156. *See Falstaff is Crying in Narragansett's Beer*, *supra* note 153, at 1056–57.

> trying to get funding so you can hire people, scale up, roll out a product, IPO, and eventually become a publicly-traded what? Corporation.
>
> Richard Hendricks: We would be different.
>
> Gavin Belson: I see. I suppose once Pied Piper is a billion-dollar company, you'll seek out your competitors and help them. Please…you think you're building something different? No.[157]

The above dialogue is from the TV sitcom 'Silicon Valley' that follows Richard Hendricks as he tries to establish a disruptive technology startup. This fictionalized dialogue provides perceptive insights on real-world acquisitions of startup technology companies by larger companies such as WhatsApp by Facebook. A large company first tries to imitate the disruptive product of the small start-up company but fails to do so. It then tries to acquire the smaller, innovative company. In the TV show, the acquisition offer is rejected because Hendricks, the young and idealistic chief executive, wants to build a company that, in his words, would be "different" from a "giant soulless corporation." The older and more experienced Belson effectively calls this the hubris of Hendricks.

Like the fictional CEO Belson, did Zuckerberg acquire WhatsApp because they were "the perfect fit?" Business analysts conjectured that Facebook's interest in Instagram and WhatsApp arose because these companies provided more popular products/services than Facebook's own offering of a similar product/service that competed with Instagram and WhatsApp.[158] Scholarship also shows that Facebook tried to develop their own products to compete with WhatsApp, but were unable to do so successfully, which motivated the acquisition.[159]

Much has been written about the WhatsApp acquisition, given it is one of the most expensive Silicon Valley acquisitions. It is also commonly studied because Facebook's easily accessible internal documents show the decision-making process behind the acquisition. Managerial statements can help understand firm decisions that may not be understood by traditional economic theory. In the words of Lao, Facebook's managerial statements "tell a more accurate story of the competitive realities facing Facebook in its core business" than reliance on

157. *Silicon Valley: Runaway Devaluation* (HBO Entertainment, Apr. 19, 2015).

158. *See* Adam Hartung, *Disrupt to Thrive in 2011: Model Facebook, Groupon, Twitter* (Jan. 10, 2011), http://adamhartung.com/disrupt-to-thrive-in-2011-model-facebook-groupon-twitter/. At the time of the acquisition, Facebook Messenger had 200 million users compared to WhatsApp's 450 million, *See* Jillian D'Onfro, *Mark Zuckerberg Says That Facebook Messenger Has 200 Million Monthly Active Users*, Business Insider April 23, 2014, https://www.businessinsider.com/facebook-messenger-users-200-million-mau-2014-4.

159. *See* Mark Glick and Catherine Ruetschlin, *Big Tech Acquisitions and the Potential Competition Doctrine: The Case of Facebook* 1, 44–45 (Institute for New Economic Thinking, Working Paper No. 104, Oct. 2019).

traditional quantitative evidence.[160] They can help to understand "why a start-up that provided no more than mobile text messaging and had not yet turned a profit nevertheless held the promise of introducing innovation and competition in social networking."[161]

Merger enforcement is coming under greater scrutiny in digital markets.[162] Facebook's Instagram and WhatsApp acquisitions are used as examples of how strategic mergers can entrench market power.[163] This case study explores the question of whether Facebook and WhatsApp were potential competitors. To scholars of strategic management it may have been apparent at the time of the acquisition that the transaction would eliminate competition between potential competitors. The fact that this was not also apparent to antitrust experts reveals the need to move beyond traditional understandings of market definition to understandings of the nature of rivalry in digital markets. This discussion adds to existing insights through use of behavioral strategy and strategic management literature. The following sub-sections provide background on the acquisition, discuss the motivations behind it, and examine the competition between Facebook and WhatsApp.

A. Background

In October 2014, Facebook completed its acquisition of WhatsApp, a mobile communications service, for a landmark figure of $19 billion USD. The transaction was famously formed after WhatsApp's founder Jan Koum spent a few days at the home of Facebook's CEO Mark Zuckerberg. The transaction was sealed over a bottle of 'Jonnie Walker' scotch, indicating the negotiation's informal nature and the important role that the personalities heading these companies played in this acquisition.[164]

This acquisition raised competitive concerns in the EU; market data collected by the European Commission (hereinafter 'the Commission') suggested that the parties had a combined market share of 30% to 40% in messaging services in iOS and Android smartphones, which is much larger than other competitors.[165] In addition, the Commission noted that Facebook and WhatsApp's market shares were calculated based on the parties' own data, which may have underestimated actual market positions, but the Commission did not have sufficient data to

160. Lao, *supra* note 12, at 1064.

161. *Id.*

162. Elena Argentesi et al., *Merger Policy in Digital Markets: An Ex Post Assessment*, 17 J. COMPETITION L. & ECON. 95, 131–32 (2020).

163. John M. Yun, *Potential Competition and Nascent Competitors*, 4 CRITERION J. INNOV. 625, 629 (2019).

164. *See* Parmy Olson, *Facebook Closes $19 Billion WhatsApp Deal*, FORBES (Oct. 6, 2014), https://www.forbes.com/sites/parmyolson/2014/10/06/facebook-closes-19-billion-whatsapp-deal/?sh=465b24ca5c66.

165. *See* Commission Regulation 139/2004, 2014 O.J. 1, 17.

independently measure market shares.[166] However, the Commission noted that large market shares may not be sustainable in the fast-growing and dynamic market for communication apps and may not cause lasting damage to competition.[167] Ultimately the Commission cleared the acquisition for reasons similar to those described in the following paragraph.

The U.S. Federal Trade Commission (FTC) also cleared the WhatsApp acquisition in 2014 through a "narrow effects analysis." At that time the FTC concluded that WhatsApp was not a direct competitor of Facebook and that the acquisition was not expected to impact competition in any relevant market.[168] However, recently the FTC brought a monopolization complaint against Facebook, suggesting that its initial assessment was mistaken. The complaint argued that the WhatsApp and Instagram acquisitions were part of and contributed to a strategy to unlawfully maintain Facebook's position of market power.[169] There is a scholarly consensus that antitrust agencies globally should have examined the Instagram and WhatsApp acquisitions more carefully. Scholarship also calls for reform in antitrust laws to address the lacunae that led to the approval of these acquisitions without much examination. For instance, Lao hypothesizes that the reason the FTC allowed the WhatsApp acquisition was due to the FTC's belief that it could not look into intent evidence, or its unwillingness to do so.[170] Lao argues that intent evidence should be incorporated in merger review.

B. Acquisition Motives

If antitrust authorities were to shift perspectives and review the WhatsApp acquisition from the lens of business strategy, they may want to first ask what was motivating the acquisition? Once the strategic considerations for the acquisition are mapped, it can be used to characterize the acquisition as opportunistic or defensive. It may then be possible to draw antitrust conclusions about the nature of competition between the entities involved in the acquisition.

Strategic acquisitions of high-growth start-ups through payment of acquisition premiums has become an all too common business strategy in digital markets.[171] Ultimately, many of these acquisitions are made when the market is still nascent and reflect the manager's intuition and beliefs about future market

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166. *See id.* at § 97.

167. *See id.* at § 99.

168. Lao, *supra* note 12, at 1049.

169. *See* Complaint for Injunctive and Other Equitable Relief at 23–39, Fed. Trade Comm'n v. Facebook, Inc., (No. 1:20-CV-03590), 2021 WL 2643627, at *2–6.

170. *See* Lao, *supra* note 12, at 1063.

171. *See* David Gelles, *For Facebook, It's Users First and Profits Later*, N.Y. TIMES (Feb. 20, 2014), http://dealbook.nytimes.com/2014/02/20/for-facebook-its-users-first-and-profits-later/.

growth instead of rational calculations, as managers do not have sufficient information to make those calculations.[172]

A behavioral view of firms tells us that a firm's decision-making is affected by the management's personality. It is significant that the decision to acquire WhatsApp was finally made by Zuckerberg, who was known to have strong feelings towards entities that he perceived were or could become a competitive threat to Facebook.[173] The appearance of the words "threat," "hurt," and "vulnerable" in Facebook's internal documents in the context of its rivals is noteworthy.[174] Zuckerberg's approach is also evident from statements such as "we can likely always just buy any competitive start-ups."[175]

Facebook's primary strategic tool to gain competitive advantage has been defensive acquisitions of popular offerings. A defensive acquisition is one where the acquisition presents a means for the acquirer to obtain something, such as entry into a new market, whereas an opportunistic acquisition is one where the acquiring firm sees their ability to enhance the value of the target as the driver of the acquisition.[176] In the case of Facebook-WhatsApp, the analysis shows that the acquisition was a defensive one. Achieving sustained competitive advantage through growth in mobile users was an important objective for Facebook and Facebook was attracted to WhatsApp's faster growth rate in mobile users.[177] As an alternative to Facebook, commentators indicated that WhatsApp offered deeper social engagements in a setting that respected users' privacy.[178] Users also spent more time and engaged more on WhatsApp.[179] Some consider the primary motivation for the acquisition as WhatsApp's user base and Facebook's hope that it could be monetized.[180] Facebook needed to bolster the growth of new users, and the easiest way to get new users was via acquisition.[181] Moreover,

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172. *See* Lao, *supra* note 12, at 1058 (arguing that intent evidence should be considered for merger review as quantitative evidence is often unavailable for nascent acquisitions and stating that, "The acquiring firm's perceptions of the market and their competition are relevant pieces of evidence because it is reasonable to assume that firms understand better than anyone else the market in which they operate, how that market may be transformed over time, and where their strongest competitive threats lie.").

173. Facebook chat log between Kevin Systrom and Matt Cohler, House Committee on the Judiciary, Documents from the Hearing on "Online Platforms and Market Power: Examining the Dominance of Amazon, Apple, Facebook and Google" FTC IG0014307, https://judiciary.house.gov/online-platforms-and-market-power/#1 [hereinafter Facebook Documents].

174. *See, e.g. id.* at FB0015978 (stating "Instagram can hurt us more meaningfully. . . .").

175. *See id.*

176. Roger L Martin, *M&A: The One Thing You Need to Get Right*, HARV. BUS. REV. 42 (2016), https://hbr.org/2016/06/ma-the-one-thing-you-need-to-get-right.

177. *See* Matt Swider, *Why did Facebook Buy WhatsApp?*, TECH RADAR (Feb. 20, 2014), http://www.techradar.com/news/internet/web/what-s-up-with-facebook-buying-WhatsApp-it-s-about-the-developing-world-1226429.

178. Glick & Ruetschlin, *supra* note 159, at 42.

179. *Id.* at 43.

180. *See* Martin, *supra* note 176.

181. Peter Curwen, *WhatsUpp*, 16(3) INFO. (2014), http://www.emeraldinsight.com/doi/abs/10.1108/info-02-2014-0011.

WhatsApp's different organization and understanding of market trends would help Facebook to grow in markets where it would have likely lost out to WhatsApp.[182] With the benefit of hindsight, Facebook was right to worry about its flagship platform, as it lost market share in its core business but was greatly benefited by its ownership of Instagram and WhatsApp.

At the time of the acquisition, it was clear that Facebook would not be providing growth capital to WhatsApp in a way that WhatsApp could not have obtained itself as the market leader. Further, Facebook's managerial oversight of WhatsApp has been limited as WhatsApp's product and strategy has not significantly changed post-acquisition (at least in a beneficial way) and no significantly successful integration of WhatsApp and Facebook's products has taken place.[183]

When combined with the threat posed by WhatsApp, Facebook's acquisition may be characterized as a defensive one. It may also be thought of as a way to "buy time" to build relevant competitive capabilities. The competitive significance of the timing of acquisitions may be worth examining in dynamic and disruptive markets as executives have less time to rationally evaluate acquisitions in these markets. In fact, Zuckerberg clarified in an email regarding WhatsApp that "what we're really buying is time."[184] When a firm is buying time, it is easy to think of it as a defensive move to stave off competition in the market. Defensive acquisitions have been found to be on average less successful than opportunistic ones.[185] The opportunistic or defensive classifications may be a useful tool for competition agencies in assessing mergers.

C. WhatsApp as a Potential Competitor

Potential competitors may be loosely considered as those firms that will likely compete with each other in the future, or a firm that may be perceived by others to be a future entrant into a market and thus, exert a pro-competitive influence on the market.[186] While the theory of potential competition was not examined by agencies reviewing Facebook's acquisition of WhatsApp, the loss of potential competition in attention markets has been proposed as a theory of harm for Facebook's acquisition of Instagram and WhatsApp.[187] The failure to apply the potential competition doctrine to this transaction has led to calls to

182. *See* Hartung, *supra* note 158.
183. Martin, *supra* note 176.
184. Facebook Documents, *supra* note 173, at FB0015881.
185. Martin, *supra* note 176.
186. *See* Yun, *supra* note 163, at 629; Wilbur L. Tomlinson, *Potential Competition: Analysis of an Antitrust Case*, 44 MO. L. REV. 458 (1979) (identifying general principles in the law of potential competition).
187. *See* Argentesi, *supra* note 162, at 106–07; Andrea Pratt & Tomeso Valletti, *Attention Oligopoloy* (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3197930.

reform doctrine.[188] In the following discussion, the question asked is whether WhatsApp was a perceived potential competitor to Facebook and whether the acquisition removed possible future competition between the two.[189] The discussion examines these questions in the context of the Commission's order in the Facebook-WhatsApp case.[190] Additionally, this section assesses whether the Commission would have arrived at a different conclusion if it viewed competition from the lens of strategic management.

The Commission's assessment of competition between Facebook and WhatsApp started with the traditional framework of market definition. The Commission found that WhatsApp and Facebook competed in two different markets: the market for consumer communications services and the market for social networking services. The Commission stated that the main drivers of competition in the market for consumer communications were (i) the functionalities offered and (ii) the extent of the network.[191] On this basis, Facebook and WhatsApp were found to differ in (i) the way the services are accessed and contacts are formed and (ii) by offering different user experiences.[192] The Commission further noted that the primary parameter on which WhatsApp competed was to provide the best "communication experience," which means offering better functionalities such as by improving reliability and offering more privacy.[193] The Commission also found that WhatsApp competed more closely with Viber, while Facebook's messenger services competed more closely with Google's "Hangouts" service and with Twitter.[194] The Commission observed that consumers generally install and use several communication apps on their smartphones simultaneously, and in particular, many consumers install and use Facebook and WhatsApp at the same time.[195] Further, there were no unique features offered by Facebook or WhatsApp that were not also offered by the many other players in the market.[196] Thus, the Commission concluded that Facebook and WhatsApp did not compete with each other directly, but offered complementary services to users. Interestingly, in Congress hearings, Zuckerberg admitted that WhatsApp provided competing as well as complementary services to Facebook.

188. *See* Mark Glick, Catherine Ruetschlin & Darren Bush, *Big Tech's Buying Spree and the Failed Ideology of Antitrust Law*, 72 HASTINGS L.J. 465, 465 (2021).

189. The perceived potential competition doctrine has been validated by the U.S. Supreme Court and stands on a comparatively stronger foundation than the actual potential competition doctrine in U.S. jurisprudence. *See* Klimowicz, *supra* note 29, at 175, 181.

190. *See* Commission Regulation 139/2004, *supra* note 165.

191. *Id*. at § 86.

192. *See* HITT et al., *supra* note 82, at 8.

193. *See* Facebook / WhatsApp, *supra* note 165, at § 87.

194. *See id*. at § 106.

195. *See id*. at § 87.

196. *See id*. at § 104.

McGeown & Barthélemy described the Commission's decision in this case as providing "interesting insights into its thinking on closeness of competition."[197] It may be argued that the Commission completely misunderstood the parameters of competition in this market. By focusing on the characteristics of the services provided by Facebook and WhatsApp, the Commission misunderstood that product differentiation is a common feature of competition in digital markets. In these markets, competition is often for the market and platforms provide slightly differentiated products in order to attract users, obtain network effects, and ultimately capture the market. Therefore, the very difference in factors of functionality and networks that the Commission considered to differentiate the markets in which Facebook and WhatsApp compete posed a competitive threat to Facebook. Instead, user engagement rather than functionality or privacy was the key parameter of product design and competition in this market. Moreover, while WhatsApp did compete with Viber, its ambition likely extended beyond that. In Zuckerberg's view, Facebook competed much more closely with WhatsApp than it did with other products like Google Hangouts.

With respect to the market for social networking services, the Commission examined whether WhatsApp was a potential entrant in this market. The EC Merger Guidelines state that mergers with a potential competitor are anticompetitive only if the potential competitor already exerts a significant constraining influence, or there is a significant likelihood that it will grow into an effective competitive force.[198] Keeping questions of whether this is a suitable standard for assessing potential competition in digital markets aside. In this case, the Commission did not examine whether or what kind of influence WhatsApp exerted on Facebook. Several third-party respondents to questionnaires sent by the Commission were of the view that, absent the acquisition, WhatsApp would have competed with Facebook in the provision of social networking services; other respondents were of the view that WhatsApp was already competing with Facebook in the market for social networking services.[199] However, the Commission did not consider WhatsApp to be a potential competitor to Facebook in the market for social networking services because it did not discover any indication that WhatsApp would enter the market and compete with Facebook.[200] The Commission concluded that Facebook and WhatsApp served different markets and fulfilled different consumer needs.[201] Here, the Commission was wrong to not further explore the third-party responses, which

197. Paul McGeown & Aude Barthélemy, *Recent Developments in EU Merger Control 2014*, 6(6) J. EUR. COMPETITION L. & PRACTICE 440, 448 (June, 2015) (stating that the Commission feels that parties with different business models are less likely to constrain each other even if they sell the same product).

198. *See* EC Merger Guidelines, *supra* note 9, at § 60.

199. *See* Commission Regulation 139/2004, *supra* note 165, at § 144.

200. *See id.* at § 145.

201. *See id.* at § 157–158.

suggested that WhatsApp was gradually providing more of the same services that Facebook was providing on its platform, such as sharing of content between groups of people. These features are allowing consumers to use WhatsApp instead of Facebook for more kinds of social engagement and networking activities. The Commission could have further explored the trends in the use of Facebook and WhatsApp over time and whether consumers were increasingly using WhatsApp for activities that they previously performed using Facebook. The acquisition could curtail WhatsApp's development of many services in competition with Facebook in the future.

Ultimately, the Commission did not make a definite statement about whether WhatsApp was a competitor to Facebook in social networking services. The Commission felt that including WhatsApp in this market would also introduce many other players into this market and therefore, the acquisition would not significantly increase concentration in this market. Here, it is worth noting that WhatsApp was the fastest growing and diversifying firm among those competitors, and therefore, was more likely to be a competitor to Facebook than any other consumer communication app.

The Commission's narrow understanding of the boundaries in which Facebook competed contrasts with Facebook's own broad competitive positioning and strategic goals, as evident from this statement by Zuckerberg announcing the acquisition: "our mission is to make the world more open and connected. We do this by building services that help people share any type of content with any group of people they want."[202] Facebook's internal documents revealed that pre-acquisition, Facebook viewed WhatsApp as a "pure competitor" and a potential replacement for Facebook.[203] In an email exchange with David Ebersman regarding Facebook's acquisition strategy for companies like WhatsApp, Zuckerberg stated that his goals for the acquisitions were to "neutralize a potential competitor" as well as to integrate their products into Facebook.[204] Facebook also kept a list of strategic competitors, and WhatsApp was a key part of that list. Facebook was concerned that the changing market for communication services, and growing consumer preferences for mobile technology would erode the value of Facebook's flagship platform in the future.[205]

The Commission's splitting hairs over communication versus networking markets was not helpful to its understanding of market dynamics in digital

202. *Facebook buys WhatsApp: Mark Zuckerberg Explains Why*, TELEGRAPH (Feb. 19, 2014), https://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/digital-media/10650340/Facebook-buys-WhatsApp-Mark-Zuckerberg-explains-why.html.

203. Sam Schechner & Parmy Olson, *Facebook Feared WhatsApp Threat Ahead of 2014 Purchase, Documents Show*, WALL ST. J. (Nov. 6, 2019), https://www.wsj.com/articles/facebook-feared-whatsapp-threat-ahead-of-2014-purchase-documents-show-11573075742.

204. Facebook Documents, *supra* note 173, at FB00015881.

205. *See* Glick & Ruetschlin, *supra* note 159, at 44.

markets. The nature of rivalry is an important consideration in the analysis of mergers. However, in dynamic markets, the focus may need to shift from the contours of competition within a market to the relationship and rivalry between specific firms regardless of the relevant markets to which they belong. This is because, in digital markets, competition is often for the market, and a particular entity not competing within a market may nevertheless have the ability to disrupt the market as a whole.[206] The competitive dynamics literature may prove useful here as it considers the extent to which two firms share markets and the importance of the market for each firm.[207] Not all firms in an industry compete with each other to the same degree; some markets have more strategic importance for certain firms than others and competitive positions between firms are not always symmetric.[208] Some firms within an industry share more markets with each other than with other firms in the same industry. The "space" or market in which firms exist is less relevant, as firms are constantly moving across different spaces, being driven by where their competitive advantage lies. Competition authorities could determine whether firms are potential competitors by examining the source of their comparative advantage along with their strategic objectives. In this case, WhatsApp's growing user base was a significant competitive concern to Facebook. Facebook's management repeatedly expressed concern that an independent WhatsApp could and would build on its features to develop social networking functions and become a closer substitute to Facebook.[209] Lao's work identifies a number of Facebook managerial statements, including Zuckerberg himself expressing concern that mobile messaging apps would eventually grow into "more general mobile social networks" and eat into Facebook's core market.[210]

This case makes it evident that staying within traditional frameworks of antitrust law can limit the assessment of competition in some markets. Literature from management studies can guide competition law in determining when defining markets and product substitutability may not be helpful in assessing the degree of competition between firms. The Commission's focus on product features was ultimately unhelpful to its analysis. Products in digital markets may not be entirely overlapping, and entrants are likely to offer only some of the

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206. Competition for the market refers to competition to create a new standard or identity for the market. For a description of competition for the market see P.A. Geroski, *Competition in Markets and Competition for Markets*, 3 J. INDUS. COMPETITION TRADE 151 (2003). In markets that are characterized by network effects, it is generally accepted that competition is for the market as an entity that attracts the largest user base can tip the market in its favor. *See e.g.* Argentesi, *supra* note 162, at 20–21.

207. *See* Ming-Jer Chen, *Competitor Analysis and Inter-Firm Rivalry: Towards a Theoretical Integration*, 21(1) ACAD. MGMT. REV. 100, 106, 120 (Jan. 1996).

208. *See id.* at 106.

209. Lao, *supra* note 12, at 1062 (citing Complaint for Injunctive and Other Equitable Relief, *supra* note 169, at 6, 32–33).

210. *Id.* at 1063 (citing Complaint for Injunctive and Other Equitable Relief, *supra* note 169).

features offered by incumbents.[211] On the other hand, if the Commission had considered Facebook as seeking to sustain its competitive advantage in competing for the market, it would have been open to viewing WhatsApp as a potential competitor that could disrupt the market. Facebook's internal documents reveal what may be described as a hyper-competitive firm, carefully monitoring outward environmental changes to ensure it was not missing out on new market opportunities that may take away its competitive advantage. To such a firm, it was WhatsApp's key metrics in terms of its number of users, growth of new users, and intensity of use on mobile phones that made it a potential competitor, as these were the metrics on which Facebook was competing.[212] Even Facebook's Annual Report identified "mobile applications with competing social features including text messaging, voice, image, and video sharing as a key source of competition for the network."[213] Looking at the parameters of competition between Facebook and WhatsApp would have greatly helped the Commission to understand that the source of competition did not lie in the features of the products offered by the parties. This case study reveals the importance of developing an overall view of competition by assessing internal company documents, views of competitors and consumers within a broader theoretical context of firm behavior. Characterizing acquisitions as defensive or opportunistic may be a helpful way to bring in these diverse theoretical contexts into competition law's understanding of how an acquisition will impact competition.

CONCLUSION

The purpose of this article has been to present a credible alternative framework of firm behavior and examine its relevance to the review of mergers in antitrust law. The paper has shown one way in which such frameworks may be articulated and used in situations where the law is seeking to determine firm decisions. The question remains as to whether these frameworks are normatively relevant; this paper does not address that question. More work must be done before these perspectives can be integrated into merger analysis. The case studies discussed provide the opportunity for more in-depth analysis, but have the limitation of lacking easily generalizable conclusions. In the two case studies undertaken in this paper, the courts/agencies were hampered in their ability to understand firm conduct by the framework of neoclassical economics and the assumption of firm rationality. In the Falstaff case, Justice Marshall's statement that subjective interpretation of firm decisions should be rejected in favor of objective evidence was shown to be a limited predictor of Falstaff's decisions.

211. *See* Glick & Ruetschlin, *supra* note 159, at 39.
212. *See* Swider, *supra* note 180.
213. Glick & Ruetschlin, *supra* note 159, at 44.

Further, in the Facebook case, the Commission was restricted by its determination of the different drivers of competition in social network and consumer communication markets. Instead, the Commission should have considered that maintaining a competitive advantage is a key motivator of firm behavior in digital markets. The Commission is already using tools of analysis that are adapted from business studies to determine the closeness of competition between merging parties.[214] This analysis, though preliminary, demonstrates that it will benefit antitrust law to incorporate insights from a diversity of disciplines. It also provides ways in which these insights can be useful to antitrust law. More work in this field will help to make the place of strategic management within antitrust law clearer.

214. In *Crown Holdings*, the Commission examined the competitive advantages of the merging parties vis-à-vis competitors in the market to see if the merging parties were close competitors. This analysis is very similar to the kind carried out in business strategy. *See* McGeown & Barthélemy, *supra* note 197, at 448–49 (analysing *Crown Holdings / Mivisa*, Commission of the European Communities Decision No. M.7104 (Mar. 14, 2014), http://ec.europa.eu/competition/mergers/cases/decisions/m7104_20140314_20212_3612433_EN.pdf).