

**Baker
McKenzie.**

Competition in the Digital Economy

An African Perspective

Introduction

Digitisation has ushered in an era of hyper-connectivity, marked by disruptive digital platforms that operate on a global scale.

According to Baker McKenzie's analysis of Refinitiv Data, 37 cross-border merger and acquisition (M&A) deals in Africa have been announced in the technology, media and communications (TMT) sector in 2021 thus far, valued at USD 768 million. In 2020, 42 deals were announced in this sector, valued at USD 876 million. The deal volume in the TMT sector has remained relatively constant since 2016 (44 deals), with 39 deals in 2017, 40 deals in 2018 and 44 deals in 2019. Deals in the TMT space were valued at USD 1 billion in 2016, USD 2.7 billion in 2017, USD 349 million in 2018 and USD 1.77 billion in 2019. The target jurisdictions in 2020 and 2021 were predominantly in South Africa, Egypt, Kenya and Nigeria, with Botswana, Chad, Ghana, Liberia, Madagascar, Morocco, Tanzania and Tunisia also being jurisdictions in which deals in the TMT space occurred in the last two years.

Boston Consulting Group (BCG) observed that the growth of M&A in the technology space in Africa has indeed been consistent with global trends. BCG noted in its report – **What's New and Next for M&A in Africa** – that fundraising for technology players increased by 64% per year from 2015 to 2019, mostly in investments with a fintech focus. BCG demonstrated the manner in which startups in three countries – Nigeria, Kenya, and South Africa – captured 80% of the capital available in this timeframe. The consulting firm further illustrated

how the pandemic had accelerated growth in tech emergence in Africa, especially in the financial services, telecommunications and retail sectors, with the healthcare and consumer goods sectors also demonstrating marginal acceleration.

There is, of course, the appreciation by businesses and competition authorities that digital markets are characterised by, among other things, multi-sided platforms, large returns to scale and complex network effects. As a result, competition authorities are increasingly presenting novel theories of anticompetitive harm, which, unlike those in the more traditional markets, are yet to be tested.

This rapid rise of the digital economy has forced competition authorities around the world to question whether features of digital markets necessitate a more nuanced approach to competition regulation. From an African perspective, this dynamic evolution of markets presents an opportunity to drive structural transformation and development, as market participants integrate to reach consumers and suppliers that would otherwise be inaccessible. To achieve this, competition authorities would need to balance the importance of upholding the regulatory process, on the one hand, with the promotion of innovation and investment on the other.



This report identifies the common themes related to merger control, abuse of dominance and cartel conduct in Africa, which point to the nexus between competition regulation and the digital economy.





Merger Control

Merger control is utilised by competition authorities across the globe as a proactive and highly effective tool in advancing competition policy objectives.

At its core, merger control is a forward-looking exercise that aims to predict the likely effects of a merger on the competitive dynamics of a particular market as well as, in some countries, the public interest.

The effectiveness of merger control as a means of furthering competition policy objectives is, however, largely dependent on the competition authorities' ability to avoid two types of errors. These errors are: (i) false positives, which occur when a merger that should have been permitted is blocked; and (ii) false negatives, which occur when a merger that should have been prohibited is approved and consequently, implemented.

It has been argued that the likelihood of false positives in the context of mergers involving major digital platforms is limited on account of the competition authorities' ostensible proclivity to approve digital transactions. Meanwhile, competition authorities increasingly perceive false negatives as being a more probable eventuality in the context of digital transactions, suggesting that there has been inadequate enforcement in this sector. This brings to the fore the question as to whether the competition authorities are adequately equipped and suitably resourced to consider mergers in digital markets and, if not, what solutions can be adopted to address any existing constraints.



MARKET DEFINITION

Market definition is indispensable to any assessment of the impact of a merger on competition – in order to quantify impact, the market in which the assessment must take place needs to be determined. Mergers can raise competition concerns if they increase the ability of firms to exercise market power within the defined market. This is often (but not always) the case where the parties to the merger possess high market shares.

However, market definition is becoming more intricate in the evolving digital era, especially in relation to so-called zero-price markets. These markets are characterised as markets where users of products or services do not pay money for the use. A common example of zero-price markets is social networks; users do not pay for using social networks, such as Facebook, Twitter, or Instagram. Competition authorities are contemplating how to define the relevant market in such a case.

In the case of two-sided platforms (which provide the platform for e-commerce marketplaces and bring together two different but interdependent user groups), market definition raises a number of issues that do not arise in conventional markets. In market environments with two-sided platforms, the question arises as to whether the relationship between the platform and the respective market sides can be considered separate markets or whether there is a single market. There is also the issue of whether there are circumstances under which a market can be viewed in isolation of the other side or whether the interplay between both sides ought always to be taken into account. Following theoretical debates on this issue, one approach is to define a market for each side. Thus, each of the two markets can be analysed separately while taking into account that they are linked through cross-group effects. This is referred to as the “multi-markets approach”.

An alternative approach is to define a single market for an intermediation service offered to both sides of the market. This is referred to as the “single-market approach”.

The application of competition law often requires an assessment of market power. In the context of two-sided platforms, high market shares are a less likely a proxy for the existence or otherwise of market power. High overall profitability may be an indication that a platform has market power in some of the markets in which it is active. Equally, however, low overall profits or losses are not proof of the absence of market power.

One of the emerging views is that because market boundaries are difficult to define and change rapidly in the case of platform markets, less importance should be placed on market definition in the competition assessment and more emphasis should instead be placed on the theories of harm and identification of anticompetitive strategies. This view is compounded by the methodological problems associated with applying traditional economic tests (such as the SSNIP/SSNDQ test) when defining markets – although these remains useful, at least as a thought experiment when considering demand-side substitutability.



MERGER THRESHOLDS

As a means of accommodating the competition authorities’ naturally limited resources, many jurisdictions have adopted merger control thresholds. Put differently, it is commonplace for mergers to be notifiable and subject to evaluation only where the merging parties meet certain financial thresholds, usually in terms of turnover figures and asset values or market share thresholds.

An unexpected consequence of the use of financial thresholds, however, is that mergers with meaningful effects in digital markets may, in certain circumstances, fall well below the prescribed monetary thresholds, with the result that market-altering transactions are able to escape scrutiny by the competition authorities. This would occur where a nascent firm operating in the digital space does not yet record a significant turnover or have sufficient assets to meet the relevant notifiability thresholds. Compounding this concern is the threat “merger creep”, where numerous small start-ups are acquired through transactions that may

appear relatively inconsequential on an individual basis but, when considered collectively, may have significant competition implications for the market.

Competition authorities argue that the traditional financial threshold-based approach to merger notifiability may need to be reconsidered and, perhaps, replaced in light of the dynamics of the digital market. This has led competition authorities to theorise as to the most appropriate metric for merger threshold assessments when considering the notifiability of mergers in digital markets. As an example, South Africa is considering a combination of deal value and market share metrics in this initial assessment around whether the transaction should be compulsorily notified.



KILLER ACQUISITIONS

The term “killer acquisitions” is used to describe the practice of acquiring start-ups or nascent firms in competing or complementary markets with the objective of extinguishing them before they can develop into formidable competitors. Since small-scale acquisitions do not trigger mandatory notifications in most jurisdictions, firms can effectively remove rival firms to avoid future competitive constraints.

Killer acquisitions are not new to competition authorities. In fact, they have been considered prevalent in the pharmaceutical sector. The perception held by competition authorities is that killer acquisitions are also a common feature of digital markets. Merger transactions may have the effect of eliminating a competitor in the market. As such, competition authorities intervene to ensure that merger transactions do not reduce market contestability or result in consumer harm (by, for instance, reducing consumer choice).

A key attribute of digital markets is the acquisition of small start-ups by large firms. Start-ups often need to be acquired to access the capital required to scale-up, leading to procompetitive effects. Africa has the fastest growing tech start-up ecosystem in the world – going forward, competition authorities will likely pay close attention to determining and distinguishing between procompetitive acquisitions intended to expand or improve product offerings from those that have the object of eliminating competition.

In South Africa, this concern has prompted the competition authority to apply greater scrutiny to digital transactions that would ordinarily not warrant notification. In addition, the South African competition authorities recently published its proposed amendments to the Small Merger Guidelines, which call for notification of small merger transactions involving digital market players based on deal value (which is significantly lower and has the consequence of capturing transactions involving start-ups) and/or the parties’ market shares.

Across Africa, competition authorities acknowledge the need for scrutiny in transactions affecting digital markets. The accelerated reliance on digital connectivity precipitated by the COVID-19 pandemic has forced authorities to anticipate how competition and consumer welfare can be impacted without conducting market-wide analyses into the effects of such transaction. It seems that a more vigilant and protectionist enforcement approach may be adopted in relation to transactions in digital markets.



Abuse of Dominance

Firms that hold a dominant position must conduct their commercial dealings in a manner, that does not amount to an abuse of dominance.

Digital markets are characterised by, amongst other things, strong multi-sided network effects, high start-up costs, low variable costs, and economies of scale, which result in a small number of incumbents holding significant market share.

Competition authorities have, through years of market enforcement, identified conduct that, if undertaken by dominant firms, may result in harm to competition. In the context of digital markets, the issue is whether existing theories of harm apply to digital markets or whether new theories of harm should be formulated and considered. In addition, it is not clear how certain abusive

conduct arising in digital markets will be assessed. In terms of the existing framework, certain conduct is automatically deemed to constitute a breach of competition with no room for the advancement of procompetitive justifications, while others are analysed by reference to the effects of the conduct on competition.

SELF-PREFERENCING

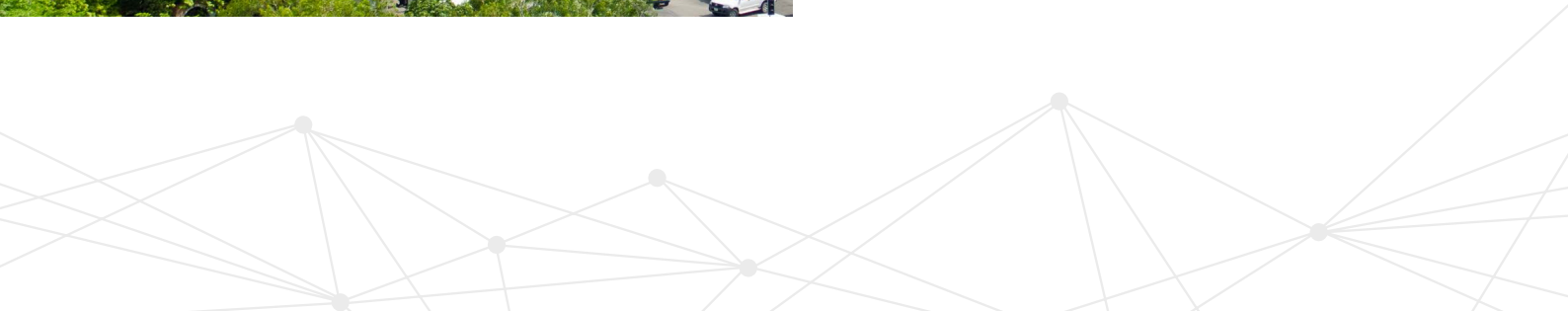
Self-preferencing is the act of giving preference to your products or services (which are often vertically integrated) over those of your rivals. Dominant firms operating in two-sided markets may leverage the market power they possess on one side of the market, to gain an advantage in the other.

Competition authorities have identified self-preferencing as potentially harmful competitive conduct that has the effect of entrenching dominance and excluding competitors. Conceptually, self-preferencing could, in and of itself, constitute an exclusionary act; however, it also overlaps with other conduct that might constitute an abuse of a dominant position such as tying or bundling arrangements, refusal to supply, and discriminatory conduct.

ACQUISITION OF DATA

It is estimated that 2.5 quintillion bytes of data is generated per person, per day through internet use. The ability to acquire, process and analyse large volumes of data gives dominant firms a comparative advantage in the digital market.

The accumulation and use of data have the potential to increase the market power of large digital firms. Concerns can be further exacerbated



if dominant firms leverage consumer information collected on one side of the market to gain an advantage in the other.

Competition authorities are concerned that firms may look to exploit user data to exclude rivals. Given its importance in the digital market, it has been debated whether data can constitute an “essential facility” and, if so, to what extent the refusal to grant access to large datasets may constitute anticompetitive conduct.

In order for data to be an “essential facility” it needs to comprise a resource that cannot be easily duplicated and without access to which competitors cannot reasonably provide products or services to customers. In South Africa, a dominant owner of an “essential facility” would risk abusing its dominance if it refuses to grant access to such facility to its competitors where it is economically feasible to do so.

There are several difficulties associated with treating data as an “essential facility” and forcing data owners to share it with competitors. Data is ubiquitous and replicable. Therefore, the same data collected by data-rich entities may already be accessible to other parties. Furthermore, given that data varies in its value and usefulness (which is extracted through use of proprietary algorithms), it cannot be guaranteed that the data held by one entity is essential for the market participation of another entity. Placing an onerous obligation on data-rich firms to share data may also enable competitors to reverse-engineer proprietary algorithms and, in so doing, encourage free riding.

Ultimately, this will deter investment in large-scale data-collection and innovation into data driven platforms. Additionally, obligations to transfer data to competitors may give rise to data privacy concerns, particularly with the recent advent of more stringent privacy legislation in South Africa and around the world.



USE OF ALGORITHMS

In simple terms, an algorithm is a computational formula, procedure, or set of instructions designed to perform a specific task through a sequence of specified actions. In digital markets, algorithms are adopted to collect, analyse and process data. There is growing concern that algorithms can result in exclusionary anti-competitive conduct and consumer harm. Potential theories of harm that are emerging include: (i) the use of ranking algorithms to manipulate consumer and limit choice; (ii) the use of algorithms to apply different pricing/terms to different categories of consumers; and (iii) the use of algorithms to manipulate platform ranking with the objective to exclude rivals.

Algorithms are complex. It is not clear how anticompetitive algorithms can be detected or assessed within the existing framework. In addition, competition authorities are faced with conceptualising whether algorithms that result in more automated processes (i.e. machine learning), can constitute “unilateral” conduct for purposes of the assessment of abusive conduct.



Cartel Conduct

Competition authorities are concerned that digital markets have altered the nature of interactions and are questioning whether the use of algorithms can facilitate agreements or coordination on price and other trading conditions in a more efficient way than traditional human interactions – this is because algorithms and machine learning have become commonplace in a vast number of markets.

Competition authorities recognise that companies may inadvertently engage in cartel conduct through algorithms. Algorithms utilise a precise list of simple operations applied mechanically and systematically to a set of tokens or objects. Algorithms iteratively learn from data without being explicitly programmed. Without the expertise and technological tools for diagnosing and identifying potentially anticompetitive

algorithms and other machine learning capabilities, competition authorities would be ill equipped to detect novel forms of cartel conduct, which would result in under enforcement.

As an example, a firm may employ algorithms to adapt to market changes while ensuring optimum returns on investments or profits. Through self-learning, algorithms may align the prices of the firm to competitor pricing in a manner that results in tacit collusion. One of the challenges for antitrust authorities would be demarcating cartelistic flow of virtual information resulting in tacit collusion (where the algorithm uses a sample of labelled data to learn a general rule that maps inputs to outputs) from mere market transparency and machine learning adaptation to such detected market trends.



The Convergence of Competition and Social Policy

The cornerstone of competition policy is the notion that inclusive economies yield better outcomes for both producers and consumers.

With social imperatives playing an increasingly significant role in the development of competition policy, renewed emphasis has been placed on the empowerment of small and medium-sized enterprises as a means of fostering a healthy economic ecosystem. Similarly, in countries such as South Africa, the need to afford sufficient opportunities to historically disadvantaged persons has seen competition policy being utilised as a tool to offer the previously disadvantaged novel forms of economic protection.

What is clear from this is that governments around the world have decisively shifted away from the purely economics-based origins of competition regulation, turning instead towards a model that acknowledges and, to an extent, caters to the broader needs of modern society. On this basis, and with digital innovation opening up the economy to many individuals and businesses that were, until recently, excluded from meaningful economic participation, it is likely that public interest imperatives will play a crucial role in the development and implementation of competition law in the digital space.



Key Contacts



Lerisha Naidu
Partner, Johannesburg

Tel: +27 11 911 4323
Lerisha.Naidu
@bakermckenzie.com



Angelo Tzarevski
Senior Associate, Johannesburg

Tel: +27 11 911 4316
Angelo.Tzarevski
@bakermckenzie.com



Sphesihle Nxumalo
Associate, Johannesburg

Tel: +27 11 911 4335
Sphesihle.Nxumalo
@bakermckenzie.com



Selma Matsinhe
Associate, Johannesburg

Tel: +27 11 911 4324
Selma.Matsinhe
@bakermckenzie.com



Zareenah Rasool
Candidate Attorney,
Johannesburg

Tel: +27 11 911 4343
Zareenah.Rasool
@bakermckenzie.com

The Baker McKenzie logo is displayed in a bold, white, sans-serif font. The word "Baker" is positioned above "McKenzie.", and a period follows "McKenzie." The background is a dark blue gradient with a network of white lines and nodes, and several red triangles of varying sizes scattered throughout.

Baker McKenzie helps clients overcome the challenges of competing in the global economy.

We solve complex legal problems across borders and practice areas. Our unique culture, developed over 70 years, enables our 13,000 people to understand local markets and navigate multiple jurisdictions, working together as trusted colleagues and friends to instill confidence in our clients.

bakermckenzie.com

© 2021 Baker McKenzie. All rights reserved. Baker McKenzie International is a global law firm with member law firms around the world. In accordance with the common terminology used in professional service organizations, reference to a "partner" means a person who is a partner or equivalent in such a law firm. Similarly, reference to an "office" means an office of any such law firm. This may qualify as "Attorney Advertising" requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.