IN PRAISE OF THEORIES OF BENEFITS



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In this article, the authors open with a CEO pitching an acquisition to financiers on the strength of synergies nobody has documented. Drawing on more than twenty-five years of reviewing filings, they describe a self-reinforcing equilibrium in which parties treat efficiency claims as an admission of competitive concern and the Commission treats them as unsubstantiated; it has never formally cleared a merger on efficiencies alone. The Draft Guidelines' encouragement of Theories of Benefits offers a way out, and the authors set out how to build one in parallel with the business case, calibrating the effort to the expected difficulty of the review.

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I. MERGER BENEFITS: THE SORRY STATE OF THE EFFICIENCY DEFENSE

A. Once Upon a Time …

Consider the following scenario. In the offices of a technology company ("Techworld"), management is presenting to members of the financial community and shareholders to explain why their planned acquisition of a competitor ("Moretech") merits financial backing. After presenting the business activities and financial health of both companies, the critical question arises: why would the two companies perform better together than as independent entities? Two versions of this presentation are instructive. In the first version, the Techworld CEO explains that the two companies are close competitors and that, over recent years, "excessive" competition between them has led to significant "loss of value." Notably, this portion of the presentation is delivered verbally, with no written record. In the second version, the CEO instead emphasizes that, by combining operations, the two companies would form a stronger, more efficient, and more innovative entity, delivering greater value to shareholders, customers, and employees.

Consider how a sophisticated financial analyst, such as a representative from a major financial institution involved in merger financing, would respond to these presentations. In the first scenario, where the two firms are close competitors, a natural concern would be that the transaction might attract scrutiny from competition authorities. Unless the combined market power of the merged entity is not materially greater than the power held by the two independent firms, the next question becomes how Techworld and Moretech plan to secure regulatory approval. Based on extensive experience, such an analyst would understand that, even with highly skilled advisors, approval is likely to require a combination of remedies (e.g., divestitures) and merger-specific efficiencies. However, efficiencies also matter outside of any competition law implications. Without them, why would one belief that the proposed acquisition is a good idea?

The CEO then proceeds to the portion of the presentation headlined "the positive case for the transaction." This section is notably brief. The CEO addresses the "synergies" that the proposed transaction would generate, describing how the combined company would achieve greater efficiency and increased innovation. However, the formal presentation provides few specifics. There is little discussion of the mechanisms through which efficiency gains would materialize. Estimates of cost reductions or productivity increases, where provided, are not supported by rigorous internal analysis or independent expert assessment. Claims regarding enhanced innovation are asserted without supporting methodology or strategy. Similarly, there is limited detail on implementation plans that would translate theoretical benefits into realized outcomes.

Would a sophisticated financial analyst be satisfied with this presentation? It seems unlikely. A sophisticated financial analyst would require documented claims supported by evidence, not mere assertions.

While the preceding paragraphs adopt a light tone, this framing is not intended to be dismissive. Rather, it reflects the authors' experience, having reviewed merger filings as members of the European Commission Directorate-General for Competition and in private practice for more than twenty-five years, during which well-documented efficiency arguments have been the exception rather than the rule. Two explanations for this pattern seem plausible. First, companies may conduct thorough due diligence but, for various reasons, do not present this analysis in the merger review process. Second, the financial community may accept relatively imprecise answers to questions that merit rigorous analysis, and companies may believe that competition authorities do not give enough credit to efficiency arguments to justify the extra effort. In either case, the revised EU merger guidelines' emphasis on documented Theories of Benefits represents a constructive development.

B. The Poor Performance of Merged Undertakings

Before turning to the procedural dimensions of efficiency arguments, it is useful to examine the empirical evidence on merger outcomes. This evidence provides important context for understanding why rigorous analysis of merger benefits, both for business planning and regulatory purposes, merits greater attention than it has traditionally received.

A substantial body of research has examined the effects of mergers on various aspects of firm performance, including market value and innovation. Three principal conclusions emerge from this literature. First, mergers tend to benefit the acquired company but not necessarily the acquirer.[2] Earlier studies suggested that acquirers, on average, experienced negative post-merger returns.[3] Second, the effect of mergers on the combined profits of the parties remains unsettled: while earlier studies found no gains on average, more recent research identifies positive but

2 See C. Bouwman, K. Fuller & A.S. Nain (2009), "Market Valuation and Acquisition Quality: Empirical Evidence," *Review of Financial Studies,* 22(2), pp. 633-679; G. Andrade, M. Mitchell & E. Stafford (2001), "New Evidence and Perspectives on Mergers," *Journal of Economic Perspectives*, 15(2), pp. 103-120.

3 See S.B. Moeller, F.P. Schlingemann & R.M. Stulz (2005), "Wealth Destruction on a Massive Scale? A Study of Acquiring-Firm Returns in the Recent Merger Wave," *The Journal of Finance*, 60(2), pp. 757-782.

modest gains. Third, significant variation exists across geographic markets; in particular, U.S. mergers tend to be more profitable than European mergers.[4] Given this evidence, one might reasonably conclude that proceeding with a merger without thorough analysis of the combined entity's prospects is imprudent from a business perspective. By encouraging the early submission of Theories of Benefits, we believe that the EU merger guidelines may help address this gap in the M&A process.

C. Is Existing Evidence Under-Exploited or Poorly Presented?

It is *p*ossible that merger decisions are, in many cases, based on carefully documented synergies and realistic implementation strategies. If so, the question becomes why such evidence is typically not submitted to competition authorities, and what it says about the incentive structures embedded in our current regulatory framework.

One interpretation, prevalent in European competition policy circles, posits a self-reinforcing equilibrium. The dynamic begins with the perception that presenting efficiency arguments implicitly acknowledges that the proposed transaction is otherwise problematic. This perception is reinforced by the current framework, which considers efficiencies only where a transaction would otherwise materially increase market power, leading to higher prices or diminished quality. In this context, presenting efficiency arguments early may be perceived as an admission of competitive concern. By the time the potentially problematic nature of a merger has been established through the review process, parties often find it more practical to pursue approval through remedies rather than presenting efficiency analyses that may be underdeveloped.

A second factor contributing to this equilibrium is that the Directorate-General for Competition has never formally cleared a merger on efficiency grounds alone. While certain merger approvals have likely been facilitated by substantive efficiency arguments, the absence of formal recognition of this fact perpetuates the perception that efficiency submissions lack practical value.

The new emphasis on Theories of Benefits may help disrupt this equilibrium by signaling clearly that submissions on merger-related benefits are expected. While formally requiring such submissions outside of the simplified procedure would have sent an even stronger signal, it would be a mistake to dismiss the discussion of Theories of Benefits as merely symbolic: once the filing of such theories is clearly encouraged in the EU merger guidelines, we believe that the European Commission will be more inclined to consider substantive parties' submissions, possibly reflecting possible interventions by the Courts.

II. PREPARING A CREDIBLE THEORY OF BENEFITS

We have argued that any sound decision to pursue a merger or acquisition should be grounded in rigorous analysis of the anticipated benefits and challenges. This does not mean, however, that such due diligence produces analysis that can be submitted directly to competition authorities without further refinement. Substantial work is typically required to reorganize existing business analysis into a coherent economic framework, to substantiate key elements of the narrative in language and analyses that reflect the distinct objectives of competition authorities relative to business stakeholders.

In this section, we try to outline the concrete steps to take to shape credible theories of benefit out of pre-existing work aimed at shareholders and the financial community. It will soon become clear that moving from business case to Theories of Benefits may require substantial work. This process should therefore start early, certainly before filing. Indeed, as we will discuss further below, there are good reasons for Theories of Benefits to be articulated at the same time as the business case for the proposed transaction.

A. Principal Sources of Benefits

Identifying potential sources of benefits should be the most straightforward part of preparing a Theory of Benefits. From the earliest stages of transaction planning, the fundamental question is "why pursue this transaction?," which necessarily requires identifying the factors that would make the combination profitable. It is useful to organize potential merger benefits into several broad categories. For each category below, we discuss the relevant conceptual considerations and provide guidance on the types of evidence that may support these claims before competition authorities.

4 For the U.K., Firth (1980), "Takeovers, Shareholder Returns, and the Theory of the Firm," *The Quarterly Journal of Economics*, 94(2), pp. 235-260, finds that, on average, takeovers yield a small loss.

B. Increased Financial Resources and Their Intended Use

While standard economic models assume that any profitable project can be funded at market rates, capital markets are imperfect in practice: collateral, reputation, and retained earnings all affect a firm's ability to secure financing. A merger can therefore improve the parties' combined ability to finance potentially profitable investments by deploying the resources of the financially stronger partner, whether through greater retained earnings or superior collateral, to fund high-potential projects at the other party. Supporting evidence would include data on retained earnings and credit ratings, as well as documentation of unfunded projects with strong potential at the financially constrained partner.

C. Lower Costs of Production

The analysis begins by identifying the type of costs involved. Are these variable costs or fixed costs? While this distinction may be less critical from a business perspective, it is highly relevant to a Theory of Benefits: competition authorities generally presume that variable cost savings are more likely to be passed through to consumers than fixed cost savings.[5]

The next step is to explain why the proposed transaction would reduce these costs. Explaining the underlying mechanism is important because it directly points to the type of evidence that might help convince the authorities. For example, consider two different mechanisms for lowering costs post-acquisition, lower input prices or increases in economies of scale and scope.

First, do the lower costs arise from the merger enabling lower input prices? If so, what mechanism produces this result, and what evidence can support it? For example, would costs decrease because larger combined orders trigger standard volume discounts from suppliers, or because the transaction increases the merged entity's bargaining power relative to suppliers? In the first case, suppliers' tariff schedules or documentation of the parties' purchasing history would be helpful. In the second case, one must explain why the combined entity would enjoy greater bargaining power. Larger size alone is insufficient. The analysis should demonstrate that the merger would improve the parties' outside options (e.g., through vertical integration or access to additional supply sources) or that there are non-linearities in the parties' payoff functions that favor the combined entity. Regardless of the specific mechanism, the submission should provide and justify broad estimates of the expected magnitude of input cost reductions.

Second, do the cost reductions arise from economies of scale or economies of scope? If so, why should such savings be expected to materialize? Three types of evidence, which are not mutually exclusive, can address this question. The first consists of academic studies (such as cost function estimates) demonstrating decreasing average costs within sectors and output ranges relevant to the merger. A second approach involves identifying the principal sources of indivisibilities in the production process, for example, specialized equipment, facilities, or personnel that are necessary but not fully utilized. This type of evidence draws on engineering expertise rather than economic analysis. A third possibility is that increased joint scale would make it economical to adopt more efficient technologies that were not viable for either party independently.

Third, a merger can lead to an increase in product variety if it reduces the fixed costs of product development or enables economies of scope in distribution, marketing, or branding. Past acquisitions may provide useful evidence, as some might have delivered such benefits and have characteristics close to the one at issue. Past acquisitions that did not enable such benefits can also be useful, to the extent that the parties can identify the reasons having prevented such benefits and can document that the merger at issue will not suffer from similar issues.

D. Increase in Innovation

As Régibeau & Rockett (2019) argue,[6] innovation activities can give rise to merger-specific efficiencies. The underlying rationale is that legal protections for intellectual property are imperfect, making innovations difficult to transfer through arm's-length licensing or sale. As a result, value-enhancing knowledge sharing may occur only after the parties have merged. In turn, the ability to exploit innovations more efficiently post-merger can increase the parties' incentives to innovate, potentially compensating (in whole or in part) for any reduction in innovation incentives arising from product line overlap between the merging parties.

5 This presumption is not necessarily correct: lower fixed costs can benefit consumers if they lead to capacity expansion or to a greater product variety. However, overcoming the presumption requires further economic arguments and evidence. Efficiency arguments based on fixed cost savings should therefore be prepared early.

6 P. Régibeau & K. E. Rockett (2019), "Mergers and Innovation," *The Antitrust Bulletin*, *64*(1), pp. 31-53.

E. One-Stop shopping, Switching Costs and Network Effects

Network effects arise in the presence of significant frictions that penalize consumers who transact outside of a given network. These frictions may take the form of shopping costs, switching costs due to psychological loyalty or reward programs, or incompatibility with products or services offered outside the network. Where such costs are material, merging two platforms that previously operated on separate networks can increase consumer welfare by expanding product variety or increasing user interactions. We believe such benefits can be significant. However, they require careful documentation. The analysis should begin with evidence establishing the existence and magnitude of switching costs, shopping costs, and barriers to multi-homing. The next step is to document the magnitude of the network effects themselves. In doing so, parties should be mindful that competition authorities may be concerned about the potential for markets to "tip" in favor of larger networks. It is therefore important to demonstrate that, while network benefits are significant in aggregate, the marginal benefit of additional network scale is decreasing over the relevant output range, that is, the incremental benefit gained by all users from each additional user diminishes as the network grows.

F. Out-of-Market Efficiencies

The draft EU merger guidelines introduce the possibility of crediting non-standard efficiencies, such as environmental benefits or increased resilience. While these categories merit exploration, parties should understand the Commission's likely approach. Under both the new draft EU merger guidelines and the existing horizontal agreement guidelines, the European Commission considers "out of market" benefits only in a specific sense: benefits arising in markets other than those where the transaction raises competitive concerns will count only to the extent they affect the welfare of consumers active in the competitively affected markets. Thus, while relevant markets continue to be defined in the traditional manner, as a set of products competing for consumers' attention in a given geographic area, the scope of creditable efficiencies is defined by reference to specific consumers: those in the adversely affected product and geographic markets. Two examples illustrate this principle.

1. Example 1: Relevant Users

Assume Firms A and B merge. They operate in the same market with material overlap, such that the combination raises competition concerns in that market. Consumers in that market are therefore the relevant recipients of potential efficiencies. Suppose the parties demonstrate that the transaction will enhance resilience at two levels. At the firm level, the merger will diversify the sources of critical inputs and provide greater flexibility in reallocating production across plants. At the EU level, the merger will increase the diversity of input sourcing within relevant EU-based sectors and expand EU production of products essential to the hospital sector.

What benefits accrue to the relevant consumer group? First, the increased resilience of the combined entity, relative to the two independent firms, means users are less likely to experience costly disruptions to their production processes or consumption patterns. This effect is equivalent to an improvement in product quality. Second, some users may value the improvement in overall EU resilience. This valuation comprises two components: (i) use-dependent benefits, where users value the fact that the inputs they purchase contribute more to EU resilience than before—these benefits accrue directly to users and should be fully credited; and (ii) non-use benefits, where any EU citizen might value the improvement in the EU's overall position, independent of their own consumption. Under the guidelines, non-use benefits are credited only for citizens who are also active users in the competitively affected market.

2. Example 2: Out-of-Market Benefits

Assume, instead, that Firm A operates only in Market 1 with Product A, while Firm B operates in both Market 1 and Market 2 with Product B. The overlap in Market 1 is sufficient to generate significant competitive concerns. Economies of scope exist between Products A and B: the unit cost of producing B decreases as the output of A increases, and vice versa. The merger is therefore likely to reduce production costs in both markets. To the extent these cost savings are passed through to consumers, they constitute allowable merger-specific benefits in Market 1, where the competitive concerns arise. But what of the likely price decrease in Market 2? Under the draft EU merger guidelines, this benefit is also credited—but only for the share of Market 2 consumers who are also consumers in Market 1. The governing principle is that benefits are counted based on who receives them, not where they
originate.

3. Evidence

When advancing novel efficiency arguments, it is prudent to begin with the more straightforward cases. At this stage, we would recommend focusing on well-defined benefits such as reductions in harmful emissions. Carbon emissions represent the clearest case, as they are readily measurable and emission permit prices provide a useful proxy for the welfare value of pollution abatement. Other environmental benefits

may also be considered, but would require additional analysis to quantify the damage to economic activities and public health that would be avoided.

Similarly, it may also be possible to advance efficiencies stemming from an increase in *resilience*. The evidentiary burden of attempting to justify an overall increase in EU resilience seems excessive; it would require detailed information about the activities of other firms in the sector. However, it may be possible to highlight increases in diversification of both input sources and export markets arising due to the merger, and combining such data with estimates of country risk, could evidence an increase in resiliency.

G. A Story to Tell

While identifying the potential sources of merger-specific benefits is useful, it is only a starting point. To engage competition authorities effectively and establish a favorable analytical foundation, these alleged efficiencies should be presented as part of a coherent narrative.

Such a narrative typically comprises four elements. First, it begins with a description of the merging firm' main activities, highlighting both their competitive strengths and the challenges they face. This overview should address the recent history of the undertakings and their markets, as well as their anticipated evolution. Second, from this background should emerge a picture of needs and opportunities: has either party experienced limitations (in funding, expertise, capacity, or supply) and what resources are required to adapt to expected market developments? Third, the narrative should explain how combining the parties' resources could address existing constraints or facilitate adaptation to changing market conditions. Fourth, the narrative should include a preliminary review of available supporting evidence, with indicative orders of magnitude. Because this narrative should be consistent with how the transaction was presented to the financial and business communities, it should be developed before the merger announcement and incorporated into that announcement.

This narrative approach serves two purposes. First, it provides context that helps competition authorities understand the business rationale for the transaction and evaluate the plausibility of claimed efficiencies. Second, it demonstrates that the efficiency claims are not post hoc justifications but rather integral to the transaction's strategic logic, a consideration that bears on the credibility and merger-specificity of the claimed benefits.

III. PRIORITIZING THE TASKS

The foregoing discussion may make the task of articulating a credible Theory of Benefits appear substantial. However, the effort required can be managed effectively by balancing early preparation against the avoidance of unnecessary work.

The starting point should be an assessment of the transaction's prospects. The simplest case is one where there is a high probability of Phase I approval without remedies, or with limited commitments that the parties are prepared to accept. Even in this favorable scenario, however, preparing a coherent benefits narrative is advisable, even if it is concise and light on supporting evidence. As noted, above, this helps establish a constructive framing for the review. Moreover, the cost of developing such a Theory of Benefits can be minimized by preparing it concurrently with the business case: this requires primarily a reframing from business to economic terminology, while drawing on evidence already assembled for the business case. We refer to this as the "basic translation" of the business case. Even this translation benefits from involvement of economic experts.

For transactions with somewhat less favorable prospects, for example, cases where Phase I approval might be achieved but only with substantial remedies, preparation should go beyond the basic translation. This involves developing a more complete narrative that identifies the principal sources of efficiencies, conducts preliminary work on gathering supporting evidence for these key elements, and integrates them into a coherent account. Other potential sources of efficiencies can remain at the basic translation level. This "light story" should be ready at the time of filing. Additionally, contingency planning is advisable: personnel who would be responsible for developing further evidence should be identified, and potential sources of additional documentation should be mapped out in advance.

For transactions that face significant competitive concerns, a comprehensive Theory of Benefits should be prepared and ready at the time of filing. "Comprehensive" does not mean complete in every detail. All elements of the narrative should be supported by some evidence, but it may be strategic to wait for the competition authority's initial response before determining which aspects warrant additional development. Given the tight deadlines of merger review, however, planning should begin early: parties should identify who would be responsible for further analysis and how additional evidence might be obtained before the filing is submitted.

IV. CONCLUSION

The new draft EU merger guidelines strongly encourage parties to supplement the traditional approach of rebutting potential theories of harm with explicit Theories of Benefits. We believe this represents a significant opportunity to move beyond a suboptimal equilibrium in which merging parties perceive efficiency arguments as implying competitive concern, while competition authorities regard efficiency claims as insufficiently substantiated. Moreover, we argue that a well-considered acquisition decision should rest on a thoroughly documented business case, which should already provide key elements of a coherent Theory of Benefits. This supports developing the business case and a Theory of Benefits in parallel. Given that documenting a persuasive Theory of Benefits can require substantial resources, we have discussed how to calibrate the timing and intensity of this effort based on the anticipated complexity of the review.

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