

COMMENTARY: Kenneth Davidson, Porter and Weller: An Antitrust Odd Couple?

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COMMENTARY

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Author: Kenneth M. Davidson, AAI Senior Fellow

Contact Information: kdavidson@antitrustinstitute.org

Porter and Weller: An Antitrust Odd Couple?

Michael E. Porter is the Bishop William Lawrence University Professor at Harvard Business School. For thirty years, from an academic wunderkind, to international business consulting superstar, to distinguished chaired professor, he has earned every accolade he has received and surely deserves the further recognition he will garner. I have read and cited his work for a quarter of a century. It was natural for me to buy and read a new book that features his work and promises insights into international development and the future of antitrust analysis. These two areas form the bulk of my work as a consultant. Terry Calvani (former FTC Commissioner, former Member of the Irish Competition Authority, former law professor, and antitrust law partner) endorsed the book as the “antidote to the conventional welfare economics that has served as the foundation for modern competition policy.” Ky Ewing (former Chair, American Bar Association, former Deputy Assistant Attorney General for Antitrust and antitrust law partner) is also quoted on the cover as saying the “book is to be relished by thoughtful people who want to explore new dimensions of the competitive process.”

I was surprised when the book arrived. Indeed before it arrived, I was perplexed by the title: **UNIQUE VALUE Competition Based on Innovation Creating Unique Value for Antitrust, the Economy, Education, and Beyond.**¹ The book is largely a collection of pieces written by Professor Porter (one is co-authored by Scott Stern) and three pieces by Charles D. Weller, Esq. (one is co-authored by Peter Staudhammer). It is unclear why these pieces are collected in a single volume. Weller’s introduction summarizes Porter’s seminal book, THE COMPETITIVE ADVANTAGE OF NATIONS, which presented in

¹ The book is paperbound and is credited to Charles D. Weller, Ed., copyright Charles D. Weller, 2004. The publisher is listed as Innovation Press, LLC and the distributor is Atlas Books BookMasters, Inc., www.atlasbooks.com/marktplc/01314.htm.

1990 his theory for analyzing competition and economic growth in international and domestic businesses. Various aspects of the theory are also described in the five essays by Porter that are included in this book.

It is not clear who the intended audience for this book is. The Porter chapters do not build to a conclusion. All the chapters appear to have been previously published. The chapters are mostly ongoing reports of research on international development. These chapters end with the only Porter piece that focuses on antitrust. Following Porter's suggestions about how to conduct antitrust analysis in merger cases, Weller adds a guide to antitrust defense attorneys on how to use *Daubert*, its progeny and successors to defeat antitrust cases brought by federal authorities. The final chapter appears to be written by Weller about Staudhammer, a scientist, and his views on education and innovation. I would be hard pressed to know who I would recommend reading this book rather than Porter's own work.

I am concerned about Professor Porter's antitrust chapter, both because its innovation perspective is one that I have long shared and because contrary to the distinguished endorsements on the book cover, I think Porter's analysis is incomplete and would leave the prosecution of merger cases even more vulnerable than they are today. If one were in doubt about the destructive potential of Professor Porter's incomplete analysis, the Weller piece openly uses it as an excuse for defeating antitrust prosecutions.

Porter's commitment to competition, like my own, is based on the conclusion that more competition makes a more substantial contribution to raising living standards as a force promoting innovation than it does by reducing monopoly profits and deadweight loss (See *e.g.*, A. Dougherty and K. Davidson, "Limitation Without Regulation: The FTC's Bureau of Competition Approach to Conglomerate Mergers," 73 Utah L. Rev. at n 107 and accompanying text (1980); K. Davidson, "How Should the US Encourage Innovation?" J. of Bus. Strat. March/April 58 (1992)); and K. Davidson, "Creating Effective Competition Institutions: Ideas for Transitional Economies," 6 Asian Pacific L. & Pol. J. at 80-83 (2005)). To be sure, monopoly profits are an unwarranted transfer of income from consumers to producers, but a much more significant economic effect of competition is the encouragement of innovation. That innovation is the source of maintaining and increasing the standard of living in the United States and throughout the world. From the agricultural green revolution, to solid state technology, to recombinant DNA, technological advance has made it possible to raise world wide living standards in a century of explosive population growth.

Porter says:

Since the seminal contributions of Schumpeter (1943), Solow (1956) and Abromovitz (1956), it is widely understood that the only means of achieving sustained productivity growth in an economy is through innovation.

* * *

Productivity growth, then is the missing, unstated link between competition and national standard of living. This provides the soundest explanation for why antitrust must protect competition: it is the key to a nation's prosperity. (at 158)

He continues:

Since the role of competition is to increase a nation's standard of living and long-term consumer welfare via rising productivity growth, *the new standard for antitrust should be productivity growth*, rather than price/cost margins or profitability. * * * [Merger] Transactions with dubious benefits for productivity growth, or those that offer only a one-time productivity benefit are likely to be net negatives for society if they pose any risk to overall health of competition. (at 165, emphasis in the original)

Porter sets out five reasons that mergers should be of particular concern for antitrust:

First, mergers raise almost inevitable issues for the health of competition by removing independent competitors from the market. The question is not whether there is a risk to competition, but how much. This risk stems from the potential lessening of competitive pressure among firms in the industry, the potential reduction in product choice and variety, and the reduction in the number of different approaches being pursued to product process development and hence likelihood of innovation.

Second, a merger requires no "skill, foresight, or industry," only financial resources. * * *

Third, the empirical evidence is striking that mergers have a low success rate. * * *

Fourth, the strategy literature suggests that smaller, focused acquisitions are more likely to improve productivity than mergers among leaders. * * *

Fifth, there are strong financial market pressures favoring mergers over other growth strategies. * * * Finally, accounting rules make merger a vehicle for distorted performance measurement, creating artificial pressures for companies to merge. (at 173-174)

I have quoted at length these excerpts from Porter's chapter because one would expect them to shape his view of appropriate merger analysis. And, at one point, Porter seems to suggest that the burden ought to be on the parties proposing a merger to prove that the proposed merger would be procompetitive: "If all other things remain equal, the merger's effect would be judged negative." (at 177)

However, Porter makes no suggestion as to burden of proof even though he recognizes that his comprehensive competitive analysis is complex:

Performing five forces (*i.e.*, Porter's) analysis requires significant effort in terms of data collection and analysis, which some argue would pose challenges to antitrust authorities with limited resources. However, a skilled practitioner can reach informed judgments based on a modest number of industry interviews and secondary sources and the approach allows effort to be quickly focused on the most important issues. (at 178-179)

I do not doubt the sincerity of this statement. Michael Porter objects to current antitrust analysis on the grounds that it focuses on the wrong factors. He, unlike most of us, is a skilled practitioner of his analytic method which contains a huge number of variables. These variables focus on issues concerning long term growth and productivity; whereas traditional antitrust analysis (which Porter characterizes as relying heavily on HHI concentration levels and price/margin ratios) focuses the analysis on static efficiency.

If Michael Porter were allowed final say in judging mergers, I might support the application of his analysis to evaluating the legality of mergers, but based on the Weller chapter which follows, the numerous variables in Porter's analysis would present an irresistible number of targets for defense attorneys to attack as forming an unproven basis for declaring mergers unlawful.

Porter's own example of a merger case study is troubling. The merger is between two offshore drilling companies who will have "the highest overall share in the industry and, a dominant share in one large, important segment [ultra deepwater drilling]." (at 183) Porter finds no problem with the merger because there are many competitors, the products are undifferentiated and customers are powerful enough to establish new competitors. This sounds like analysis under the existing merger guidelines.

I am at a disadvantage in analyzing Porter's hypothetical because all I know about drilling rigs is what I have seen in tv advertisements and news stories. Nevertheless, I am troubled by this sketch of his analysis. Most troubling is the lack of any discussion of innovation in a chapter that purports to be about innovation. I suppose any concern about diminution of innovation is assumed to be irrelevant because the products are "undifferentiated." That seems inconsistent with the existence of a submarket for ultra deepwater drilling. More importantly, the assumption that innovation will not occur is a static assumption. There is no support for that assumption in the example or elsewhere in the article, apart from a fragment of a sentence on the previous page "drastic innovations in industries occur only once every few decades." (at 182) Professor Porter probably has studied the drilling industry and has considered the innovation question. Maybe, he knows that supply companies rather than drillers produce innovations in the industry. But I am skeptical that we can ignore the cumulative effect of less drastic innovations in the operation of rigs, the speed and quality of service, the learning curve techniques that can be duplicated only with experience on the rigs. Years of listening to respondents at the FTC talking about efficiencies that were not there, the research for the FTC's STUDY OF THE COMMISSION'S DIVESTITURE PROCESS, Porter's own studies of failed mergers all suggest that the future is highly problematic.

It may be true that innovation is not a relevant issue in this example. If so, why choose this example to illustrate how the new analysis is to be done if it does not include an

evaluation of the effect of innovation? This is not a small point. The five policy concerns listed by Professor Porter apply generally to mergers. Those should form a basis for some kind of presumption against mergers. The effects of mergers cannot be predicted with certainty because they deal with the future. Consequently, we need a burden of proof allocation that reflects what we know in general and places the burden on those most likely to be able to predict the effects of mergers. Professor Porter has made a major contribution to identifying relevant merger factors but has not yet formulated a tractable legal framework for considering those issues.

The legal framework of a trial brings me to the chapter on antitrust litigation by Charles D. Weller. As he concedes, “This chapter is different. . .”

Specifically, this chapter is written first for defense lawyers with clients prepared to go to court to win specific types of antitrust cases in unconventional yet legally and factually robust ways. (at 189)

In brief, the chapter is about how *per se* antitrust rules are inappropriate, in general, and how expert testimony based on neoclassical analysis, in particular, is unsupportable under the *Daubert* standard, its progeny and predecessors. If one were to assume that Professor Porter had demonstrated that standard antitrust analysis is wrong headed, it would be hardly necessary for Mr. Weller to go further to show that antitrust prosecutions are flawed. And, of course, the chapter contains no hint of how to bring a successful antitrust case.

One wonders why Mr. Weller has included the earlier chapters by Professor Porter which repeatedly show that economic growth and innovation do much better in countries that have free markets and implement inevitably flawed antitrust programs. Apart from the introduction, one might have assumed that his condemnation of “standard” antitrust by showing that courts frequently do not agree with neoclassical assumptions or with econometric models are designed to show that the courts are in the process of moving towards agreement with Professor Porter and that in time new generalizations will condemn anticompetitive behavior using the Porter techniques. But he has no such ambition.

Mr. Weller condemns *per se* rules citing courts that have rejected them in certain instances. I agree that, in some instances, *per se* rules are wrong or even silly. In talking with competition officials from transitional and developing countries, I have often found the attraction to *per se* rules to be a hindrance, rather than a help, to their understanding of antitrust law because it puts the focus of analysis on specific business actions rather than the anticompetitive effects of business actions. Having said that, it is usually more effective to consider the *per se* formulations as imperfect generalizations or presumptions of illegality that direct the burdens of proof.

Violations of *per se* categories generally provide the best examples to demonstrate competitive harm. It is usually possible to show precise economic effects of such practices if they have been put into effect. The harm in terms of higher prices to customers is clear. The effect on lower rates of innovation may be harder to quantify; but those who receive service from an unregulated monopoly usually have complaints about

service and quality. The experience of looking at the economic harms that resulted from a *per se* price fixing agreement that was in effect for a period of time seems relevant to analyzing a price fixing agreement that has not yet come into effect. Experience should teach us to expect harm and therefore the burden ought to be on the defendant to show why an exception should be made for price fixing in this circumstance.

Mr. Weller seems more inclined to throw the baby out with the bath water. In the guise of promoting new better antitrust analysis, he seems to advise that we forget what we know. Professor Porter, in contrast, seeks to improve on the existing analysis. Their views should not be coupled together.