

Comments to the CMA in re: Facebook/GIPHY merger

Submitted to the Inquiry via [facebook.giphy@cma.gov.uk](mailto:facebook.giphy@cma.gov.uk), 1 September 2021

Thank you for the opportunity to submit comments in the matter of the Competition and Markets Authority's Facebook and GIPHY merger inquiry. On behalf of the Competitive Enterprise Institute (CEI) in the USA and the Adam Smith Institute in the UK, we offer the following reasons why the Authority's provisional findings should not become final. Both Institutes are public policy organisations with an interest in promoting free market solutions to economic problems. CEI has analysed problems associated with increased antitrust law since its founding in 1984.

### 1. Extraterritoriality

While we accept that UK law gives the CMA power to police mergers and acquisitions by overseas parties that clearly negatively affect UK consumers, we believe that the exercise of these powers by the CMA in the current case dramatically lowers the bar on such acquisitions and thereby constitutes an inappropriate "power grab" by the Authority.

The Facebook/GIPHY merger (hereinafter "the merger") is a small merger in global terms. Indeed, the merger is such small beer that in the United States it counted as "non-reportable" to the Federal Trade Commission (although the Commission has since changed its rules, former Commissioners and staff members have expressed the view that the merger should not be regarded as questionable in retrospect). Moreover, as the provisional findings make clear, the merger was so low in value that Facebook board approval was not even required.

It therefore follows that in seeking to block the merger, the CMA is saying to competition authorities all over the world that it can and will block mergers that those authorities regard as inconsequential if the companies concerned have large numbers of UK consumers. This amounts to an assertion by the CMA that it intends to act as the world's policeman of mergers and acquisition activity – a role that is clearly outside the scope of the CMA.

The CMA should be extremely careful about using its discretionary powers in this way. While it is clearly the case that the Authority might use its powers to block a merger between two large social media companies regardless of where those companies are based, it is less obvious that this is an appropriate use of power given the size of the merger.

Blocking this merger could begin a "race to the bottom" between competition agencies, as each organisation tries to assert its own conditions for what constitutes an acceptable level of competition between companies in various sectors. Such rivalry between agencies would chill merger and acquisition activity to minimal levels. That would exacerbate the chilling effects on innovation and investment considered in section 4 of this submission.

The CMA might insist its hands are tied by law. However, the CMA is incorrectly applying the law in this case, given the lack of consideration of the proper counterfactual discussed in the next sections. A more appropriate counterfactual would free the Authority from inappropriate extensions of its powers beyond the UK's borders.

## 2. Relevant market

As the provisional findings admit, “in markets such as the ones in which Facebook and GIPHY operate, where there is a wide range of different products and offerings, and where new features and products are introduced regularly, it can be difficult to define the precise boundaries of a ‘market’.” The search for a definable market often leads competition agencies to define a market too narrowly, something scholars have begun to term the “relevant market fallacy” (see, e.g., Ryan Young and Clyde Wayne Crews, Jr., “The Case Against Antitrust Law,” Issue Analysis April 2019 No.1, Competitive Enterprise Institute (2019.))

For instance, the first market defined by the Authority is that of “searchable GIF libraries,” in which the CMA finds GIPHY to have significant market power. Yet when most people search for a GIF, they do not go to a “searchable GIF library,” but to a generic search engine, most likely Google. As the provisional findings indicate, GIPHY’s biggest competitor in this small market, Tenor, is owned by Google. So, in an image search on Google for the famous Michael Jordan “get some help” meme, the first five images returned are either from Tenor or from a third supplier, gfy.com. The first GIPHY image supplied is the eleventh in search order. A Google search for the Drew Scanlon “blinking man” meme turns up Tenor and GIPHY sources in approximately equal amounts.

This suggests that GIPHY may be at something of a disadvantage compared to Tenor when one considers the likeliest method of searching for GIF files, which is to use a dedicated search engine. In that respect, integration into Facebook and Instagram’s internal search features only slightly offsets Google’s market power in this field. (We make no claim that Google is harming consumer welfare or biasing its search results.) Failing to consider the most likely search behaviour of all users looking for GIFs is a clear instance of the relevant market fallacy. It is akin to considering searches for consumer goods using only retailer website search functions and not considering search engine searches.

Moreover, even if the relevant market is the one portrayed by the Authority, the agency has failed to demonstrate that consumer harm would arise from the merger. Better integration of GIPHY’s services into widely used social media platforms is an obvious benefit to the users of those platforms. Given Facebook’s assurances that it will not end GIPHY’s contracts with other services and platforms, there is little to no evidence of consumer harm from the merger. In contrast, there is an obvious loss to consumer welfare from the merger not going ahead.

## 3. Counterfactual

The counterfactual the CMA constructs to assess how GIPHY might fare in the absence of the takeover is implausible.

To begin with, the provisional findings admit that GIPHY is a loss-making enterprise. The company has been unable to establish a successful monetization model. The provisional findings also indicate that several potential buyers of the company had dropped out of the bidding process due to the Covid-19 pandemic. Although this section of the findings is heavily redacted, it appears that there were only a few companies with the capability of turning round GIPHY's loss-making model through immediate integration, and that of those, only Facebook had made a substantive offer.

Nevertheless, the CMA asserts that GIPHY could have survived, despite the pressures of the pandemic, and continued to innovate and develop its model, perhaps even somehow developing an advertising model that could have grown to threaten Facebook. It is hard to reconcile this with the business situation on the ground; it is, in the end, purely speculative, going beyond the requirements to produce a robust hypothetical alternative.

It is hard to see how many more funding rounds GIPHY could attract while still making losses and without the prospect of acquisition by a larger technology player. Like the "underpants gnomes" of TV's South Park, there is a missing step in the Authority's logic between "GIPHY remaining independent" and "profit."

This step is particularly apparent in the CMA's findings relating to GIPHY's putative advertising business. Not only has the Authority committed the relevant market fallacy in separating display advertising from other forms of advertising, but the finding that GIPHY's loss-making "paid alignment" model could potentially become a competitor to Facebook in the display advertising space is highly speculative. As the provisional findings say, "Despite ... plans for expansion, GIPHY's forecasts did not envisage becoming anything like the size or scale of Facebook in the medium term." Such speculation in no way justifies the exercise of extraterritorial powers, especially when the CMA admits that the potential entrant into the market "is likely to be small."

Once again, the counterfactual used by the Authority does not establish any consumer harm compared with the merger going ahead. A more realistic counterfactual or set of counterfactuals might suggest that GIPHY's services could indeed be lost to consumers as the business withers on the vine.

Finally, the Authority speculates that Facebook would have an incentive to cease offering the GIPHY library to competitors. Such an outcome would not be economically rational, especially as Facebook has committed to honour GIPHY's contracts with competitors. The Authority should have better reason than mere speculation to assume that Facebook would breach its contracts in this way. Moreover, the finding is in tension with the frequent observation in the findings that Facebook would acquire more data about users because of the merger. If that

data is as valuable as is suggested, then Facebook would have far less incentive to cut off competitors than the Authority admits.

#### 4. Chilling effect on innovation and investment

Unfortunately for consumers, the CMA does not consider the counterfactual of what happens in a world where acquisitions of small companies by larger ones are routinely policed by foreign competition agencies. We contend that this will have a chilling effect on start-ups, investment, and innovation.

First, the United States is the world leader by far when it comes to start-up companies. The USA is home, according to Startupranking.com, to over 68,000 start-ups compared to just over 5,000 for the UK (which is by far the leader in Europe). Per capita, the USA to UK ratio is closer to 3 to 1, but it is still the case that the US is home to a very large proportion of the world's start-ups.

However, recent changes to financial regulation in the United States have made it much more difficult for a US firm to go public via IPO at an early stage than it was in previous decades. This has meant that acquisition is an important part of the exit strategy built into most business plans (indeed, the recent growth of Special Purpose Acquisition Companies, or SPACS, appears to be a reaction to these regulatory changes.)

If the prospect of acquisition being stopped by a foreign agency grows, the regulatory burden on start-ups will grow considerably, creating a chilling effect on their formation. It may become easier for the potential entrepreneur simply to take her idea to a large company in the first place.

The second chilling effect will be on investment. Venture capitalists will have fewer opportunities to invest, and they are likely to make lower profits from those investments they do make. This will affect the British investment market just as badly as that of the United States.

Finally, the dearth of start-ups and investment will lead to a chilling effect on innovation. The CMA should be familiar with the late Harvard Professor Clayton Christensen's concept of "the innovator's dilemma," which suggests that most true innovations happen outside existing corporate entities.

As a result, companies looking for innovations need to look for innovations to acquire as much as to develop in-house. If they cannot acquire innovations, there will be fewer of them, as currently only larger companies have the capabilities needed to bring many innovations to scale. While it remains entirely plausible that the next Facebook is being thought up right now in a dorm room or garage, the likelihood of it happening is lessened as more regulatory burdens are piled on entrepreneurs by well-meaning agencies.

For all the above reasons, we submit that the CMA should revisit its provisional findings and allow the merger to go ahead.

Sincerely,

Iain Murray  
Competitive Enterprise Institute  
iain.murray@cei.org

Matthew Lesh  
Adam Smith Institute  
mlesh@adamsmith.org