

Completed acquisition by Facebook, Inc. of GIPHY, Inc.

Summary of the CMA's decision on relevant merger situation and substantial lessening of competition

ME/6891-20

Introduction

1. On 15 May 2020, Facebook, Inc. (**Facebook**) acquired GIPHY, Inc. (**GIPHY**) (the **Merger**). Facebook and GIPHY are together referred to as the **Parties**, or for statements referring to the future, the **Merged Entity**.
2. The Facebook group offers various online products and services to customers in the UK, including the Facebook app, Instagram, Messenger, WhatsApp, Oculus, Portal and Workplace.
3. GIPHY is also active in the UK, with an online database and search engine that allows users to search and share GIFs and GIF stickers. A GIF is a digital file that displays a short, looping, soundless video, while a GIF sticker displays an animated image comprised of a transparent (or semi-transparent) background over which images or text are placed. Unless otherwise specified, the term 'GIFs' refers to both video GIFs and GIF stickers. GIPHY offers its GIFs and GIF stickers both on its own website and app, and via Application Programming Interfaces (**APIs**) that allow third party apps (eg Snapchat, TikTok or Instagram) to integrate GIPHY's GIF and GIF sticker databases. GIPHY's products are offered free of charge to users and companies using its APIs globally. Until May 2020, GIPHY generated revenues in the United States by offering brand partners a 'paid alignment' service to align their GIFs with popular search terms (so that users see them first when searching for a GIF), or to insert them into GIPHY's trending feed, in exchange for a fee.
4. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of Facebook and GIPHY is an enterprise and that these enterprises have ceased to be distinct as a result of the Merger. The four-month period for a decision, as extended, has not yet expired. The CMA believes that the share of supply test is or may be met on two bases (which are distinct from the frames of reference in which the CMA has found concerns, as described in more detail below):

- (a) The supply of apps and/or websites that allow UK users to search for GIFs, in which the Parties have a combined share (by average monthly searches) of [50-60]% with an increment of [0-5]%; and
 - (b) The supply of searchable libraries of animated (ie non-static) stickers (including both GIF and non-GIF stickers), provided direct to users in the UK, in which the Parties have a combined share (by sticker library size) of [80-90]% with an increment of [0-5]%.
- 5. The CMA has considered the impact of the Merger against two counterfactuals, and considers that the realistic prospect standard is met in both scenarios:
 - (a) Pre-Merger conditions, in which GIPHY would have continued to operate independently of Facebook, generating revenue through activities such as its paid alignment contracts and pursuing additional funding via external investment; and, in the alternative
 - (b) The acquisition of GIPHY by an alternative purchaser, possibly another social media platform.
- 6. To the extent that one counterfactual scenario is considered more competitive than the other, the CMA has considered this further in its competitive assessment.

Frame of reference

- 7. The CMA considered whether GIFs are substitutable for other types of content. The CMA has found that GIFs have unique characteristics that differentiate them from other types of content (eg videos, music, micro-games, animations, emojis, animojis, memes, etc), and that GIPHY's internal documents did not suggest that GIPHY considered other content types as competitive constraints. The CMA also found that an important part of Facebook's rationale for the Merger focused on the importance of GIFs specifically, and the impact on Facebook were it to lose access to GIPHY's GIFs.
- 8. The CMA considered whether the product frames of reference for social media platforms and for display advertising should be expanded. In particular, the CMA carefully considered the findings in its recent market study into online platforms and digital advertising (the **Market Study**), which found that the strongest competitive constraints on Facebook with regard to social media were imposed by providers that were close substitutes, and that providers in other sectors are unlikely to provide a strong constraint on Facebook. In

relation to digital advertising, the Market Study found that search and display advertising serve distinct purposes, with only limited substitutability between them, and that there is limited substitutability between digital advertising and traditional advertising media. The CMA found no evidence suggesting that different product frames of reference would be more appropriate.

9. With regard to geographic frame of reference, the CMA found that:
 - (a) in relation to the supply of searchable GIF libraries, GIPHY's GIFs are generally available to users throughout the world, as are the GIFs provided by GIPHY's competitors;
 - (b) in relation to social media, Facebook and its competitors' services are generally available to users throughout the world (which is also supported by previous cases in this sector); and
 - (c) in relation to display advertising, advertisers are often interested in targeting users with particular characteristics, including (among others) their location, language and culture, supporting a national frame of reference.
10. The CMA has therefore assessed the impact of the Merger in the following frames of reference:
 - (a) The supply of searchable GIF libraries worldwide;
 - (b) The supply of social media worldwide; and
 - (c) The supply of display advertising in the UK.

Competitive assessment

11. The CMA's recent Market Study concluded that Facebook had significant market power in both social media and display advertising. In particular, the Market Study found that the competitive threat to Facebook from the entry and expansion of other platforms is limited by several self-reinforcing barriers, including same-side network effects, cross-side network effects, and the breadth of the Facebook 'family' of apps. The Market Study also found that Facebook is by far the largest supplier of display advertising, and that it is viewed as a 'must have' by advertisers both because of its reach and its extensive data on users. Facebook's 'data advantage' both increases the value of Facebook's advertising inventory and creates barriers for its competitors in display advertising.

12. Given the recency of the Market Study findings, and the breadth of evidence considered by the Market Study, the CMA believes that the evidence and findings of the Market Study are relevant for the competitive assessment of the Merger, and that any reduction in competitive constraints should be considered in the context of Facebook's existing market power in social media and display advertising. In this context, the CMA's concern about any given level of constraint removed or reduced by the Merger may be greater than in a scenario where Facebook did not have such significant market power.
13. The CMA has considered the following four theories of harm:
 - (a) Theory of harm 1 (**TOH1**): Loss of potential competition in display advertising;
 - (b) Theory of harm 2 (**TOH2**): Vertical effects through the foreclosure of social media platforms;
 - (c) Theory of harm 3 (**TOH3**): Raising barriers to entry and expansion by increasing Facebook's data advantage in display advertising; and
 - (d) Theory of harm 4 (**TOH4**): Loss of potential competition in the supply of searchable GIF libraries.

TOH1: Loss of potential competition in display advertising

14. The CMA has considered whether the Merger may lead to a loss of potential competition in display advertising. In particular, the CMA has considered whether, absent the Merger, GIPHY would have expanded in digital advertising, including via its paid alignment offering, and whether this would have resulted in greater competition with Facebook. The CMA considered whether the Merger may (i) reduce GIPHY's incentives to continue with ongoing efforts towards expansion, and/or (ii) lessen future competition between Facebook and GIPHY; both these effects could cause competitive harm in display advertising.
15. The CMA has found that while GIPHY was not active in digital advertising in the UK at the time of the Merger, it had plans to start monetising its GIFs internationally outside the US, including in the UK, and to increase the overall scale of its digital advertising activities through its paid alignment services absent the Merger. One of the unique selling points of GIPHY's paid alignment services is the opportunity to include non-intrusive adverts within messages when users browse or search for GIFs. This is reflected in GIPHY's internal documents, some of Facebook's internal documents also discuss the importance of monetising messaging.

16. The CMA also found that while GIPHY was yet to reach profitability at the time of the Merger and had not yet begun providing paid alignment services to UK customers, GIPHY's revenues from its US sales had been increasing prior to the Merger, and it had plans to expand internationally. The CMA also found that GIPHY had only recently started offering digital advertising, via its paid alignment services, having invested significant resources to reach its size and build its network of integration partners. Accordingly, the CMA believes that its revenues understate its expansion potential. The CMA also found that GIPHY's ability to raise external funding indicated that external investors believed that GIPHY had the potential to generate significant revenues from digital advertising in future, and that this was likely the basis on which GIPHY was able to obtain such funding.
17. In the context of Facebook's significant market power in display advertising, the CMA also found that were GIPHY to expand successfully in digital advertising, and were GIPHY's paid alignment opportunities to become a prominent channel for advertising on messaging and other social media platforms, Facebook would potentially face stronger competitive constraints in display advertising, which could threaten its market power and push it to compete more vigorously.
18. The CMA believes that the Merger may reduce GIPHY's efforts to expand its digital advertising business – both geographically and in terms of range of advertising formats and partners – reducing future competition in display advertising. In particular, the CMA notes that GIPHY's paid alignment services may strengthen the advertising offering of messaging and social media platforms competing with Facebook. This impact may have been even more significant if GIPHY had been acquired by an existing display advertising competitor such as another social media platform. By acquiring GIPHY, an alternative platform could have strengthened its digital advertising offering and posed a stronger competitive constraint on Facebook.
19. The CMA therefore believes that the Merger gives rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of a loss of potential competition in display advertising.

TOH2: Vertical effects through the foreclosure of social media platforms

20. The CMA has considered whether, as a result of the Merger, the Merged Entity could harm Facebook's rivals and lessen current and future competition in social media and display advertising by (i) ceasing to supply GIPHY's GIFs via GIPHY's API integrations (total foreclosure), and/or (ii) engaging in strategies that worsen the terms of GIPHY's supply or otherwise harm

Facebook's competitors, such as requiring them to provide more user data to access GIPHY (partial foreclosure). These foreclosure strategies could also limit competitors' ability to benefit from revenue share agreements with GIPHY, which could be particularly significant were GIFs to become an important advertising channel.

21. With regard to the Merged Entity's ability to engage in foreclosure, the CMA has found that GIFs are an important feature for driving user engagement on online platforms and that GIFs may become an even more important input for social media platforms in future as an advertising channel within messaging. Third parties told the CMA that having a significantly worse GIF offering would have some impact on their competitiveness and ability to win and retain users. The CMA also found that usage of GIFs has been growing rapidly in the last few years and that GIFs appear to be particularly popular among younger users – the CMA believes that this trend may continue in future.
22. Whilst Tenor (which is owned by Google) is generally viewed as a strong competitor to GIPHY (both by third parties and in GIPHY's internal documents), other GIF providers were considered less attractive by third parties who responded to the CMA. In line with this evidence, GIPHY had by far the highest share of API/SDK searches in the UK in 2019 ([80-90]%), followed by Tenor ([10-20]%). In contrast, Gfycat – the next largest competitor – had a very low share ([0-5]%). While some integration partners may be able to switch to Tenor in the event of foreclosure, the CMA has found that for some social media platforms, it is important for them to have more than one GIF provider. Some third parties also submitted that switching to another GIF provider could affect user experience and/or engagement on their platforms. Importantly, the CMA believes that, were GIFs to become an important advertising channel in the future, their importance to social media platforms may increase significantly, providing them with an opportunity to enhance their digital advertising offering.
23. With regard to the Merged Entity's incentive to engage in foreclosure, the CMA has considered the costs and benefits of a vertical foreclosure strategy. In particular, the CMA believes that total or partial foreclosure may harm Facebook's competitors by affecting user experience on their platforms, to the benefit of Facebook, which would face weaker competitors as a result. Total or partial foreclosure could also limit Facebook's competitors' ability to benefit from revenue share agreements with GIPHY, which could be particularly significant were GIFs to become an important advertising channel.
24. The CMA also believes that there is little risk of any reduction in GIPHY's traffic materially affecting the quality of GIPHY's services as a result of total or

partial foreclosure, suggesting that there is little cost to Facebook of adopting such a strategy. As the Market Study found, Facebook's activities are highly profitable, and, overall, the CMA believes that Facebook may benefit substantially from any strategy that may weaken Facebook's competitors and sustain Facebook's market power, and there would be limited cost to doing so.

25. With regard to the effect of any foreclosure strategy, in the context of Facebook's significant market power in both social media and digital advertising, the CMA found that any reduction in competitive constraint resulting from a foreclosure strategy may give rise to greater concerns than in a scenario where Facebook did not have such significant market power in social media and display advertising.
26. The CMA therefore believes that the Merger gives rise to a realistic prospect of an SLC as a result of vertical effects in social media and display advertising.

TOH3: Raising barriers to entry and expansion by increasing Facebook's data advantage in display advertising

27. As noted above, the CMA's recent Market Study found that Facebook has a significant data advantage over smaller platforms and publishers, which creates barriers for its competitors to overcome. The CMA has assessed whether the Merger may further raise these barriers to entry and expansion by increasing Facebook's data advantage in display advertising.
28. The CMA has found that the Merger may lead to Facebook having access to additional data via GIPHY about the usage of GIFs on competing platforms. However, the evidence seen by the CMA does not suggest that the additional data to which Facebook may gain access post-Merger would materially increase its existing data advantage. Facebook's access to its competitors' user data may be limited by GIPHY integration partners' ability to curtail the data that is passed to GIPHY through proxy and content caching servers. Whilst the Merged Entity may require Facebook's competitors to provide more user data as a condition of accessing GIPHY after the Merger, the evidence suggests that at least some competitors would stop using GIPHY rather than providing more user data, even if this were to result in a deterioration in their offering (see TOH2 above). This suggests that even in these circumstances, the amount of new data gained by Facebook and the impact that this data may have on Facebook's data advantage may be limited.

29. The CMA therefore believes that the Merger does not give rise to a realistic prospect of an SLC as a result of raising barriers to entry and expansion by increasing Facebook's data advantage in display advertising. However, to the extent that the Merged Entity may require more user data from its integration partners as a condition of accessing GIPHY, this has been taken into account in the assessment of TOH2.

TOH4: Loss of potential competition in the supply of searchable GIF libraries

30. The CMA assessed whether, absent the Merger, Facebook would have successfully developed a searchable GIF library, and whether this would have resulted in increased competition. The CMA found that a few of Facebook's internal documents discussed the possibility of building its own GIF library, but that this was not its preferred option. Were GIPHY to have been acquired by a third party competitor, absent the Merger, the CMA believes that developing a GIF library may have become a priority for Facebook. The CMA also considered a number of factors which suggest that Facebook would have had the ability to successfully build its own GIF library, including Facebook's resources and large existing user base. The CMA believes Facebook may have had the ability and incentive to develop a GIF library, in the scenario where GIPHY was acquired by a third party competitor.
31. The CMA also considered whether Facebook's expansion would have had an impact on competition, noting that if Facebook had successfully developed a GIF library, there would be an increase in the total number of GIF libraries. However, Facebook's internal documents indicate that Facebook's sole motivation would have been self-supply and the CMA has not seen any evidence to suggest that Facebook would have provided third parties with access to its GIF library. In these circumstances, the CMA does not believe that the Merger would have a material impact on competition for the supply of GIF libraries.
32. The CMA therefore believes that the Merger does not give rise to a realistic prospect of an SLC as a result of a loss of potential competition in the supply of searchable GIF libraries.

Conclusion

33. The CMA therefore believes that it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC as a result of:
- (a) loss of potential competition in display advertising in the UK, and

(b) vertical effects, in relation to social media worldwide, and in relation to display advertising in the UK.

34. The CMA is therefore considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (**the Act**). Facebook has until 1 April 2021 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger pursuant to sections 22(1) and 34ZA(2) of the Act.