



The Competition and Markets Authority's Call for Evidence on Merger Efficiencies

Response from BRG experts

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I Introduction and Executive Summary

BRG is a global economic consultancy that regularly advises clients on issues relating to UK merger control. This response sets out BRG experts' views on the Competition and Markets Authority's (CMA) call for evidence on merger efficiencies, drawing on our experience advising on UK merger control. We welcome the opportunity to respond to the CMA's call for evidence.

In this response, we discuss a range of rivalry-enhancing- efficiencies that mergers can generate, such as the combination of complementary assets, reductions in variable and long-run costs and the elimination of double marginalisation (EDM). These efficiencies can materially strengthen competition and benefit UK consumers.

While the CMA acknowledges such benefits in its Merger Assessment Guidelines (MAGs),¹ in practice its approach remains asymmetric: potential harms are examined extensively, whereas efficiencies typically receive limited engagement and are considered only after a provisional substantial lessening of competition (SLC) finding. This sequencing, combined with high evidentiary thresholds, means that rivalry-enhancing efficiencies rarely influence outcomes.

We propose four targeted changes to the CMA's merger control procedure and assessment to move towards a more balanced assessment framework: (1) earlier and more meaningful engagement with efficiencies, including at pre-notification and Phase 1, (2) incorporating efficiencies directly into the SLC analysis to reflect the net competitive impact of a merger, (3) applying a more symmetric evidentiary standard when assessing the harms and benefits arising from mergers, and (4) strengthening the CMA's analytical toolkit to better capture dynamic and non-price dimensions of competition.

Taken together, these adjustments would allow the CMA to assess more accurately the overall impact of mergers on competition and ensure that pro-competitive efficiencies are given appropriate weight.

II There are a range of rivalry-enhancing efficiencies

We consider a range of rivalry-enhancing efficiencies the CMA should account for in its assessment of mergers (where relevant). These include:

1. **Combination of complementary assets:** when one merging party is more productive at certain roles than the other, a merger can create a more competitive firm to the benefit of consumers. For example:

¹ <https://www.gov.uk/government/publications/merger-assessment-guidelines>

- a. A merger between a firm with access to cheaper capital and a firm with innovative products can facilitate the roll-out of innovative products to markets, benefitting customers and intensifying competition.
 - b. An acquisition by a firm with high-quality management of another with poor-quality management can result in lower prices/higher-quality products for the target's customers as the high-quality management replaces the low-quality management.
 - c. In data-driven markets, a merger between two firms with complementary sets of data can allow the merged entity to deliver higher-quality products to customers.
 - d. A merger in a market where scale is necessary to deliver higher quality and lower prices will benefit customers and competition (e.g. Vodafone/CK Hutchison).
2. **Variable cost reductions:** a merger can result in the merged entity realising lower variable costs, which economic theory identifies will be passed on to customers (at least in part). For example:
- a. A larger, merged entity may enjoy volume discounts (e.g. due to enhanced buyer power), reducing its variable costs of production.
 - b. A merger may reduce variable costs by allowing the merging parties to secure the lowest possible input prices or by converging on the best technical solutions ("best in class").
 - c. An EDM in a vertical merger, such that the merged entity will have an incentive to lower prices downstream, as downstream prices will include only one markup over upstream variable costs (EDM is therefore equivalent to a reduction in variable costs for the merged firm).
3. **"Fixed" cost reductions:** mergers can also result in cost savings which are not variable in the short run (e.g. a merger which eliminates duplicative assets). While these are not typically considered in merger assessments, all costs become variable in the long run, and efficiencies in short-run fixed costs (e.g. by employing more efficient, productive technology in relation to overheads) will eventually become variable. If a merger reveals a more efficient and productive way to operate to the market, this is expected to lead to all firms implementing that productive technology, and—given that these costs are variable in the long run—these efficiencies will lead to lower prices to the benefit of consumers.

III The CMA currently applies an asymmetric approach in merger reviews

In its MAGs, the CMA acknowledges the benefits that can arise from mergers. However, notwithstanding this acknowledgement, the MAGs employ an asymmetric approach to assessing (1) rivalry-enhancing efficiencies (i.e. pro-competitive effects) and (2) SLCs (i.e. anti-competitive effects). The focus of the analysis is almost entirely on assessing whether the conditions for an SLC exist with limited consideration given to rivalry-enhancing efficiencies. This asymmetry has been borne out in the CMA's historic merger control activity, in which only a handful of cases have extensively explored merger efficiencies.²

² Since 2018 we are aware of only *Vodafone/CK Hutchison* and *Sainsbury's/Asda*.

The MAGs set out that rivalry-enhancing efficiencies should meet each of the following conditions:³

- enhance rivalry in the supply of those products where an SLC may otherwise arise
- be timely, likely and sufficient to prevent an SLC from arising
- be merger-specific
- benefit customers in the UK

These conditions create a high bar for merging parties to have cases with rivalry-enhancing efficiencies accepted by the CMA, and the testing of these conditions is usually much more stringent than the test for whether a merger gives rise to anti-competitive effects. Moreover, the CMA typically does not engage meaningfully with efficiencies put forward by merging parties at an early stage. For instance, efficiencies tend not to feature during pre-notification or Phase 1. Engaging only at Phase 2 leaves the CMA with limited time to comprehensively understand the efficiencies specific to each case.

It is therefore unsurprising, based on our review of the CMA's Phase 2 decisions since 2018, that the CMA has (1) rarely concluded that rivalry-enhancing efficiencies have met its strict criteria (as detailed above)⁴ and (2) not yet cleared a merger based solely on rivalry-enhancing efficiencies that otherwise created an SLC.

This approach—or downplaying or ignoring potential merger efficiencies—is inconsistent with the CMA's approach in other aspects of the competitive assessment. For instance, the CMA regularly recognises that larger firms can be more effective competitors. The CMA often places a greater weight on branded or national chain competitors (e.g. in local markets cases). It must follow that a merger between a branded/national chain and an independent must have a rivalry-enhancing component because the merger will lead to the independent firm becoming part of a branded firm, and hence its competitive “weight” will increase. The CMA's thinking is presumably that the competitive offer of the branded/national chain firm is more attractive to rivals. If so, it must follow that it would make sense for the branded/national chain firm to introduce that offer into the target and hence increase rivalry where the target firm is present.

This example clearly meets the four conditions set out in the MAGs. It (1) enhances rivalry by definition, (2) arises at the same time as any potential SLC or in short order after the merger, given that the acquirer has every incentive to generate the competitive benefits from the merger as quickly as possible, (3) is merger-specific—otherwise the target would have replicated them itself prior to the merger, and (4) benefits customers in the UK.

Similarly, in considering whether rivals are credible purchasers for divested assets, competition authorities including the CMA typically restrict their attention to purchasers that are considered credible by customers. These are typically larger firms with greater financial resources and market presence. Again, if it is necessary to be of a sufficient size to be a credible purchaser (read: competitor), mergers that create new firms above this size threshold are likely to increase competition and rivalry.

³ MAGs, paragraph 8.8.

⁴ The only example we have found is *Sainsbury's/Asda* (2018), where the CMA concluded that the rivalry-enhancing efficiencies claimed by the parties passed its evidentiary bar for grocery-related efficiencies (but not fuel-related ones).

The CMA's historic practice therefore reveals both an asymmetry in approach and inconsistencies in thinking about rivalry-enhancing efficiencies.

IV The CMA should move towards a more symmetric merger assessment through four targeted changes

The current approach to dealing with merger efficiencies—after the finding of an SLC—inevitably means that in almost all cases the CMA and merging parties will have no meaningful engagement. The process by which the CMA identifies first whether there is an SLC, before considering whether merger efficiencies might offset that SLC, results in three problems:

1. Given that the CMA will have already concluded that a transaction gives rise to an SLC, it is not realistic for the CMA to approach the question of efficiencies with an open mind at that stage, no matter how independent and neutral the CMA seeks to be.
2. There is immense time pressure at the point that the CMA has made a provisional SLC finding, and it is not realistic to think that the CMA has sufficient time or resources to engage properly with the question of efficiencies at this stage, even if the previous point did not apply.
3. It is conceptually incorrect to consider efficiencies only once an SLC finding has been made. All the efficiencies set out in Section II above will increase rivalry and should therefore be taken into account at the stage of assessing the prospect of an SLC.

Given these issues, we would suggest that the CMA move towards a more symmetric assessment framework by making four changes to its merger control procedure and assessment:

1. **Early and meaningful engagement with efficiencies.** The CMA should engage seriously with efficiencies claims as early as practicable, including during pre-notification and Phase 1. This could be achieved through greater emphasis on efficiencies in early requests for information and in teach-in sessions, ensuring that the CMA understands potentially pro-competitive aspects of a merger from the outset.
2. **Incorporating efficiencies into the SLC assessment.** Efficiencies should be incorporated into the assessment of whether an SLC is likely, rather than being considered only at a later stage after an SLC has been identified. Many efficiencies represent pro-competitive changes in price or non-price parameters of competition and there is no reason to exclude them from the core competitive assessment. The SLC test should reflect the net effect on competition, taking account of both anti- and pro-competitive effects. On this basis, mergers should be cleared at Phase 1 where, following a holistic assessment, there is no realistic prospect of an SLC overall once rivalry-enhancing efficiencies are considered. This approach would also incentivise merging parties to bring forward efficiencies claims, providing robust evidence earlier in the process and allowing the CMA more time for a reasoned assessment.
3. **A symmetric evidentiary standard for efficiencies and harms.** The CMA should update its approach in order to apply a more symmetric evidentiary standard to anti-competitive effects and efficiencies. At present, efficiencies are required to be timely, likely and merger-specific; but SLC findings, particularly in dynamic markets, can be based on distant and uncertain

theories of harm. We recognise that some efficiencies, particularly innovation-related effects, are inherently more uncertain and may materialise over longer time horizons. It is therefore reasonable for the CMA to weight more uncertain or more distant effects less heavily than effects that are more immediate or certain (although a similar argument would also apply to SLC findings). However, where the potential upside is large, such efficiencies should still carry material weight (again, with a similar argument applying to SLC findings).

- 4. Strengthening the analytical toolkit for efficiencies.** Finally, the CMA should update its standard analytical toolkit to place greater emphasis on the incorporation of efficiencies. This could include greater use of techniques that include non-price and/or dynamic dimensions of competition, such as investment, innovation and product quality, alongside traditional price effects.

The CMA may consider that merging parties do not currently present sufficient evidence on efficiencies resulting from mergers at an early stage in the process for these proposed changes to work. However, our experience is that this is because there is a belief that the CMA will not consider these arguments seriously in any event, and that—because an efficiencies argument can only be taken into account once an SLC finding has been made—acknowledging efficiencies at an early stage is a tacit admission by merging parties of potential merger concerns. Individual parties cannot realistically overcome these concerns by themselves. Only the CMA can alter the relevant dynamic.

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