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## Beijing's Antitrust Blunder

*By any normal standard, the Coke-Huiyuan deal would have been approved with flying colors.*

By **PATRICK CHOVANEC** | From today's Wall Street Journal Asia.

The Chinese government's summary rejection, on antitrust grounds, of Coca-Cola's \$2.4 billion bid to buy Chinese juice-maker Huiyuan sent a sharp chill through the global business community when it was announced last week. Since this was China's first major ruling under its new competition law and China has not specified the criteria it's using, experts are poring over it for clues as to how Beijing will put the law into practice. One place to start is by comparing this outcome to what might have happened if regulators in the United States or European Union had vetted the deal.

With any newly proposed merger, the first step in both the U.S. and EU is to use an economic measurement called the Herfindahl-Hirschmann Index (HHI) to screen for whether the deal poses any concern that might merit regulatory scrutiny. HHI is the sum of the squares of the market shares of each competitor. (For example, a market with 100 firms that each have a 1% market share would generate an HHI of 100, whereas a market divided 50-50 between two firms would produce a score of 5,000.) The higher the HHI, the more concentrated the industry, and the greater the chance a large player can exercise anti-competitive pricing power.

The threshold test in both the U.S. and EU is similar: Proposed deals with a post-merger HHI of less than 1,000 are presumed not to pose any antitrust concerns, and generally receive preemptory approval without any further inquiry. Even mergers that generate HHI scores above 1,000 may receive immediate approval if they produce only modest changes in the industry's HHI. Failing the threshold test does not mean the deal is rejected, just that a more thorough evaluation is required.

How would the Coke-Huiyuan deal have fared under such initial scrutiny? By my calculations, the transaction produces HHI scores that would have resulted in a summary dismissal of antitrust concerns in either the U.S. or EU.

Using recently released 2008 market share data from Euromonitor, I calculated the pre- and post-merger HHIs for the fruit- and vegetable juice market in China. Coca-Cola's company market share for all its juice brands was the largest in China at 11.8%, while Huiyuan's was second-largest at 8.5%. We will generously assume their geographical markets within China overlap each other entirely. The post-merger HHI works out to 552, up from 352 before the deal -- well shy of the threshold for pursuing even a serious inquiry.

Chinese media has focused on Huiyuan's 33% share of China's pure juice market as prima facie evidence of industry concentration. Based on the principles applied by U.S. and EU regulators, however, pure juice is too narrow a market definition because many kinds of juice products are seen as potential substitutes by consumers.

The Ministry of Commerce, which vetted the deal, implied in a statement that it was focused on the broader not the narrower market, expressing concern that Coca-Cola could leverage its commanding 52.5% share of China's soda market to exercise anticompetitive power over the soft drink market as a whole. So let's take a look at Euromonitor's 2008 data for the soft drink market, which includes all nonalcoholic, nondairy branded products. Coca-Cola has a

15.8% market share, while Huiyuan a 2.0% market share. The post-merger HHI comes in at 639, up from 576 before the transaction -- higher, but still way short of the threshold of 1,000.

The fact that Beijing scuttled a deal that would not even qualify for investigation in the U.S. or EU suggests either that it will apply a significantly stricter standard than these two counterparts, or that antitrust enforcement is being used as a cover to enact a more political agenda. If the former is true, it will be interesting to see whether the same strict standards are applied to mergers among domestic Chinese companies, particularly state-owned firms. The recent pattern of large-scale, government-directed consolidations (such as China Netcom and China Unicom, or Shanghai Auto and Nanjing Auto) suggests this is rather unlikely.

The latter conclusion, that the Ministry of Commerce is pursuing a more political agenda, appears closer to the truth. The ministry's statement reveals what that agenda was: Coke's acquisition, it explained, would "threaten small and medium enterprises in the fruit juice sector, and create market conditions that have an adverse effect on China." In other words, China blocked the deal to protect domestic producers from a capable foreign competitor.

There is a precedent here. In 2005, Beijing blocked the Carlyle Group's bid to buy out construction equipment maker Xugong in what was widely viewed as a political play to keep foreigners out of a booming sector. Unfortunately, the message of the Coke-Huiyuan case seems to be that Beijing now has a new legal tool with which to impose similar results when it wants to.

As China's first major antitrust review, the Coca-Cola bid was the ministry's chance to set a solid, well-reasoned precedent that would establish the credibility of its new competition law -- and it botched it, badly. Instead, China sent the worst message it possibly could send to its global trading partners at this moment.

The real loser in this debacle won't be Coca-Cola, which has the resources to introduce and market its own brands in China. It will be the owners, employees and shareholders of Chinese companies like Huiyuan. With this precedent, the people who built these dynamic new brands -- in food, clothing, electronics and other sectors -- will reap a smaller reward for their efforts and enjoy fewer opportunities to take their firms to the next level of global competitiveness. China will be the loser.

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