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Brands, Consumer Protection, and Antitrust—Why China is Special

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I. INTRODUCTION

From China's first and only decision to block a merger, involving the purchase of the Huiyuan juice brand by Coca-Cola,² brands have been widely observed to be one of the important factors in Chinese merger control decisions. Brands are also at the forefront of Chinese industrial policy, with a clear focus from the State Council on the need for China to improve the quality of its brands.³ International commentators have noticed this, and have sometimes criticized the Ministry of Commerce ("MOFCOM"), the Chinese merger authority, for an excessive focus on protecting famous Chinese brands as a result of broader industrial policy.⁴

This paper proposes a microeconomic justification for treating brands differently in Chinese antitrust analysis. It argues that, due to the weaker level of consumer protection in China, there are good reasons for thinking that a strong brand confers more market power in China than it does in other jurisdictions, but also that this market power may have greater beneficial side-effects than it would elsewhere. As a consequence, we believe that it is correct in general to place a relative emphasis on brands in Chinese antitrust analysis, though we do not discuss to what extent MOFCOM treats brands differently from authorities in other jurisdictions, or whether the treatment of brand mergers in China is more compatible with industrial policy, social policy, or microeconomic considerations. Instead, we conclude with a discussion of the ways the special nature of brands in the Chinese economy might lead to decisions that may differ from those in alternative jurisdictions.

We focus almost exclusively on merger analysis in China due to the relative scarcity of relevant enforcement decisions in other areas of the law.

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² Notice of the Ministry of Commerce of the People's Republic of China, [2009] Order No. 22, *Coca-Cola/Huiyuan*, March 18, 2009. This decision found that brands are a critical factor that affects competition in the beverage market.

³ China's National Intellectual Property Strategic Guideline states that, as a part of the strategic targets for the next five years from 2008, a number of world-famous brands should emerge and a number of enterprises with famous brands and rich experience in utilizing the intellectual property system should also emerge. National Intellectual Property Strategic Guideline, [2008] Notice of the State Council No. 18, *available at* http://www.gov.cn/zwggk/2008-06/10/content_1012269.htm.

⁴ Terry Calvani & Karen Alderman, *BRIC in the International Merger Review Edifice*, 43 CORNELL INT'L L.J. 131 (2010).

II. BRANDS IN CHINESE ANTITRUST DECISIONS AND BROADER GOVERNMENT POLICY

The Chinese Anti-Monopoly Law itself does not mention brands; nor do published rules on implementing the substantive merger notification and review process.⁵ However, guidance concerning notification documents and materials requires companies to inform MOFCOM if the concentration involves “famous brands” among other factors.⁶ In addition, Article 12 of the Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors allows MOFCOM to review (and potentially block) deals that fall below the standard notification thresholds if they involve “famous Chinese brands.”⁷ While the recently released rules on China's national security review system do not mention brands explicitly,⁸ given the focus on brands elsewhere there is some uncertainty as to whether brands are included in the security analysis.

In any event, five high profile cases suggest that MOFCOM pays close attention to brands and their development:

- Coca-Cola/Huiyuan where, despite disagreement between commentators about whether industrial policy concerns affected the decision, it is uncontroversial that brands and brand power were important elements of the analysis;⁹
- InBev/Anheuser Busch¹⁰ where, as a remedy, InBev was not allowed to increase its shares in two famous Chinese brewers or acquire shares in another two of the largest domestic brewery groups;¹¹

⁵ The implementing rules include the rules on notification, review, competitive impact assessment, and business/asset divestiture published by MOFCOM, available at <http://fldj.mofcom.gov.cn/static/column/c.html/1>.

⁶ Guiding Opinion on Documents and Materials for Notifications of Concentrations between Business Operators, promulgated by MOFCOM on January 5, 2009, available at <http://fldj.mofcom.gov.cn/aarticle/xgxz/200901/20090105993841.html>.

⁷ MOFCOM revised the Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors in 2009 to ensure the consistency between that regulation, on the one hand, and the Anti-Monopoly Law and the merger filing thresholds set by the State Council, on the other hand. However, Article 12 of the regulation remains unchanged. According to that provision, mergers and acquisitions involving transfer to foreign investors of control rights of domestic enterprises owning famous brands or China time-honored brands shall be reported to MOFCOM in advance. See Regulation on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, as amended, available at http://www.gov.cn/flfg/2009-07/24/content_1373405.htm.

⁸ Circular of the General Office of the State Council concerning the Establishment of a Security Review System for Mergers and Acquisitions of Enterprises within China Involving Foreign Investors, [2011] General Office of the State Council Document No. 6, available at http://www.gov.cn/zwggk/2011-02/12/content_1802467.htm.

⁹ Wang Xiaoye, *Comments on MOFCOM's decision involving Coca-Cola and Huiyan*, presentation at Asian Competition Forum 2009: “MOFCOM's prohibition was pursuant to the AML and based on the market competition considerations and aimed to maintain effective competition in China's juice beverage market, [not to] serve to protect the homegrown brand.” See also, (Angela) Zhang Huyue, *Problems in Following E.U. Competition Law: A Case Study of Coca-Cola/Huiyuan*, PEKING UNIV. J. LEG. STUDIES, forthcoming: “Indeed, contrary to the critics' view that the Coca-Cola/Huiyuan decision was primarily influenced by protectionism, a more thorough study of the case reveals that the outcome may have been driven by MOFCOM's misreading of the E.U. competition law.”

¹⁰ Notice of the Ministry of Commerce of the People's Republic of China, [2008] Order No. 95, *Inbev/Anheuser-Busch*, November 18, 2008.

¹¹ Analysis of Euromonitor International reported by China Daily, available at http://www.chinadaily.com.cn/bizchina/2008-11/19/content_7219360.htm (English); analysis of Citic Securities, available at http://epaper.stcn.com/paper/zqsb/html/2008-11/19/content_44519.htm (Chinese); and analysis of Sinolink Securities, available at <http://www.yangtze.org.cn/news/?NewsID=003A003B003B00360039> (Chinese).

- Diageo/Sichuan Swellfun which was formally unconditionally cleared after a lengthy process reportedly involving senior government officials from both the United Kingdom and China as well as the divestiture of Quanxing—Sichuan Swellfun’s most famous brand;¹²
- Nestle/Yinlu which was also cleared unconditionally, but only after substantial negotiation at the provincial level that assured MOFCOM officials in Xiamen that the Yinlu brand would continue operating as a separate entity;¹³ and
- Yum!/Little Sheep which was expected to benefit the development of the Chinese brand and was unconditionally cleared in Phase 3 after lengthy analysis.¹⁴

In addition to standard concerns relating to ensuring a reasonable amount of competition, official pronouncements suggest Chinese brands should be supported to help Chinese firms move from being producers of commoditized goods to producers of the high value-added goods that the government would like them to aspire to.¹⁵

Further, and more relevant for our argument, is that strong brands help Chinese consumers trust the products they buy. In a speech to The National Quality Control Conference in July 2007, Chinese Premier Wen Jiabao said:

Only when our businesses have brand name products of proven quality can they capture a larger market and can their products build a good image for themselves. In the face of the new situation, we must fully understand the important significance of product quality and food safety, and so we must heighten our awareness of doing a good job in this regard.¹⁶

¹² Reuters Dealtalk, *Diageo's China deal signals rare breakthrough*, July 6, 2011, available at <http://uk.reuters.com/article/2011/07/06/us-dealtalk-china-takeovers-idUKTRE7650PH20110706>.

¹³ Xiamen Commerce Bureau, Nestle/Yinlu Case Approved and the Contract to be Signed at the China International Fair for Investment & Trade on September 8th, available at <http://www.xmtdc.gov.cn/jmzx/xwdt/274118.htm>: “The antitrust notification for Nestle’s acquisition of Xiamen Yinlu, a Chinese local brand of food and beverage, was accepted by MOFCOM on May 24, 2011 and unconditionally cleared on August 26, 2011. During the antitrust review, Xiamen Commerce Bureau, the MOFCOM branch in Xiamen, required Nestle and Yinlu to clarify the development plan of the “Yinlu” brand and the future operating mode of the Yinlu headquarter in Xiamen.” (Authors own translation).

¹⁴ See analysis of some MOFCOM expert(s) reported by China National Radio, available at http://www.cnr.cn/china/ygxw/201111/t20111114_508774937.shtml and the analysis of the spokesman of China Cuisine Association reported by China National Radio, available at http://www.cnr.cn/jingji/gs/201110/t20111027_508692501.shtml.

¹⁵ In May 2010, China’s government initiated the Chinese Brands Worldwide Proclamation with social responsibility, ethical innovation, energy saving, and emission reduction as the foci, in order to increase enterprises’ awareness of responsibility and enhance the influence of Chinese brands worldwide. In the press release of this initiative, it was again recognized that fostering national brands is important to make China from a world factory to an innovative nation. See Press Conference of the Kick-off Ceremony for “The Worldwide Proclamation on Chinese Brands,” available at <http://www.scio.gov.cn/xwfbh/qyxfbh/201005/t636949.htm>. It is also plausible that the role that brands play in shaping self-image and national identity may be a consideration, see Lily Dong & Kelly Tan, *The use of western brands in asserting Chinese national identity*, J. CONSUMER RESEARCH 504 (October 2009).

¹⁶ See Wen Jiabao Addresses the National Quality Control Conference in Beijing, available at http://news.xinhuanet.com/2007-07/27/content_6440596.htm.

We suggest that this second reason, the role of brands in strengthening consumer trust, is more important in China than in other jurisdictions, and that this has implications for merger analysis.

III. BRANDS, MARKET POWER, AND PRODUCT QUALITY INCENTIVES

Brands are more than just a trademark—they are a set of signals and designs that capture consumers' feelings and attitudes as well as their purchasing motives and logic.¹⁷ Despite this complexity, there are two broad theories of how brands affect consumer choice. The first, more traditional, theory is that brands help consumers provide important information about likely product quality and other characteristics.¹⁸ The second theory is that brands have a strong impact on consumers' sense of identity, and that a symbiotic relationship exists between consumers' own identities and the purchasing of brands that reinforce and shape that identity.¹⁹

The two theories of brand strength are not mutually exclusive, and are both applicable for most goods and services: A poor quality good not only reduces the customer trust of the brand as a mark of quality, but also likely undermines the strength of identification. While the second theory may be relevant for the construction of social policy, what is necessary for our argument is that the first theory has at least some power for most brand purchases in China.

If it is the case that brands associated with high quality goods or services have high levels of consumer value, then those goods or services will be able to command a premium in the market. Likewise, the firms that own those brands will have a high incentive to maintain high levels of quality since providing low quality goods will tarnish the brand. In these days of the internet and efficient consumer-to-consumer communication it is possible for only a few examples of poor quality control to cause substantial damage to a brand's image. As such, the greater the investment in the brand, the greater the brand's market power, and the greater the incentive for the firm to maintain quality for fear of losing the value of their investment.²⁰

In this way brands can resolve the problem of firms competing only on cost, at the expense of quality. If a number of firms in a market are all trying to develop trusted brands, then competition between those brands can lead not to excessive cost cutting and low quality, but to a fight to establish a reputation for high-quality and reliability. As such, brands can provide a market solution to a lack of consumer protection by exposing firms to clear pecuniary incentives to maintain consistent and trusted product standards.²¹

¹⁷ Burleigh B. Gardner & Sidney J. Levy, *The Product and the Brand*, 33 HARV. BUS. REV. 33 (March-April 1955).

¹⁸ Stacey Dogan & Mark Lemley, *Trademarks and Consumer Search Costs on the Internet*, 41 HOUS. L. REV. 777, 786-787 (2004).

¹⁹ Melanie A. Dempsey & Andrew A. Mitchell, *The Influence of Implicit Attitudes on Consumer Choice when Confronted with Conflicting Product Attribute Information*, J. CONSUMER RESEARCH 614 (June 2010). See also, Dong & Tan, *supra* note 15.

²⁰ Rachel E. Kranton, *Competition and the Incentive to Produce High Quality*, 70 (279) ECONOMICA 385-404 (August 2003) for an overview of the theory of brands, competition, and product quality, including analysis of situations where brand competition is not sufficient to increase quality.

²¹ A particularly interesting version of this argument is presented in David K. Round & Zeljka Sporer, *Globalisation and Consumer Protection in East Asia: is it a zero sum game?* ASIAN PACIFIC ECON. LIT. 39 (2003), which discusses the impact of the globalization of brands on their incentive to maintain both product and corporate responsibility standards. A failure in one country can impact the value of the brand across the world, as evidenced by the experiences of Nike, Nestle, and Apple.

The market power enjoyed by a product with a trusted brand will be particularly strong in the absence of strong consumer protection since there will be a relatively high risk for consumers of experimenting and purchasing from brands that they had not heard of, or do not yet trust.

While this argument holds in the majority of circumstances, there are exceptions. For example, in the absence of any competition even firms with a valued brand may face little incentive to maintain that value since consumers will not be able to go elsewhere if the value is diluted. In addition, if consumers find it hard to identify product quality and brand ownership then the incentives to maintain quality are also substantially reduced.

Nonetheless, theory clearly suggests that where consumer protection is weak, brands can provide consumers with substantial informational benefits to help support trust in the goods they buy, and provide businesses with strong incentives to cultivate and maintain that trust through high product quality standards. In the process, successful brands may also confer greater market power on the firms that own them due to the greater trust that consumers place in them relative to the outside option of experimentation.

IV. CONSUMER PROTECTION IN CHINA

If consumer protection in China is relatively weak, then there may be a case for Chinese merger authorities taking brands relatively more seriously.

Anecdotal evidence from the recent sequence of consumer protection scandals, in particular ones that have plagued the food industry, suggests consumer protection in China is relatively ineffective.²²

This is supported by an analysis of the law and institutional framework that makes consumer redress particular difficult. Consumer protection in China involves several law branches including economic, administrative, and criminal. The core statute is the Law on Protection of Consumers' Rights and Interests, which became effective in 1994 and is now being revised. Compared with other jurisdictions, China's consumer protection law is less effective because, among other factors, consumers' associations have no standing to bring public interest litigation; legal proceedings lack flexible arrangements for dealing with small disputes;²³ sanctions

²² During the meeting with the counselors of the State Council and the members of CPC Central Research Institute of Culture and History on April 14, 2011, Premier Wen Jiabao denounced the scandals of poisonous milk powder, clenbuterol, illegal cooking oil, and color steamed bread. *See* Wen Jiabao Meets the Counsellors of the State Council and the Members of the CPC Central Research Institute of Culture and History, *available at* http://www.gov.cn/ldhd/2011-04/17/content_1846206.htm. During 2011, a group of Chinese students read all the online news in Chinese on China food safety problem from 2004 to 2011 and set up a database on the status of China food safety at <http://www.zccw.info>. The database consists of 2,849 records showing the contaminated food, the place that the scandals relate to, and the harm to people's health, for the netizen's search based on keywords. The database is open for the netizen's update based on latest news. *See also*, Roland Berger Associates, *Brands and Buzz: Understanding how to Reach Today's Chinese Consumers*, ROLAND BERGER STRATEGY CONSULTANTS (2010). Figure C.1.3 outlines product quality issues that have affected Chinese consumers approach to brand attractiveness.

²³ According to Article 34 of the Law on the Protection of Consumers' Rights and Interests, consumers can resort to various remedies including conciliation with the business, mediation of consumers' associations, complaints to relevant administrative agencies, arbitration, and lawsuit. However, as consumers' associations lack "sanction power" and relevant administrative agencies do not always act in time due to unclear obligations among different agencies, if the businesses don't cooperate in conciliation efforts, and don't agree on arbitration, it would be time-consuming and expensive for consumers to get remedied in the normal lengthy litigation proceedings. Zheng Feng,

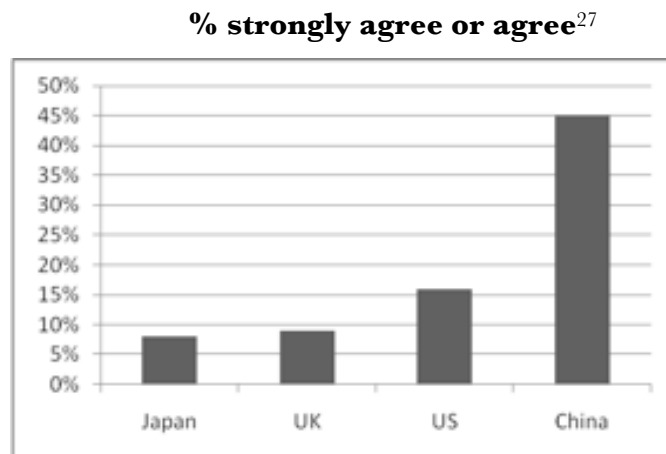
do not provide sufficient deterrence; and there is no product recall system.²⁴ These defects in the law make consumer redress difficult and decrease the effectiveness of the statute.²⁵

V. CHINESE CONSUMERS' APPROACH TO BRANDS

Theory predicts that, due to the low levels of consumer protection in China, Chinese consumers will place a greater emphasis on brands to signal product quality.

Empirical research conducted by McKinsey suggests that this is so, with Chinese consumers valuing brands highly²⁶ and using brands to distinguish quality more than consumers in other comparable countries:

Table 1: “Well known brands are of better quality”



Source: McKinsey & Company, McKinsey Consumer & Shopper Insights: 2010 Annual Chinese Consumer Study (2010), Exhibit 8

While Chinese consumers may also value brands as a way of forming and expressing identity,²⁸ it appears clear that Chinese consumers' strong preference for brands is in large part due to the ability of brands to signal product quality.

Revision and Improvement of the Law on the Protection of Consumers' Rights and Interests(2010), available at <http://fzsy.chinacourt.org/public/detail.php?id=4724>.

²⁴ *Id.*

²⁵ See Round & Sporer, *supra* note 21 at 45. Round & Sporer place China in the second worst category, out of four, for consumer protection outlook. The *Survey on the Status of China Consumers Protection 2010*, conducted by China Consumers News, its affiliated website, and Sina showed that, in 2010, among all the respondents, 97.10 percent of the surveyed consumers' rights were harmed and 55.6 percent of the harmed consumers did not demand damages or compensations. See 3·15 Annual Survey: Study the Truth behind the Figures, available at <http://www.ccn.com.cn/news/yaowen/2011/0314/350798.html>.

²⁶ McKinsey & Company, McKinsey Consumer & Shopper Insights: 2010 Annual Chinese Consumer Study (2010), p. 23: “One longstanding tenet of Chinese retailing is that consumers are extremely brand conscious.”

²⁷ *Id.*

²⁸ See Dong & Tan, *supra* note 15 for a discussion of the identity relationship between brands and Chinese consumers. However, the McKinsey report suggests that Chinese consumers' level of brand loyalty is actually quite low, offsetting any concern that it is brand image and aspiration that is the primary driver of the choice of final good. McKinsey Consumer & Shopper Insights: 2010 Annual Chinese Consumer Study (2010), p. 24: “While consumers tend to gravitate towards the biggest brands, the final purchasing choice is very often made on the basis of their assessment of the relative value offered by a handful of competing products.”

VI. IMPLICATIONS FOR POLICY

Chinese consumers place a high value on brands. This is at least in part because of the importance that they place on the ability of brands to communicate information about product quality. This is likely to be caused by the ability of brands to compensate for the lack of consumer protection in China. As such, brands are likely to confer greater market power than in other jurisdictions. However, trusted brands will also provide consumers with greater benefits.

These factors have implications for merger policy in at least three areas: the definition of the relevant market, the assessment of market power, and the assessment of the impact of a concentration.

A. Market Definition

If brands in China command greater value relative to unbranded, generic goods, then standard methods of defining the market, such as the SSNIP test, may lead to narrower market definitions. For example, where both branded and unbranded goods may be considered to be in the same market in Western jurisdictions, they may be in two separate markets in China, increasing market share and decreasing the chance of clearance in a merger procedure.

Such a conclusion would only be reliable if there was clear evidence that Chinese consumers do not consider generic goods a reasonable substitute for branded ones. Consumer surveys estimating diversion ratios between branded and unbranded goods may be particularly helpful.²⁹

B. Market Power

Determining the market and estimating market shares is only the first step of analyzing market power, and thus the likely impact of any concentration on competition. It is also necessary to consider factors such as the closeness of competition between the merging entities and the likelihood of new entry, to offset any increases in market power that a concentration may have led to.³⁰

If surveys suggest that consumers place particular value on brands in the relevant market, then this has two implications:

First, branded goods will be relatively closer competitors and competition between branded and unbranded goods will be relatively weak. As such, mergers between branded and unbranded goods will be relatively less harmful. More importantly, perhaps, mergers that reduce the number of brands competing with each other should be treated with caution. For example, if the market consists of two branded goods and a series of unbranded generic goods, even if the market shares of the two branded goods are not that large, the removal of competition between the brands may substantially reduce the firms' incentives to maintain or increase product quality in order to win market share from their rivals.

²⁹ A guide to good practice in designing and implementing consumer surveys to support merger filings can be found at http://www.ofc.gov.uk/shared_ofc/consultations/merger-inquiries/Good-practice-guide.pdf.

³⁰ Provisional Regulation on the Assessment of the Impact on competition of Concentrations between Business Operators, [2011] MOFCOM Order No. 55, available at <http://fldj.mofcom.gov.cn/aarticle/c/201109/20110907723357.html>.

Second, if brands are important, then market entry will be difficult, increasing the resilience of the market power of all brands within the market, and decreasing the chance that any reduction in competition created by a merger will be offset by future entry.

C. Impact of Concentration

The objective of the Anti-Monopoly Law in China is multifaceted, but includes consumer welfare, the public interest, and the healthy development of the socialist market economy.³¹ In the context of brands, all three of these require a balancing on behalf of the authorities between minimizing the market power of firms and maximizing the incentive of firms to provide high quality products.

The evidentiary basis for this balancing will usually require determining both the role quality plays in brand value, and the nature of brand vs. brand competition.

If brands are important to consumers as indicators of quality, then the market power that brands hold has value to the consumer, and is akin to the market power held by firms with superior products that consumers are willing to pay more for. This may be particularly relevant where a trusted brand in one market is considering the purchase of a firm with less trusted brands in another market. While its brand strength in the first market may give it an advantage over other participants in the second, any product quality failure in either market would damage the brand in both markets, leading the firm to have an increased incentive to maintain product quality in both markets.

As such, while the merger may negatively impact competition in the second market, perhaps through leveraging of unexploited market power, it may do so by providing consumers with a product which they can trust in that market, and, as long as consumers are aware that the brand operates in more than one market, exposing the merged entity to greater incentives to maintain that trust. We note, though, that this extension of brand power from one market to another will have substantially less beneficial effects if there are no alternative brands to which consumers can turn if the merged entity fails to maintain consistent quality standards.

VII. CONCLUSION

We have described how, in the absence of consumer protection, brands play a strong role in encouraging consumer trust in markets. Due to this role, brands also confer greater market power. Chinese consumers react to the low levels of consumer protection in China by placing a particularly value on brands, at least in part due to the informational signals that brands portray about quality. As a consequence, it is correct that antitrust policy in China may treat brands differently from how they are treated elsewhere.

We have provided three examples of where the special role and power of brands in China may lead to different merger decisions, and suggested the evidence that may be required to support such decisions. These are summarized in the table below:

³¹ Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No.68, art. 1.

Table 2: summary of possible impact of brands on merger decisions

Issue	Evidence required	Different conclusion
Market definition	<i>If</i> consumers place greater value on brands	<i>then</i> market definition might be restricted to only branded goods, excluding unbranded alternatives
Market power	<i>If</i> consumers place greater value on brands	<i>then</i> mergers between two branded goods might be looked at less favorably <i>then</i> mergers between branded and unbranded goods might be looked at more favorably
Impact of concentration between brands in one market and brands in another market	<i>If</i> consumers place value on brands as guarantors of quality, <i>and</i> brands face competition in at least one market	<i>then</i> the benefits of increased consumer trust might offset concerns about decreased competition through leveraging of market power

We have not provided an exhaustive account of how the special nature of brands in China might affect merger control, nor have we discussed its impact on the establishment of dominance or subsequent abuse. We also have not considered the industrial or social policy reasons why the Chinese government may wish to protect national brands, as distinct from merely encouraging brands that Chinese consumers trust. Nonetheless, we hope we have helped provide suggestions for how the special nature of brands in China may change antitrust decisions, and what evidence may be required to understand what those changes might be.