

Anticipated acquisition by Facebook Inc of Instagram Inc

ME/5525/12

The OFT's decision on reference given on 14 August 2012. Full text of decision published 22 August 2012.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Facebook, Inc. (Facebook)** is an internet platform for people to stay connected and to express themselves to their family and friends. Within the Facebook environment, there are multiple ways for users to share information including: posting news items, individual messages, displaying photos and videos, playing games and organising events. Third party software developers can develop apps and websites and make them available to users in the Facebook environment. In the year ended 31 December 2011, Facebook earned revenues of US\$3.7 billion from advertising, and sales of digital and virtual goods.
2. **Instagram Inc. (Instagram)** was founded in March 2010 and as at 6 June 2012 consisted of 13 employees. Instagram's product is a free mobile phone photo application. It functions by allowing users to take photos, apply digital filters to those photos, and then share those photos on the Instagram network or via other social networks, including Facebook. Instagram has generated no revenue since it was established.

TRANSACTION

3. Facebook proposes to acquire the entire issued share capital of Instagram for consideration of \$300 million in cash and 22,999,412 shares of

Facebook common stock (**Transaction**). Facebook proposes to acquire Instagram through [].

4. The Office of Fair Trading (**OFT**) opened its own investigation into the Transaction on 21 May 2012. The administrative deadline is 16 August 2012.

JURISDICTION

5. As a result of the Transaction Facebook and Instagram will cease to be distinct. Given that Instagram has not generated any turnover since it was established, the turnover test set out in section 23(1)(b) of the Enterprise Act 2002 (the **Act**) is not met. The parties overlap in the supply of virtual social networking services. Facebook's share of supply in the UK of virtual social networking services is over 25 per cent¹ and, given that Instagram is active in the supply of virtual social networking services, the Transaction would result in an increment.² Consequently, the share of supply test in section 23 of the Act is met.
6. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

FRAME OF REFERENCE

7. Social networks are two-sided markets. They compete to add users and to attract advertising revenue. Advertisers are willing to pay to purchase advertising space on the social networks' sites and apps based on the number of users that the network has and the information that the networks records on those users (for example, their demographics).

Product scope

8. Facebook is active in the provision of three relevant services: social networking to users, a camera app to users (launched after the

¹ As measured by Experian Hitwise Data: www.hitwise.com/uk/press-centre/press-releases/microsoft-bing-improves-uk-search-market-share/

² The parties are deemed to supply these services even though they do not charge for them by virtue of section 128(3)(c) of the Act.

announcement of the transaction), and advertising space to advertisers. The majority of Facebook's advertising is display advertising.

9. Instagram provides an app allowing users to take and modify photos and share those photos with other users on the Instagram network or post the photos to other social networks (including Facebook).
10. As no substantial competition concerns arise on any reasonable frame of reference affected or potentially affected by the Transaction, it was not necessary for the OFT to reach a conclusion on the exact scope of the frame of reference in this respect.

Geographic scope

11. Subject to limited exceptions, users can access Facebook anywhere in the UK that they can obtain an internet connection. Advertisers are interested in targeting users with particular demographic, psychographic, and behavioural characteristics. Third parties told the OFT that the scope of the geographic market may be limited by national boundaries because of idiosyncrasies of language and culture.
12. Instagram users need internet access to download the app and share photos electronically, but do not need internet access to take photos. Once uploaded to say the iTunes store (for example), apps can be downloaded from anywhere that the mobile telephone user has an internet connection.
13. The relevant frames of reference are likely to be international, albeit some advertising is likely to be national. As no substantial competition concerns arise on any reasonable frame of reference affected by the Transaction, it was not necessary for the OFT to reach a conclusion on the exact scope of the geographic frame of reference in this respect.

HORIZONTAL ISSUES

14. The OFT considered two unilateral effects theories of harm: actual competition in the supply of photo apps and potential competition in the supply of social network services.

Actual competition in the supply of photo apps

15. Instagram allows users to take photos, apply digital filters to those photos, and then share those photos on the Instagram network or via other social networks. Facebook launched its mobile photo app in May 2012, weeks after it had announced that it would acquire Instagram. Facebook's app has similar functionality to Instagram's. It allows users to apply filters, tag photos, comment on photos, and post the photos to Facebook.
16. The parties advised that virtually all smart phones have a photo-app pre-installed by the original equipment manufacturer ('OEM'). These apps often allow users to take and share photos, although they tend to have more limited photo enhancement functions than dedicated third party apps. It is unlikely that these apps are close substitutes to Instagram. Third parties identified other photo sharing apps as being the closest competitors to Instagram. These include Camera Awesome, Camera +, Flickr, Hipstamatic, Path, and Pixable.
17. According to data provided by the parties, Camera Awesome and Hipstamatic have been downloaded more than three times more than Facebook Camera, Facebook's camera app. Camera+ has been downloaded more than six times more than Facebook's camera app. Instagram has been downloaded more than 45 more times than Facebook Camera. Whilst this is an imprecise measure of market share and does not scale for Facebook Camera's relative recent entry onto the market, it gives some indication of the availability and popularity of other photo sharing apps.
18. In terms of whether Instagram may have the potential to compete with Facebook's photo sharing app for advertising revenue, one third party told the OFT that it does not consider that Instagram provides significant marketing opportunities. The commercial opportunities are limited because consumers take and upload photos, but do not spend a significant amount of time in the app. This limits its attractiveness to advertisers for two reasons. First, eyeballs are not on the app for a significant period of time and second, limited user data is captured.
19. Some third parties took a different view, namely that social apps and websites do not always present monetisation opportunities from the outset, but rather grow their user base and then develop monetisation

opportunities once they have a large enough user base to be attractive to advertisers. Few third parties, however, believed that Instagram presented immediate monetisation opportunities.

20. One third party took the view that the transaction would lead to better advertising opportunities, not because Instagram's photo app itself presents a direct monetisation opportunity, but because it will improve consumer engagement with Facebook and thereby increase usage of Facebook.
21. To conclude, there are several relatively strong competitors to Instagram in the supply of camera and photo editing apps, and those competitors appear at present to be a stronger constraint on Instagram than Facebook's new app. The majority of third parties did not believe that photo apps are attractive to advertisers on a stand-alone basis, but that they are complementary to social networks. The OFT therefore does not believe that the transaction gives rise to a realistic prospect of a substantial lessening of competition in the supply of photo apps.

Potential competition in the supply of online display advertising

22. The merger parties and third parties told the OFT that the functionality of Instagram's social network and Facebook's social network are significantly different. While Facebook is predominantly used by off-line friends using their real identities to connect online and share experiences (including photos), Instagram is predominantly used to share artful images by individuals often using pseudonyms. The information posted on Facebook is generally shared amongst friends only. By contrast, on Instagram the default position is that photos are available to all other users of the service. Users of Instagram can also post individual photos to other social networks (including Facebook).
23. The parties' revenue models are also very different. While Facebook generates revenue from advertising and users purchasing virtual and digital goods via Facebook, Instagram does not generate any revenue.
24. Instagram is not currently an actual competitor to Facebook for advertising revenue and it has limited social networking functions. The OFT therefore considered whether Instagram is perceived as a potential competitor to Facebook. For example, Facebook may have been concerned that if it

increased its advertising prices then Instagram would have the incentive to alter its offering to be a closer competitor in terms of functionality or display advertising inventory to Facebook's.

25. It is likely that pre-merger Facebook was aware of Instagram's growing user base: Instagram was Apple's App of the Year in 2011 and had several high profile users (such as Barack Obama). Given that Instagram's user base was growing rapidly it may have been the case that Facebook perceived that Instagram would grow to be a credible social network competitor. Third parties advised that it would not be difficult or expensive for Instagram to expand its services to a website and to add at least some functionality similar to Facebook's.
26. Internal documents provided by the parties indicate that [].
27. The parties did not provide market share information for its UK advertising sales. They advised, however, that Facebook has a market share of [0-10] per cent of European [online] display advertising by revenue and [0-10] per cent of European online advertising³ revenues. The parties advised that Google has a 44 per cent share of global online advertising expenditure.
28. Third parties advised that the main constraints on Facebook for advertising income are sites that gather user demographic and behavioural data (amongst other information) and are effective outlets for brand advertising. These sites include Google, Yahoo, and Microsoft. This contrasts with sites that are effective for advertising designed to directly lead to a sale (described by one third party as 'transactional advertising'). Sites identified as being appropriate for such advertising are eBay and Amazon.
29. In summary, the evidence before the OFT does not show that Instagram would be particularly well placed to compete against Facebook in the short run. In addition, there are other firms that appear to be presently able to compete against Facebook for brand advertising. For these reasons, the OFT believes that there is no realistic prospect that the merger may result in a substantial lessening of competition in the supply of display advertising.

³ Includes display, classified and directory, and search advertising.

VERTICAL ISSUES

30. The OFT considered two vertical effects theories of harm: the foreclosure of social networks competing with Facebook by limiting Instagram users to uploading their photos to Facebook and the foreclosure of other photo apps by preventing them from uploading their photos to Facebook. The OFT's ability, incentive, effect criteria for this kind of theory of harm are cumulative: all of the limbs must hold for the theory of harm to stand⁴.

Foreclosure of competing social networks

31. The OFT considered whether the merger parties would foreclose rival social networks by (a) preventing Instagram users from uploading their photographs to those networks and the effect of such an action on competition; or (b) deteriorating the quality of the connection of the API between Instagram and rival social networks.
32. Third parties agreed that the parties have the technical ability to prevent Instagram users from uploading their photos to rival social networks. In terms of incentive, the benefit of the foreclosure strategy may be to increase the likelihood that a photo taken with Instagram would be posted to Facebook. The cost would be that Instagram may become less attractive to users if its social functionality were more limited.
33. However, third parties were unclear about the impact of any such restriction on the popularity of the Instagram app. They noted that at least part of Instagram's appeal is that photos can be uploaded to other social networks. It is also the case that there are a myriad of photo apps with similar functionality to Instagram which can upload photos to social networks.
34. One third party informed the OFT that Google is the strongest constraint to Facebook because it has a social network, Google + , and because its combined services allow it to gather large volumes of information on users making it an attractive proposition for advertisers. Google has an additional ability to constrain Facebook through its Adsense subsidiary which matches advertisers to online advertising space. In this regard, the OFT

⁴ OFT 1254 A joint publication of the Competition Commission and the Office of Fair Trading *Merger Assessment Guidelines*, paragraph 5.6.7.

notes that Google recently acquired Wildfire Interactive, a marketing firm that specialises in social media marketing. The third party advised the OFT that, whereas websites such as eBay are appropriate for 'transactional advertising' (described above), websites such as Facebook and Google may be more appropriate for advertisers intending to engage users and to create brand awareness.

35. In addition to its strength in advertising, its competitor status through Google+ and its important role as an advertising intermediary, Google also operates Google Play, an online app store for the Android mobile operating software. Overall, Google appears to have several options for retaliation in the event that its social network was foreclosed by the merger parties.
36. In terms of whether other apps or social networks could replicate Instagram's success, it is relevant that Instagram grew rapidly from having 1.4 million users in January 2011 to around 24 million users in February 2012. Whilst this indicates the strength of Instagram's product, it also indicates that barriers to expansion are relatively low and that the attractiveness of apps can be 'faddish'. Indeed there is some speculation that the acquisition by Facebook in itself may discourage some Instagram users from using the app.
37. In conclusion, third parties generally perceived that the merger parties may have the technical ability to foreclose rival social networks. It is likely to be the case that at least part of the value that users place on Instagram is owing to the ability to post to several social networks including Facebook. Blocking users from uploading their photos to other social networks would likely diminish the value of the app, at least in part and may cause users to switch to other apps and social networks.

Foreclosure of competing mobile photo apps

38. The OFT considered whether the merger parties would foreclose competitors' mobile photo apps from posting to Facebook and the effect of this strategy on competition.
39. Third parties generally agreed that the merger parties would have the technical ability to foreclose rivals or to partially foreclose rivals by reducing their ability to upload to Facebook. The majority of third parties did not, however, believe that this would be a sensible commercial strategy

on the merger parties' part. They believed that Facebook has the incentive to allow its users to upload photos from as many sources as possible – customer engagement increases the volume of user information that Facebook has and thereby makes the network more appealing to advertisers.

40. In terms of the effect of any such action, third parties told the OFT that camera apps would still be able to upload photos to social networks other than Facebook. The OFT also note that there is at least one app, TwitPic, dedicated to uploading photos to Twitter, a rival social network. Moreover, it is possible to link in Facebook to photos on other social networks.
41. On balance, it appears as though the merger parties may have the technical ability to foreclose competing photo apps. The majority of third parties did not believe that the parties would have the incentive to pursue such a strategy because it would likely decrease users' level of engagement with Facebook. In any event, users would not be prohibited from using competing camera apps nor from posting their photos to several other popular outlets.

THIRD PARTY VIEWS

42. Some third parties expressed concerns about the merged entity's ability and incentive to foreclose rivals. These comments have been incorporated where relevant in the decision.

ASSESSMENT

43. The OFT examined this merger on the basis that the parties overlap in the supply of social networking services.
44. In the photo app space, there are several relatively strong competitors to Instagram which appear to impose a stronger constraint on Instagram than Facebook's new camera app currently does. In the social networking space, the OFT has no reason to believe that Instagram would be uniquely placed to compete against Facebook, either as a potential social network or as a provider of advertising space.

45. Although the OFT considers that the merger parties may have the technical ability to engage in input or customer foreclosure, the evidence received by the OFT does not suggest that the parties would have the incentive to pursue such a strategy.
46. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom”.

DECISION

47. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.