Mergers and Acquisitions

- We just looked at firm strategies designed to induce exit by competitors from the industry.
- An alternative way to eliminate competition is to merge with or acquire the rival firm.
- Mergers and acquisitions generally imply exit and entry of firms into the industry.
- Several causes for mergers and acquisitions:
- These include synergies, increase bargaining power with retailers, cost savings when horizontally differentiating, lowering risk of parent company.

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- Horizontal mergers are those between two firms in the same industry.
- What are the implications of mergers?
- In one case it's easy to see what will happen.
- If there n firms that compete Cournot, with same marginal cost c and fixed cost F.
- If two firms merge, the new firm will have the same fixed and marginal cost, so the new Cournot equilibrium will be the the Cournot equilibrium but now with $(n-1)$ firms.
- But we saw from before is that with fewer firms in the Cournot equilibrium resulted in higher prices.
- Consequently, this results in a loss in consumer welfare.

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- From the firm's point of view, it must be the case that mergers increase the value of the firm, or why do them.
- This can be explained by cost efficiencies/ synergies that can aries by, for example, avoiding duplication of fixed costs.
- As a result, we can conclude that mergers normally result in an increase in prices and a reduction in costs.
- This will be tradeoff to consider in public policy analysis.
- However, it should be pointed out that synergies are not the only reason why mergers may be profitable.
- For example, the mode of competition may change after the merger- e.g. from Bertrand to Cournot.

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- Or if it changes from Cournot to Cournot, as we saw before, a more concentrated industry can allow for a greater degree of collusion among competitors.
- Note also that nonmerging firms can be the beneficiaries from a merger. Without incurring an costs, the nonmerging firm's competitors have decreased by 1. (They effectively "free-ride" off the merging firms.)
- One thing to note about merger activity is mergers seem to occur in waves- many merges followed by periods of stability.
- This can be explained by exogenous causes (i.e. deregulation), or endogenous causes.

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- To see the latter explanation, we can go back to our Cournot analysis, and calculated the profit per firm.
- We can see that if it is initially not profitable for the first two firms to merge in an industry if 4 firms, if firms 3 and 4 do merge, so now there are 3 firms in the industry, it will then become profitable for firms 1 and 2 to merge.
- Example of the endogenous mergers are the supermarket business and the airline industry.
- From a public policy perspective towards mergers, the three parties the policy maker takes into account of a merger are the merging firms, the nonmerging firms, and the consumer.
- As mentioned, two issues to be taken into account are the increase in prices and possible efficiency gains.

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- One general rule is that the greater the price increase, the less desirable (from a policy perspective) the merger is.
- The likely increase in price from a merger can be inferred from some of our conclusions in the chapter on market structure and market power.
- For example, the greater the market concentration, the greater the market price, so a merger between two large firms likely to imply a greater increase in price.

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- This is the unilateral effect of mergers on prices.
- Another effect is the collusion effect- i.e. collusion is easier with fewer firms.
- This estimated increase in prices was the main reason why the FTC blocked the proposed merger between Staples and Office Depot.
- A second rule for merger policy is that the smaller the relative size of the merging firms, the less likely the overall impact of the merger will be negative.
- This is because the merger will results in a lower price increase and the efficiency gains are higher