Econ 243

October 3, 2018

(Horizontal) Mergers

Base model is n-firm oligopoly

- algebra for firm profits with 8 firms. our normal assumption that firms identical in technology and access to capital and all that. in long-run equilibrium all should be the same.

so if 2 firms merge in our 8-firm oligopoly, what happens?

- the new firm (2/8 = 1/4 of the industry) will want to cut output to raise price and thus profits
- but then the 6 outside firms that didn't merge will each raise their output a little as they see an increase in demand [that higher price thing!]
- so the merged firm shrinks, bit by bit, while the others expand. we end up with 7 equal-sized firms with identical market shares.
- but if we look at profits, the new firm at the point of the merger has 1/4 of the profits in an 8-firm industry, and ends up with 1/7 the profits in a 7-firm industry
- more algebra: shareholders in the newly merged firm see profits fall!! and that's a general result.

discussion

- • not a story of vertical mergers. we have no tools (yet) to analyze.
- • claim that backed by empirical evidence.
  - - add in bidding wars, and firms often overpay:
    - » "winners curse": if 3 firms are bidding, the most optimistic and/or egotistical one wins.
  - - easier to finance a merger when there are other mergers, which tends to happen when
    - » stock prices in general are high
    - » those thought to be possible acquisition targets can start even higher
- • so key: **synergies**. can the new management either:
  - - save on costs because of (insufficient) pre-merger economies of scale?
  - - benefit from the share of technologies?
  - - buy a poorly-performing firm and turn it around (see GE case next class)?
  - - successfully cross-market products?
- • an example is Teleflex: a focused firm that over time has acquired many small firms that operate in its technical footprint (cables, eg, boat steering and throttle cables, orthoscopic surgery cables). it has manufacturing, design/engineering and sales expertise that small firms typically lack
- • an example that didn't work: Daimler's acquisition of Chrysler, as part of a series of acquisitions that left Daimler shareholders US$60 billion poorer, back when US$1 billion was a lot of money.
    - » engineers didn't work together: pride (we can't put Chrysler parts in a Mercedes), lack of organizational structure to facilitate,
    - » no cross-selling benefits. Daimler didn't help Chrysler expand into Europe (no Jeeps rebranded as Mercedes)
    - » operational mistakes (Daimler didn't know how to manage a volume-segment car company; *did not discuss in class*)