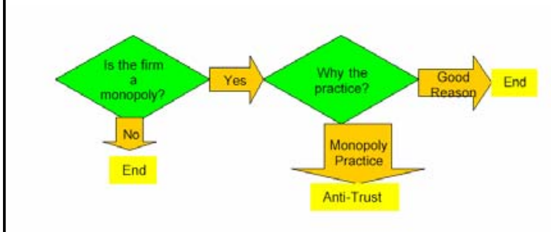
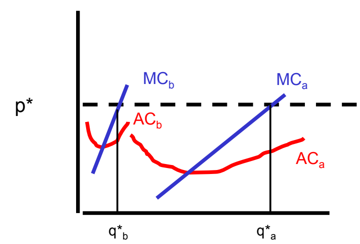
Mergers



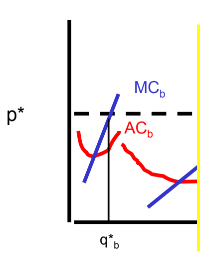
Other Issues

- Predatory Pricing
- Refusal to Deal
- Tie-in
- **Mergers**
- Cartels

The Economics of Mergers

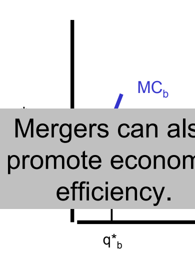


The Economics of Mergers



If firms A and B merge, they can create a monopoly. Thus mergers are of interest to anti-trust economists and lawyers.

The Economics of Mergers



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Mergers can also promote economic efficiency.

The Economics of Mergers

Initially courts adopted the “big is bad” rule and looked askance at most monopolies. Modern economic theory argues that there can be economic advantages to a merger.

Two Types of Mergers

- Horizontal Mergers
- Vertical Mergers

Horizontal Mergers

- Two firms producing the same product merge to achieve economies of scale.

Horizontal Mergers

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  - Bank A has a huge back office function to clear checks. It can just as easily handle another 500,000 customers.

Horizontal Mergers

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- The right size can change over time

Horizontal Mergers

- Two firms producing the same product merge to achieve economies of scale.
- The right size can change over time
  - McDonald and Douglas aircraft corporations initially merged to compete with Boeing.
  - Boeing and McDonald-Douglas merge to compete with AirBus.

Vertical Mergers

- A firm in industry A sells its output to industry B.

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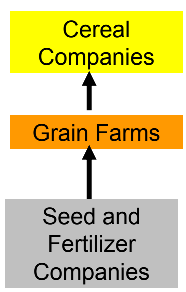

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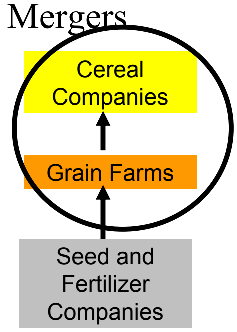

Vertical Mergers

- A firm i
A sells
industry
- Two fir
integrat
product

Cereal

Basic Theorem: you cannot create monopoly power by a vertical integration. If one industry is monopolized, it does not increase its monopoly power by vertical integration into a competitive industry.

Reasons for Vertical Integration

- Economies of Scope
  - A bank that now sells insurance can have one salesman selling both products to the same person.

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- Economies of Scope
  - A bank that now sells insurance can have one salesman selling both products to the same person.
- Economies of Control
  - A gas company that buys a pipeline does not have to worry about negotiations with the pipeline company.

American vs. European Theory

- Most large mergers require approval from both the Federal Trade Commission and the Monopolies Commission of the European Union.

American vs. European Theory

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- **US: Is consumer and producer surplus created? If so, approve merger.**

American vs. European Theory

- Most large mergers require approval from both the Federal Trade Commission and the Monopolies Commission of the European Union.
- **EU test: does this reduce competition? That is, the number of firms selling a product.**

General Electric/Allied Signal

- **Companies in different markets. US saw economies of scope, integration and control.**

General Electric/Allied Signal

- **Companies in different markets. US saw economies of scope, integration and control.**
- **EU saw loss of competition. GE would be buying more from Allied Signal and less from other companies.**

General Electric/Allied Signal

- Companies in different markets. U… c… i… control.
- EU Saw loss of competition. GE …ing …lied …s from other companies.

US approved merger,
EU did not,
and merger died.

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Who was right?

End