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International Journal of Industrial Organization
23 (2005) 129–153

International Journal of Industrial Organization

www.elsevier.com/locate/econbase

Should alternative mergers or acquisitions be considered by antitrust authorities?

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Received 10 April 2003; received in revised form 31 March 2004; accepted 26 August 2004
Available online 30 December 2004

Abstract

This paper illustrates how taking alternative mergers into consideration when analyzing the effects of a proposed merger may provide some information to the antitrust authorities. In particular, the use of revealed preference may allow the authorities to establish an expected upper limit on the efficiency gains obtained in a given merger that also increases the participants' market power. Such limit can then be compared to the lower threshold necessary for merger approval. The policy implications of this result are discussed.
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JEL classification: L41; L10

Keywords: Mergers; Acquisitions; Revealed preference; Synergies

1. Introduction

There is an ongoing debate regarding the way antitrust authorities intervene in the markets. The debate concerns to their objectives (should the authorities aim at increasing consumer surplus or net social welfare?), the scope of their analysis (should an efficiency defense be admitted or not?), as well as the "long-term" consequences of a decision (what

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doi:10.1016/j.ijindorg.2004.08.005

are the effects of a rejection: the status quo or an alternative merger? What is expected to happen after the approval of a merger?). The issue of the authorities' objectives is the subject of recent work by Lyons (2002), Fridolfsson (2001) and Neven and Roller (2000). Nilssen and Sorgard (1998) discussed the possibility of sequential mergers, where the occurrence of a second merger depended on the authorities' decision regarding an earlier one. Some of these aspects are also briefly discussed in Horn and Stennek (2002).

Although theoretically satisfactory, the view that the authorities should foresee the consequences of approving or rejecting a given merger or acquisition in terms of its effect on other concentration operations (that might be prevented or induced) is hard to defend. Economic theory hardly presents a consensus methodology for anticipating which mergers will occur, and even if it did, the informational requirements would be prohibitive.[1] However, this does not necessarily mean that alternative mergers or acquisitions should not be taken into account. In fact, looking at other mergers that might have taken place instead of the merger(s) under analysis may reveal information that would otherwise be unknown to the authorities. This paper explores a way of obtaining such additional information using revealed preference. The revealed preference for a merger that leads to an increase in market power may enable the establishment of conditions that will narrow the admissible range for some parameters that are unknown to the authorities.[2] We are especially concerned with the case in which these unknown variables relate to the extent of the cost reductions generated by the merger, typically considered as unobservable by the authorities (see, for instance, Farrell and Shapiro (1990) and also the 1997 revisions to Section 4 of the US Merger Guidelines, where it is stated that "Efficiencies are difficult to verify and quantify in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized").

We will assume that the proposed concentration operation, which is under analysis, is the most profitable one among those considered admissible. We use the fact that a merger for market power is likely to be more profitable than an alternative merger (in which market power plays a lesser role) when efficiencies are not very significant to establish an upper bound on the magnitude of cost reductions. This happens because large unit cost reductions tend to be more profitable when firms produce larger quantities, and firms are more likely to produce a large output after a merger that does not substantially increase market power. One crucial assumption is that the cost reductions under scrutiny are not merger specific in the sense that these may be obtained in any merger and do not depend on the identity of insiders.

[1] For instance, if one were to adopt the core concept as in Horn and Persson (2001a,b), one would need to have information on the cost reductions obtained in any conceivable alternative merger. The full extent of the externalities involved in the formation of any possible coalition(s) would also have to be addressed. Alternatively, mergers may be assumed to result from some noncooperative game. Such endogenous mergers have been studied, for instance by Bloch (1995, 1996), but in most cases, the results depend crucially on the protocol (particularly on the order firms move).

[2] Revealed preference has been previously applied to analyze the consistency of merger policy by Nilssen (1997).

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