Takeovers and Industry Competition

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US antitrust enforcement (1)

- 1890: The Sherman Act
- 1950: Celler-Kefauver amendment to Section 7 of the Clayton Act
  - Since 1950, the DOJ and FTC have filed more than 600 antitrust complaints against firms involved in mergers
  - The charge is that the mergers would "substantially lessen competition" and thus violate Section 7 of the Clayton Act

US antitrust enforcement (2)

- 1978: Hart-Scott-Rodino Antitrust Improvements Act
  - Instituted pre-merger notification rules
  - Requires a 30-day pre-notification of merger proposals of a certain size
  - A request for further information triggers another 20-day delay
  - The HSR Act established the right of the DOJ to issue Civil Investigative Demands to the merging firms and related parties

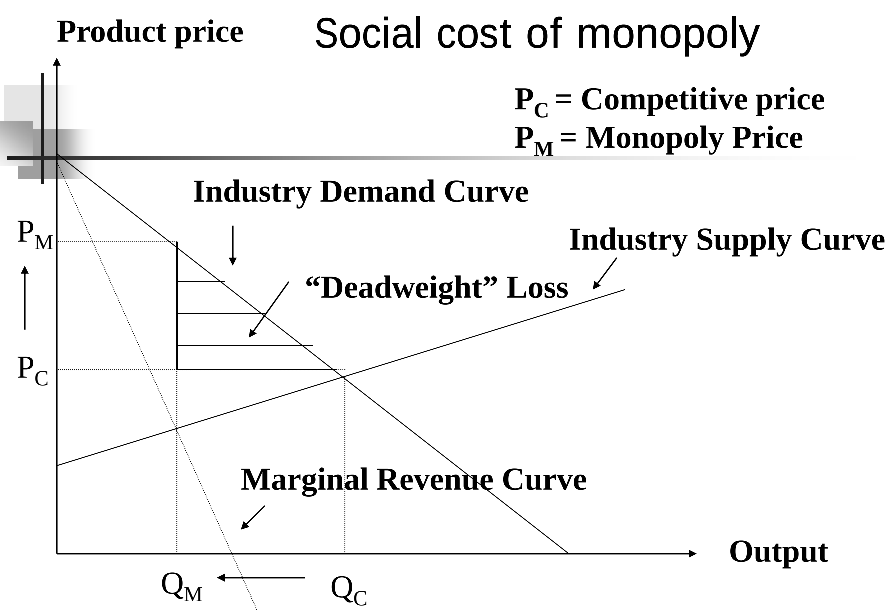
US antitrust enforcement (3)

- Vigorous Section 7 enforcement deters merger activity
- Approximately 85% of complaints filed against horizontal mergers
- Approximately 80% of the complaints resulted in divestiture of cancellation of merger proposal
- If a case is litigated, the court outcome favors the government’s position in about 80% of the cases

Market concentration doctrine (1)

- Classical oligopoly models [Cournot (1838), Nash (1950)] imply that, as the number of firms in the industry decreases (e.g., through merger), the degree of industry monopolization increases
  - Critical assumption: new firms do not enter the industry as the product price increases due to increased market power

Social cost of monopoly



Market concentration doctrine (2)

- High industry concentration is associated with high industry-wide monopoly rents
- MCD forms the intellectual basis for the market share and market concentration restrictions in the DOJ Merger Guidelines, designed to deter anti-competitive mergers

Key enforcement questions

- Is market concentration a RELIABLE index of industry market power?
- Does the agencies case selection procedures identify TRULY anti-competitive mergers?

Looking for market power...

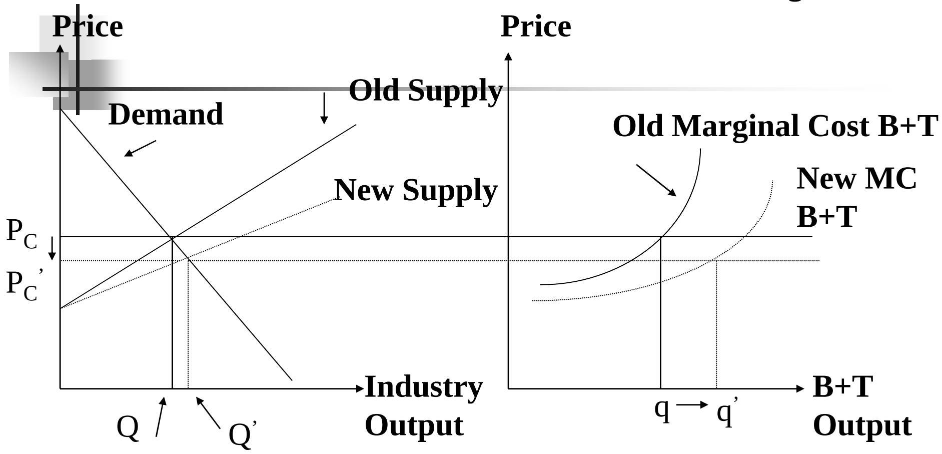
- Since “market power” is unobservable: how would you infer that a merger is truly “anti-competitive”?
  - You are looking for evidence of incased monopoly rents as a result of the merger
  - Suppose a merger increases the market value of the bidder and target firms
  - Need to infer whether this increase reflects monopoly rents or rents due to increased economic efficiency

Efficiency effects of mergers

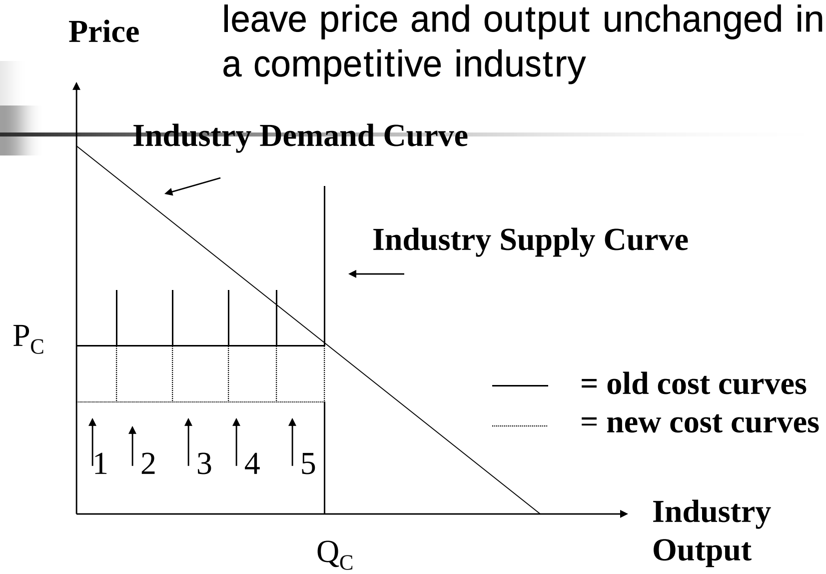
- Mergers may result in economic efficiency for a number of reasons
  - technological complementarities (synergy)
  - replacing inefficient management
  - reducing taxes and bankruptcy costs
  - reducing free cash flow
- Note: A merger may also signal the availability of these gains to other industry participants

Scale-increasing merger in a competitive industry

B = Bidder Firm
T = Target Firm



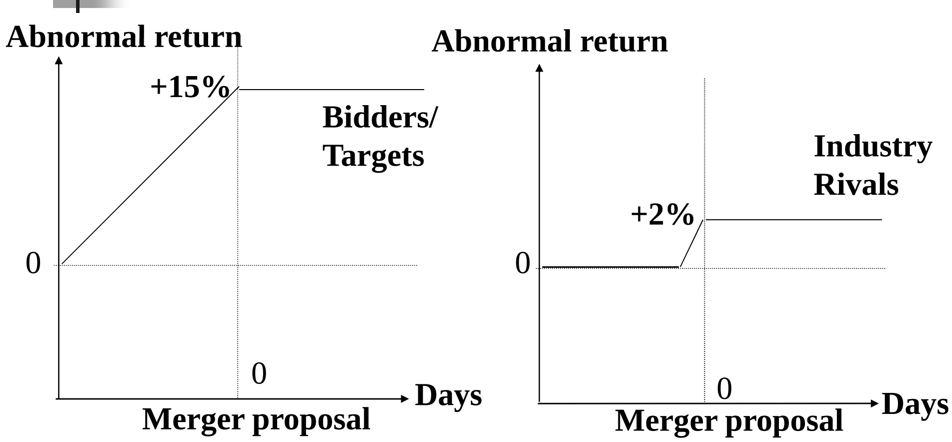
Series of cost-reducing mergers that leave price and output unchanged in a competitive industry



Market value predictions (AR)

Announc. of:	Merger	Proposal	Antitrust	Complaint
Hypothesis	**Bidder/ Target**	**Industry Rivals**	**Bidder/ Target**	**Industry Rivals**
Collusion	>0	>0	<0	<0
Predation	>0	<0	<0	>0
Efficiency 1: Prices	>0	<0	<0	>0
Efficiency 2: Info	>0	>0	<0	=0

Eckbo (1983): 100 Horizontal Section 7 Cases, 1963-82 (on average 15 listed rivals per merger)



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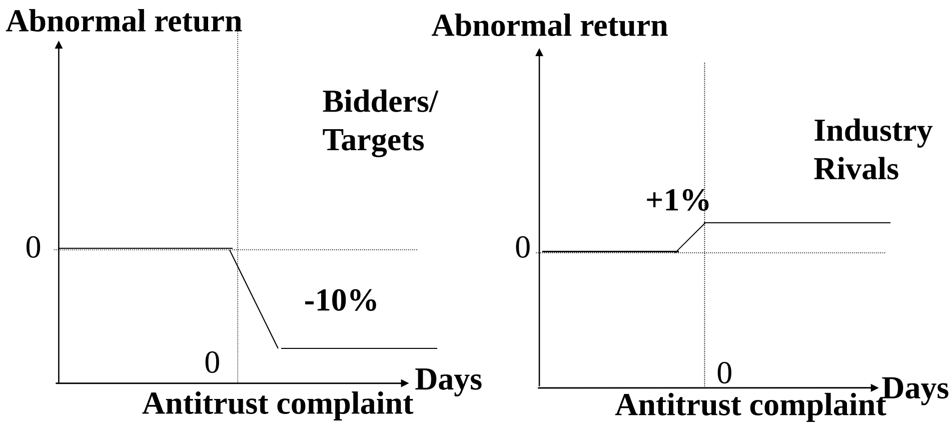

Conclusion: Collusion Rejected

- Rivals experience positive abnormal returns both in response to the initial merger proposal announcement and the subsequent antitrust complaint announcement
  - This pattern of abnormal returns is inconsistent with both both collusion and predation
  - Consistent with efficiency and information

Additional evidence

- Abnormal return to rivals are <u>decreasing</u> in the industry concentration increase
  - inconsistent with market concentration doctrine
  - Results hold *a fortiori* when using a set of industry rivals supplied by the DOJ
  - Results hold *a fortiori* after the HSR Act
- In Canada, with no antitrust merger enforcement, rivals earn <u>negative</u> abnormal returns to merger proposals

Misguided antitrust policy?

- Who benefits? The industry rivals!
  - Case in point: GM-Toyota joint venture proposal in 1983 to build cars in California.
  - Stock price of Chrysler fell 7% upon joint venture announcement. Chrysler and Ford got the FTC to "look into antitrust issues" which delayed the venture for one year
- Market power is unobservable, so cases are decided using theoretical arguments
  - Extremely weak empirical basis for policy

Policy recommendation

- (R1) If the market value of industry rivals <u>fall</u> in response to a horizontal merger proposal, the merger is expected to create a more fierce competitor, so don't block the proposal
- (R2) If the market value of industry rivals <u>rise</u> in response to a horizontal merger proposal, continue to look into the case, but be beware of the potentially positive information effect of an efficient merger

Microsoft (1)

- Government argued that Microsoft (1) is a monopoly and (2) abuses its monopoly power by preying on rivals and stifling innovation
- Microsoft argued that (1) there is basically free entry into the web-browser business and (2) Microsoft's business practices reflect a fiercely competitive firm

Microsoft (2)

- From 1991-1997, 29 reports of antitrust action against Microsoft <u>decreased</u> value of portfolio of 159 industry rivals by $1 billion per event
- Eight retreats or setbacks in enforcement <u>increased</u> competitors value
- This is inconsistent with the “predation” hypothesis