



Contents lists available at ScienceDirect

# Journal of Financial Economics

journal homepage: [www.elsevier.com/locate/jfec](http://www.elsevier.com/locate/jfec)



## Horizontal acquisitions and buying power: A product market analysis <sup>☆</sup>

Sugato Bhattacharyya <sup>a,1</sup>, Amrita Nain <sup>b,\*</sup>

<sup>a</sup> Ross School of Business, University of Michigan, 701 Tappan Street, Ann Arbor, MI 48109, USA

<sup>b</sup> Faculty of Management, McGill University, 1001 Sherbrooke Street West, Montreal, QC, Canada H3A 1G5

### ARTICLE INFO

#### Article history:

Received 21 January 2009

Received in revised form

9 December 2009

Accepted 5 January 2010

Available online 7 August 2010

#### JEL classification:

G34

D42

D43

#### Keywords:

Takeovers

Mergers

Buying power

### ABSTRACT

Horizontal mergers exert price pressure on dependent suppliers and adversely affect their performance. Consistent with the theory of countervailing power, concentrated suppliers and those with greater barriers to entry experience larger price declines after consolidation downstream. Time-series results suggest that consolidation in dependent supplier industries follows mergers in main customer industries, indicating that consolidation activity travels up the supply chain. The findings are broadly consistent with pervasive beliefs in the business community about the buying power effects of horizontal mergers.

© 2010 Elsevier B.V. All rights reserved.

“... apparel-company executives say they are bracing for store closures, cutbacks and thinner profit margins. The potential fallout reflects the huge negotiating power that a combined Federated-May would wield and the diminishing clout of suppliers. ... it could also

accelerate consolidation among apparel suppliers, as they strive to get bigger to better face off against their giant customers.”

— Wall Street Journal article<sup>2</sup>

### 1. Introduction

There is a long-standing debate in the economics and finance literatures on the motives for horizontal mergers. While managers of firms undertaking horizontal mergers usually cite expected improvements in productive efficiencies, i.e., synergies, as the key rationale behind such moves, antitrust authorities frequently express concern that horizontal mergers may increase market power vis-à-

<sup>☆</sup> The authors thank Kenneth Ahern, Amy Dittmar, E. Han Kim, Francine Lafontaine, Vikram Nanda, Linda Tesar, Bilal Zia, participants at the 2006 Conference on Empirical Research in Corporate Finance at the University of Oregon, 2007 Western Finance Association meetings, the Finance Brownbag series at the University of Michigan, the McGill Finance Seminar series and the Saw Centre Finance Seminar at the National University of Singapore. The second author thanks Institut de finance mathématique de Montréal for generous research funding. Comments from the referee, Husayn Shahrur, have helped to improve the paper greatly.

\* Corresponding author. Tel.: +1 514 398 8440.

E-mail addresses: [sugato@umich.edu](mailto:sugato@umich.edu) (S. Bhattacharyya), [amrita.nain@mcgill.ca](mailto:amrita.nain@mcgill.ca) (A. Nain).

<sup>1</sup> Tel.: +1 734 763 9777

<sup>2</sup> “Combined Federated-May could stress apparel makers,” *The Wall Street Journal*, March 1, 2005.

vis customers and suppliers of the merging firms' industry. The latter view is also often supported in discussions in the business press pertaining to specific deals, as evidenced by the quote above. Academic research has extensively examined the effect of horizontal acquisitions on market power vis-à-vis customers and arrived at conflicting conclusions.<sup>3</sup>

There is, however, a major selection bias inherent in studies that look for signs of selling power created by horizontal mergers. The bias arises due to the fact that horizontal mergers expected to increase selling power and result in higher prices for customers will be anticipated to be blocked by antitrust authorities. Thus, mergers which clearly enhance selling power may never be observed when one looks for evidence in product or stock markets. The same logic, however, does not hold so far as the impact on suppliers is concerned. Horizontal mergers that increase buying power may contribute to lower costs of production downstream. Moreover, enhanced buying power downstream may counteract established selling power upstream and force suppliers to charge competitive prices. In fact, antitrust authorities may very well look upon such mergers favorably. Consequently, we examine the possible creation of buying power through horizontal acquisitions by studying their impact on suppliers. An auxiliary motivation for looking at the effect of horizontal mergers on supplier industries is that the industrial organization literature already shows the importance of being a large buyer: buyer size and buyer industry concentration have long been known to be correlated with lower seller profits.<sup>4</sup> Yet, the upstream effects of a major corporate event – industry consolidation through mergers – that can create large buyers and increase buyer industry concentration remain largely unexamined.<sup>5</sup> Thus, the objective of this paper is to ask one overarching question: do horizontal mergers create buying power?

We answer this question by first examining the effect of horizontal mergers on profits and product prices in the supplier industry. We use a relatively large, cross-industry sample to examine whether horizontal mergers bring about a decline in the profits of supplier industries and whether such a decline can be attributed to a decline in prices at which supplier industries sell. Using mergers and acquisitions (M&A) data from 1984 to 2003, we construct a sample of industries that experienced a significant jump in horizontal merger activity in a specific quarter. Having identified these downstream *merger events*, we ask whether supplier industries more dependent on the

downstream merging industry experience greater adverse changes in profits and output prices after the event. We find that supplier industries selling a larger fraction of their output to the downstream consolidating industry have lower cash-flow margins following downstream consolidation. The abnormal cash-flow margin of dependent supplier industries after downstream consolidation is, on average, 3% lower than that of non-dependent supplier industries. Thus, we confirm Fee and Thomas's (2004) finding that some supplier industries suffer declines in operating profits after a horizontal merger downstream.

However, we recognize that a decline in supplier profit margins may also result from changes unrelated to the creation of market power downstream. To attribute deterioration in profit margins upstream to an increase in buying power downstream, we need to also show a decline in upstream selling prices. As a result, we use the Producer Price Index (PPI) as a measure of selling prices to examine changes in selling prices in dependent supplier industries. Controlling for changes in input prices and demand shocks faced by the supplier industry, we first establish that prior to downstream consolidation, changes in the PPI of dependent and non-dependent supplier industries over a three-year period are statistically indistinguishable. In contrast, dependent supplier industries exhibit significantly larger declines in PPI in the three years following downstream consolidation. The differential impact is of the order of 0.1% per month, translating to a difference of up to 3.6% over the three years following downstream consolidation. Our results are robust to alternative regression methods. A difference-in-differences test in the pooled data lends further confirmation of dependent suppliers performing significantly worse than non-dependent suppliers, but only in the post-merger period. To show that such declines are not due to secular time trends independent of downstream consolidation, we create random 'event dates' and use them as break points to further examine the evolution of supplier selling prices. We find that there is no difference in the selling prices of dependent suppliers before and after such random event dates. Based on this battery of tests, we conclude that the decline in supplier selling prices may, indeed, be attributed to consolidation downstream.

While a decline in supplier prices after downstream consolidation is consistent with the creation of buying power, it may also be consistent with merger-induced improvements in efficiency. For example, if downstream consolidation created production efficiencies resulting in a decline in the demand for inputs, this could also lead to lower supplier selling prices. The existence of such a straightforward alternative explanation, therefore, requires us to design additional tests to attribute the decline in selling prices upstream to enhanced buying power downstream.

To this end, we draw on Galbraith's (1952) theory of countervailing acquisitions where he argues that economic power is held in check by the countervailing power of those who are subject to it. Thus, if sellers earn non-competitive rents due to small numbers (oligopoly),

<sup>3</sup> Focusing primarily on announcement returns, Eckbo (1983), Stillman (1983), Eckbo (1985), Eckbo and Wier (1985), Fee and Thomas (2004), and Shahrur (2005) conclude that horizontal mergers do not create selling power vis-à-vis customers. Looking at product prices directly, Barton and Sherman (1984), Borenstein (1990), Kim and Singal (1993), Singal (1996), Akhavan, Berger, and Humphrey (1997), and Prager and Hannan (1998) conclude that horizontal mergers create selling power.

<sup>4</sup> See, for example, Lustgarten (1975), Clevenger and Campbell (1977), McGuckin and Chen (1976), and Schumacher (1991).

<sup>5</sup> Exceptions are Fee and Thomas (2004) and Shahrur (2005). Both these studies find some preliminary evidence that downstream mergers adversely affect suppliers in concentrated industries.

متن کامل مقاله

دریافت فوری ←

**ISI**Articles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات