Preemptive mergers under spatial competition

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Abstract

Mergers for market power generally benefit outsider firms more than participating firms. Hence, outsiders should welcome such mergers between their competitors but, frequently, this is not the case. Under spatial competition some outsiders gain more than the participating firms but others might benefit less. Thus, if the number of admissible mergers is limited, firms may decide to merge to preempt rival mergers. This paper studies the incentives for preemptive merger by firms engaged in spatial competition.

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1. Introduction

Mergers for market power are frequently modelled as a reduction in the number of active firms: see especially the Cournot paradox paper of Salant et al. (1983). Their provocative result (contrary to common intuition) that mergers were likely to be unprofitable led the way to a new line of literature. Relaxing some of their assumptions, various authors showed that the effects of a merger were not necessarily negative for the participating firms (insiders) even in the absence of

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efficiency gains. For instance, Kwoka (1989) addressed the issue of profitability under non-Cournot behavior (using conjectural variations), establishing that mergers are more likely to be profitable in relatively competitive environments. More recently, Ziss (2001) showed that merger profitability is increased if the output decision is delegated to an agent with appropriate incentives. Along a different line, Deneckere and Davidson (1985) analyzed mergers between firms competing in prices and selling symmetrically differentiated products. In this context the merger has implications other than changing the number of firms. Due to the fact that one owner controls the prices of several substitutes, firms are no longer symmetric after the merger takes place and this is sufficient to have profitable mergers.

A common factor to these models is that, as argued by Stigler (1950), non-participating firms (outsiders) benefit more from the merger than participating firms. This is true both under Cournot and Bertrand competition and may be relevant when the decision to merge is endogenous: firms may find it more profitable to stay outside a merger (even if mergers are profitable) and just wait for other firms to merge, having therefore a higher payoff. If all firms were symmetric and had the same kind of reasoning, then a possible outcome would be a hold-up situation, in which all firms decided to wait.

These results suggest that, in the presence of a merger for market power involving their competitors, outsider firms should react passively, behaving as free riders. However, outsiders frequently take action to prevent a given concentration operation from taking place as the following examples illustrate.

Following the announcement in February, 1999, of the friendly merger between ´´Paribas and Societe Generale, Banque Nationale de Paris (BNP), France’s largest bank, decided to acquire both banks. This was interpreted as due to the fear of being outside the merger. Since cost synergies were not presented as the main driver of the merger, market power and market interaction must have been at the origin of this reaction.

Likewise, when Banco Santander Central Hispano (BSCH) announced its intentions of acquiring a relevant stake at Mundial Confiança (MC)—an insurance company holding three Portuguese banks, Banco Pinto e SottoMayor (BPSM),

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1 Along similar lines, Levin (1990) analyses the impact of a merger if insiders are not restricted to remain Cournot players.

2 This is a consequence of modelling mergers as a reduction in the number of symmetric firms but may also happen in other circumstances, as the Deneckere and Davidson (1985) case illustrates. The existence of efficiencies or synergies may invert this result as is shown, for instance, by Perry and Porter (1985). However, we are interested in mergers motivated by market power alone.

3 The fact that outsiders have substantial gains resulting from a merger is responsible for the difficulties in monopolizing a given market described by Kamien and Zang (1990).
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