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Mergers and synergy: Lessons from contemporary telecommunications history

Sumit K. Majumdar [a], Ulku Yaylacicegi [b,*], Rabih Moussawi [c]

[a] University of Texas at Dallas, Richardson, TX, USA
[b] University of North Carolina Wilmington, Wilmington, NC, USA
[c] University of Pennsylvania, Wharton Research Data Services, Philadelphia, PA, USA

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ABSTRACT

Using contemporary historical data, the analysis reported in this article has evaluated the impact of the various mergers of the local exchange companies that took place between 1988 and 2001 on financial performance. Performance was measured using an important metric normally used to measure synergies of firms undergoing mergers. The analysis has revealed that the relative cash flow variable for firms worsened after mergers. If the synergy motive had been primary in influencing merger decisions, and also approvals, then the past mergers approved led to decreased performance levels and corresponding welfare losses for American consumers; thus, the mergers of communications common carriers were not in the interest of the public, the shareholders and customers. On the other hand, given the negative outcomes, views that the quiet life, hubris or a quest for possible market power motivated the mergers could be discarded. The lessons of such contemporary historical analysis have suggested that antitrust oppositions to contemporary telecommunications sector mergers may have basis in fact and salient evidence.

1. Introduction

During the past two decades, mergers in the information technology and the telecommunications sectors have defined the overall merger landscape. These have been the largest, priciest and possibly the most exciting mergers of recent times. Take the list of mergers given in Table 1. These mergers defined the merger wave of the late 20th century. Collectively, these mergers were valued well over $1.2 trillion. Recently, the merger of the T-Mobile's United States operations with AT&T, in a deal valued at $39 billion, has come in the news. After permitting numerous mergers in the industry to occur, including the last big merger of AT&T with Bell South, in early 2007, the Antitrust Division of the United States Department of Justice has opposed the AT&T takeover of T-Mobile's operations in the United States.

So far, in the last decade and a half, the determining factor behind the approval of such mergers, at least in the United States, has been performance enhancement. With the publication of the Joint Merger Guidelines by the Department of Justice and the Federal Trade Commission in 1992 (United States Horizontal Merger Guidelines, 1992), and their subsequent revision by the agencies in 1997, the idea that the process of competition, as upheld by antitrust authorities, would generate efficiencies has been institutionally codified (Farrell & Shapiro, 2001; Kolasky & Dick, 2003). Specifically,

* Corresponding author. Tel.: +1 910 962 3901.
E-mail addresses: majumdar@utdallas.edu (S.K. Majumdar), yaylacicegiu@uncw.edu (U. Yaylacicegi), rabih@wharton.upenn.edu (R. Moussawi).

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Table 1
List of big ticket mergers in the 20th century telecommunications merger wave.
Source: Data till 2000 from Le Blanc and Shelanski (2002).

Date	Description	Merger amount
April 1996	Bell Atlantic and NYNEX[a]	$26 billion
April 1997	Pacific Telesis and SBC[a]	$17 billion
November 1997	MCI and Worldcom	$40 billion
May 1998	Ameritech and SBC[a]	$62 billion
June 1998	AT&T and TCI	$48 billion
March 1999	Comcast and Media One	$53 billion
May 1999	Air Touch and Vodafone	$75 billion
May 1999	Olivetti and Telecom Italia	$33 billion
July 1999	Q West and US West[a]	$35 billion
September 1999	Bell Atlantic and GTE[a]	$70 billion
October 1999	MCI Worldcom and Sprint	$129 billion
October 1999	Telia and Telenor	$47 billion
October 1999	Mannesmann and Orange	$34 billion
November 1999	Mannesmann and Vodafone	$180 billion
January 2000	AOL and Time Warner	$160 billion
May 2000	France Telecom and Orange	$46 billion
June 2000	Vivendi and Seagram	$40 billion
July 2000	Deutsche Telecom and Voice Stream	$53 billion
October 2004	Cingular and AT&T Wireless	$41 billion
November 2005	SBC and AT&T	$17 billion
December 2006	AT&T and Bell South	$89 billion

[a] One of the mergers evaluated in this analysis.

Section 4 of the 1997 guidelines has stated that "mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction."

According to Kolasky and Dick (2003, p. 209), the Brown Shoe case (*Brown Shoe Co. vs. US, 370 US 294*, 1962) highlighted the protection of competition, by preventing the occurrence of market power, and the generation of efficiencies as directly conflicting objectives. In a number of subsequent merger related cases, such as the Philadelphia National Bank case (*US vs. Philadelphia National Bank, 374 US 321*, 1963) and the Procter and Gamble case (*FTC vs. Procter and Gamble Co., 386 US 568*, 1967), the efficiency doctrine was treated negatively, and, as Kolasky and Dick (2003, p. 211) have suggested, the Procter and Gamble decision even seemed to treat the notion of efficiencies arising from a merger as an offense.

Based on the original Williamson (1968) idea that even if a merger were to be allocatively inefficient, because the merged firms could raise prices, provided dynamic productive efficiencies and cost savings were to be engendered, these efficiencies would outweigh the negative effects of market power and such a merger would enhance welfare. Since then, a large literature in policy and strategy (Areeda, Hovenkamp, & Solow, 2002; Farrell & Shapiro, 1990; Pitofsky, 1999; White, 1987) has incorporated the performance criterion as a key element of antitrust policy, and corporate strategy, in the United States, in deciding a merger to be in the public or corporate interest. A key component of this public policy and corporate interest criterion is that the performance effects be specific to the merger. Merging firms will have possessed complementary assets and skills. These would have enhanced operational performance, resulting in synergy (Farrell & Shapiro, 2001).

The rationale behind the recent decision, of the Antitrust Division of the United States Department of Justice, to oppose the AT&T and T-Mobile's merger, has been based on allocative efficiency considerations. The merger of the two of the largest firms in the United States wireless sector can create a potential behemoth, which can dictate prices in the market, leading to a sharp increase in retail prices and a commensurate sharp decrease in consumer welfare. The evidence, in general, of the impact of telecommunications mergers, is slim. What are particularly missing are the allocative efficiency analyses of these mergers, though some recent evidence does look at the operating efficiency (Majumdar, Moussawi, & Yaylacicegi, 2010a) and the human capital (Majumdar, Moussawi, & Yaylacicegi, 2010b) consequences of telecommunications mergers in the United States.

A stated reason behind almost all of the telecommunications mergers has been synergy generation. Consequently, the combined companies would have more resources to upgrade their technological infrastructures, for customers to gain.[1] Similar synergy-generation for the purpose of raising funds sentiments were espoused for the AT&T and T-Mobile merger,

[1] For example, with respect to the AT&T and Bell South merger, in a letter dated October 13, 2006, addressed to the Honorable Kevin Martin, Chairman of the Federal Communications Commission, Robert W. Quinn, Jr., Senior Vice President, Federal Regulatory, of AT&T Services, Inc., had written that "As an initial matter, we reiterated our firm conviction that the merger should be approved promptly without any conditions whatsoever. We noted that, throughout the course of this proceeding, AT&T and BellSouth have demonstrated that the merger will decidedly advance the public interest by bringing together two companies with complementary assets and strengths, thereby creating a more efficient, more innovative company capable of accelerating and expanding the delivery of high quality advanced technologies and services (italics ours) to all classes of customers, large and small. We