Monopolizing Practices: Merger and Predation

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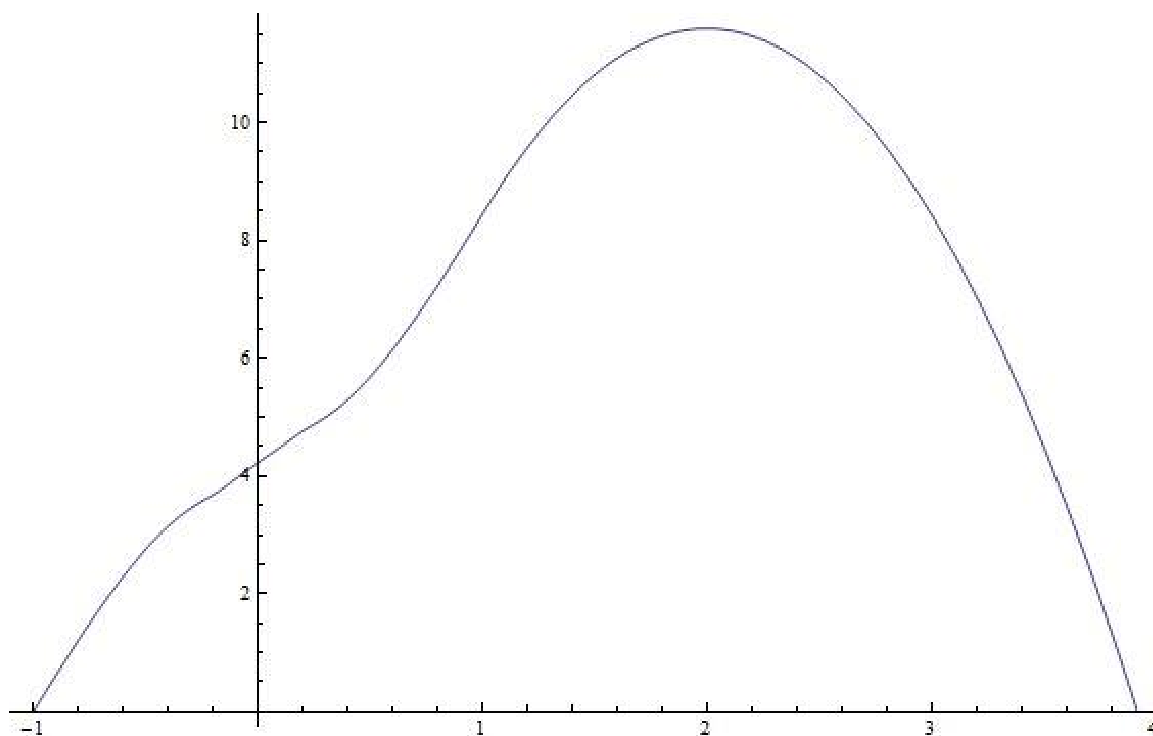

Figure 1: **Temp diagram holder**

Predatory Pricing US Supreme Court, Brooke Group (1993) "there is a consensus among commentators that predatory pricing schemes are rarely tried and even more 22 tried, rarely successful." No successful suits since then. Europe is much harsher. In 2002 a German court ordered Wal-Mart to increase its sugar and milk prices. Predatory Pricing The US policy is that predatory pricing occurs only if its purpose is to drive out competitors AND the price is below average avoidable cost (AAC) 23 cost AAC). AAC is similar to average variable cost, but it includes any fixed (doesnt depend on Q) but not sunk (cant be recovered by stopping production) cost of producing the range of products. The FTC Statements on the Justice Dept. Report The Justice Dept. issued a report suggesting to the courts that Sherman Act, Section 2 be applied more carefully 24 2, carefully. Three FTC Commissioners disagreed with Justice. The FTC Chairman, Kovacic,

agreed with Justice.

The Three Commissioners Two Big Themes The welfare of consumers is the goal, not economic efficiency.

Economic theory is not the same as law. The Three Commissioners: The Justice Reports 4 Premises 1. The search for market power drives innovation. 2. Overenforcement of laws is worse than underenforcement. 3. It is too costly to try to control monopolization as much as we do. 4. Per se rules are better than rule of reason. The Three Commissioners: Specific Areas of the Law 1. Predatory pricing 2. Loyalty discounts (repeat customers get a discount) 3. Price bundling (a discount for buying two products together) 4. Tying (you MUST buy two products together) 5. Refusals to sell to rivals 6. Exclusive-dealing contracts Chairman Kovacics Response The courts have moved towards looking only at economic effects— not to protecting small firms or forestalling political power of large firms. The Chicago School scholars brought in economic theory. The Harvard School scholars brought in a concern for usable court tests. Both worried about government failure-– overdeterrence and the limitations of courts.

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Clayton Act, 15 U.S.C.

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Acquisition by one corporation of stock of another

No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another

person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

No person shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of one or more persons engaged in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.

This section shall not apply to persons purchasing such stock solely for investment and not using the same by voting or otherwise to bring about, or in attempting to bring about, the substantial lessening of competition. Nor shall anything contained in this section prevent a corporation engaged in commerce or in any activity affecting commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition.

1992 HORIZONTAL MERGER GUIDELINES a) Post-Merger HHI Below 1000. OK. b) Post-Merger HHI Between 1000 and 1800. An increase in the HHI of less than 100 points is OK. A bigger increase needs analysis.) P t M HHI Ab 1800 A i i th 36 c) Post-Merger Above 1800. An increase in the HHI of less than 50 points is OK. An increase of more than 100 is presumed to be likely to create or enhance market power or facilitate its exercise, but the presumption may be overcome by showing that competition would be vigorous anyway. 7/25/2010 7 Examples (1) Two firms have market shares

of 10% and 15%, and all other firms are tiny. Can the two firms merge? (2) Two of the firms have market shares of 5% each. C th ? 37 Can they merge? (3) Two firms have market shares of 10% each. Can they merge? Case 2: Merger Reduces Cost and Price Each of the two firms in the industry has TC = 2 + 3Q, so MC=3 and FC =2. Each produces 10 units, so TC = 2 + 3*10 = 32 for each firm. Average cost is 3.2 and marginal cost is 3. The price is 4. Industry profit is 4*20 - 2(2 + 3*10) = 80 - 2*32 = 16. 38 The merger allows the firms to share complementary technologies and reduce marginal cost. Therefore, after the merger, there is just one firm, with TC = 2 + .5Q. The firm could reduce output from 20 to 15 and the price would rise to 5. Its profit would be 15*5 - [2 + .5(15)] = 75- 9.5 = 65.5. But the firm prefers to increase output from 20 to 30, which drives down the price to 3. Its profit is 30*3 - [2 + .5(30)] = 90 - 17 = 73. Case 3: Merger Reduces Costs but Raises Price Each of the two firms in the industry has TC = 3Q, so MC=3 and FC =0. Each produces 10 units, so TC = 3*10 = 30 for each firm. Average cost is 3 and marginal cost is 3. The price is 4. Industry profit is 4*20 - 3*20 = 80-60 = 20. 39 The merger allows the firms to share complementary technologies and reduce marginal cost. Therefore, after the merger, there is just one firm, with TC = 2Q. The firm could increase output from 20 to 30, which drives down the price to 3. Its profit would be 30*3 - 30*2 = 90-60 = 30. But the firm prefers to reduce output from 20 to 15 so the price will rise to 5. Its profit would be 15*5 - 15*2 = 75 - 30= 45. Table 7.1 Minimum % cost reduction to make a merger raise PS+CS %Price Elasticity of demand Increase 3 2 1 .5 40 5 .43% .28 .13 .06 10 2.00 1.21 .55 .26 20 10.37 5.76 2.40 1.10 Staples-Office Depot Merger (1997) The FTC and Justice were notified (Hart-Scott-Rodino Act) Wh t i th t ti ti ? 41 What is the concentration ratio? Staples, Office Depot and Office Max clearly competed. Who else? What is the market? Price and Cost Effects Assume no cost change. The FTC said the merger would raise prices 7.3%. Staples said 2.4%. What are cost savings? The FTC said 42 g 1.4% of sales, passed along to consumers. Staples said more, and being passed along was irrelevant. What is the ul-

timate price effect? The FTC said a 7.3% increase. Staples said a 2.2% decrease. 7/25/2010 8 An Efficient Merger? Use the FTC numbers: Costs fall by 1.4% of sales, prices rise by 7.3%. Suppose the elasticity of demand is 1, which is average loosely speaking. Table 7.1 says a merger is OK if costs fall by .55% or more, prices rise by 10% and the elasticity is 10%,

Even if the elasticity is 2, if costs fall by 1.21% or more, the merger is OK. But the FTC and the Court said the efficiency analysis wasnt going to decide the case.

Questions You Should Be Able to Answer

Terms to Know

Homework Questions

HERE PUT EXAMPLES WITH DIFFERENT NUMBERS THAN IN THE TEXT