Mergers in the Presence of Economies of Scope: A Study on Coalition Formation

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Abstract

In the extensive economics literature on mergers, there is little theoretical work as to whether economies of scope might explain mergers between firms and, if so, what type of mergers will occur. Some recent applied literature on different industries, both in the EU and the USA, has produced mixed conclusions regarding the significance of economies of scope in explaining firms’ mergers. We build a theoretical model to study the possible impact of economies of scope on the type of mergers that might occur in a three-firm two-product economy. The model entails two stages. The first stage is a coalition formation game, where firms might decide to merge. The chosen framework is a partition function form game, where the core is one of the adopted solution concepts. In the second post-merging stage, firms compete in a Cournot game. We conclude that the degree of product differentiation and the significance of economies of scope can lead to different equilibrium ownership structures, hence, to different mergers, and we compare the effects on social welfare these different mergers will have, which might inform policy making on merger activity. In particular, we show that: stable mergers might be social welfare decreasing; social welfare increasing mergers might not be stable; when studying the stability of a particular merger, it is necessary to go beyond profitability and take into account outsiders’ strategic behavior; as a result, a merger that would allow for the creation of economies of scope, thus being highly profitable for the insiders, might not be stable precisely due to such strategic behavior.

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