Horizontal Merger Analysis with Endogenous Product Range Choice

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Abstract

Many mergers involve multi-product firms and may result in a readjustment of the merged entity's product range. We consider the consumer welfare implications of mergers between multi-product firms in a market with a monopolistically competitive fringe of single-product firms. Aggregate product variety is determined by endogenous product variety choices of multi-product firms and entry/exit decisions of single-product firms. We assume that a merger may result in marginal cost savings or fixed cost savings. The fixed cost in our setup represents the marginal cost of producing one more variety. Our analysis reveals that the consumer welfare impact of mergers depends on two factors: the reallocation effect and the price effect. The reallocation effect helps consumers if it implies that with the merger, a larger portion of the production gets reallocated to the firms with lower prices. The price effect is always negative and refers to the increase in prices of the varieties produced by the merged firm. We show that mergers with sufficiently high marginal cost synergies harm consumer welfare, despite causing an increase in aggregate variety, if and only if multi-product firms have a fixed cost advantage. However, mergers with sufficiently high fixed cost synergies always hurt consumer welfare. Our results imply that mergers which generate high synergies or an increase in aggregate variety do not necessarily improve consumer welfare.