Corporate Political Strategy and Antitrust Policy: The Role of International Competitive Effects

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Abstract

Management scholars have considered a number of dimensions to mergers and acquisitions, but have not considered the determinants of antitrust review outcomes. The Corporate Political Strategy literature has analyzed the effect of corporate political activity on regulatory, macro-economic and social-economic policies, but not the effect of corporate political activity on antitrust policy. This paper takes a corporate political strategy perspective to explaining antitrust-review outcomes. The Integration approach within the Political Economy literature, and the Industrial Organization literature on horizontal mergers are relied upon to theoretically frame and support a number of propositions. The main contention here is that domestic mergers with international competitive effects are more likely to invoke both private interest pressure and public interest support, and are thus more likely to earn positive antitrust reviews.

Key Words: Corporate Political Strategy; Non-Market Strategy; Antitrust Policy;

I. Introduction

The 1990s witnessed an unprecedented spate of mergers-and-acquisitions, with the value of annual US mergers-and-acquisitions rising from under $200 billion in 1990 to $835 billion in 1997 (Vrana, 1997). Management scholars have accordingly studied many dimensions of M&As: merger motives (Chatterjee, 1986; Trautwein, 1990; Walter & Barney, 1990; Meuller, 1997); stock market reactions (Chatterjee, 1986, 1992; Chatterjee, et al. 1992; Flanagan, 1996; Lubatkin, 1987; Matsusaka, 1993; Morck, et al., 1990; Shelton, 1988; Singh & Montgomery, 1987); top-management turnover (Cannella & Hambrick, 1993; Walsh, 1988, 1989; Walsh & Ellwood, 1991); layoff announcements (O'Shaughnessy & Flanagan, 1998); R&D expenditures (Hitt, et al. 1991; Long & Ravenscraft, 1993); and other firm management changes. An important omission in this list of research topics is the ability of management to gain positive antitrust-review outcomes. More than just a market phenomenon, M&As involve a significant political economy dimension, as successful M&As require antitrust policy approval. A corporate political strategy perspective can help fully round out the management literature's investigation of the domestic merger phenomenon.

A simple example drawn from recent history motivates the need for management scholarship on the corporate political determinants of successful antitrust reviews. Two of the more controversial mergers considered by US antitrust authorities in 1997 included the Staples/Office Depot and Boeing/McDonnell Douglas mergers. Both transactions would reduce competition and effectively lead to duopolistic markets; however, antitrust authorities blocked the Staples/Office Depot merger but allowed the Boeing/McDonnell Douglas merger (OECD, 1998). The answer to this puzzle may lye in the fact that Boeing's acquisition involved international competitive effects, while the Staple's merger was strictly a domestic phenomenon. International competitive effects can play a crucial role in altering the political competition for antitrust approval; thus, a corporate political strategy perspective can help explain why some mergers are approved and others not.[1]

One main endeavor of the corporate political strategy literature has been to change management's traditional one-way perspective that government impacts business decisions to a two-way perspective that also finds business impacting government decisions. In support of business impacting government decisions, management scholars have studied many different dimensions of corporate political strategy: political strategies used by corporations (Aplin & Hegarty, 1980; Marcus, Kaufman & Beam, 1987; Getz, 1993; Rehbein & Schuler, 1995; Schuler, 1996); determinants of corporate political activity (Esty & Caves, 1983; Zardkhooi, 1985; Masters & Keim, 1986; Lenway & Rehbein, 1991; Grier, Munger & Roberts, 1994); the efficacy of corporate political activity (Keim & Baysinger, 1993; Grier, Munger and Roberts, 1991); and international variation in effective corporate political activity (Hillman & Keim, 1995; Boddewyn & Brewer, 1994). However, one concern expressed in the corporate political strategy literature has been the lack of systematic research. Mitnick (1983, p.3) calls for systematic study of "why certain strategies or tactics are adapted under certain conditions". Vogel (1996, p. 159) calls for interdisciplinary research that attempts "to theorize about the role of politics in managerial decision making or the importance of politics to business". Management theorists have been calling for a more systematic and rigorous approach to corporate political strategy.

Beyond the need to push the literature on corporate political strategy further, I implicitly argue by topic choice that antitrust policy should be included as a public policy that can be influenced by political pressure. The corporate political strategy literature has strictly focused on economic, regulatory, and social policies as subject to corporate influence. This author is aware of only one article by management scholars--a recent article by Hillman, Zardkoohi and Bierman (1999) on firm benefits from government service--that even mentions the ability of business to shape antitrust outcomes. The omission in the management literature is almost completely shared by political theorists in other disciplines; though, an embryonic Public-Choice literature has begun to analyze the societal determinants of antitrust outcomes (Coate, Higgins & McChesney, 1990; McChesney & Shughart, 1995).

In this paper, I attempt to address the concerns mentioned above: 1) the puzzle regarding the contradictory antitrust decisions with Staples and Boeing; 2) the lack of corporate political strategy literature regarding mergers and antitrust policy; 3) the need for more systematic research on corporate political strategy. First, this paper suggests that international competitive effects played a crucial role in Boeing's successful antitrust review.

Second, this research squarely addresses the ability of corporate political activity to affect antitrust policy. Third, the analysis attempts to add to a more systematic approach to corporate political activity by setting testable propositions that find support in the existing Political Economy and Industrial Organization literature.

Beyond addressing the above concerns, this paper makes one main contention regarding corporate political activity: the concurrence of private interest pressure and public interest support ensures the success of domestic M&As (hereafter referred to as mergers for simplicity), and the international competitive effects of domestic mergers promote the concurrence of private interest and public interest political forces. First, international competitive gains spur additional pro-merger political pressure by firms--furthering private interest pressure. Second, and contrary to orthodox thinking, international competitive effects increase the national welfare merits of domestic mergers--furthering public interest support. Consequently, domestic mergers with significant international competitive effects are more likely to obtain antitrust approval than are domestic mergers without significant international competitive effects.

The main argument--that domestic mergers with significant international competitive effects invoke both private and public interest political forces--draws from two distinct literatures. First, the Integration literature (Katzenstein, 1978; Becker, 1983; Jarrell, 1984; Keeler, 1984; Kalt & Zupan, 1984; Mansfield & Busch, 1994), so categorized because these scholars integrate Private Interest and Public Interest political approaches--political approaches that more often duel in scholarly literature. Integration theorists expect more responsive public policy (a policy more likely to be approved) when significant private interest and public interest political forces concur (Becker, 1983; Langenfeld & Rogowsky, 1988; Mansfield & Busch, 1994). Second, the Industrial Organization literature on horizontal mergers (Farrell and Shapiro, 1990) aids in conceptualizing the link between the international competitive effects of a domestic merger and enhanced private interest pressure and public interest support.

This paper draws extensively from the political economy literature; thus, requiring some background in this vast discipline. The paper is organized as follows to support the main contention. Section II reviews the relevant political economy literature--the subfields of Private Interest, Public Interest and Integration--in order to frame the theoretical contribution. Section III narrows the discussion by offering an Integration theory approach to explaining antitrust review outcomes; institutional analysis plays a significant role in explaining the relative explanatory power of Private and Public Interest approaches. Section IV uses the political economy literature discussed in sections II and III and the Industrial Organization literature on horizontal mergers to develop the main contention that international competitive effects further both private and public interest political forces. Section V concludes.

II. Review of the Relevant Political Economy Literature

I draw from the broad Political Economy literature to support and frame the paper's theoretical contribution. Vogel (1996) calls for management scholars to draw from the existing political literature in order to ground our research in a long and rigorous tradition. Political Economy theorists are chiefly concerned with what drives political outcomes or, more specifically, what political forces can be credited with explaining public policy. Three specific approaches to political theory--Private Interest, Public Interest and Integration--that cut across the various political literatures are used in this analysis. These three approaches are reviewed and presented here for those less familiar with the political economy literature.

A. Private Interest Tradition

Private Interest analysis considers society as the determinant of public policy outcomes. Political competition amongst societal groups that coalesce around common interests determines public policy outcomes (Bentley, 1908; Truman, 1951; Downs, 1957). Well-established and concentrated groups have an advantage in this competition for political favors and more easily overcome free rider problems (Olson, 1965). Successful cooperation and political persuasion depend on the presence of concentrated interests; however, public welfare is not often served when these concentrated interests influence public policy. Powerful pressure groups determine political outcomes at the expense of national welfare. Concentrated producer groups are deemed the probable winners of political competition due to their ability to secure political benefits, while diffuse consumer interests are deemed the probable losers of political competition.

The public choice and political economy of regulation literatures particularly embrace private interest analysis. Stigler (1971) helped spawn these two literatures by stating that regulation was attained by and for industry at the expense of public welfare. Stigler's *capture theory* held that the most cohesive and powerful groups control regulation policy. Peltzman (1976) pushed theory further by modeling the political competition for regulation policy and concluding that political outcomes (or better said, political equilibria) are found where policy makers' marginal political costs equal their marginal political benefits. Peltzman's work moved Private Interest analysis beyond the 'all or nothing' result set of capture theory (Becker, 1976), and helped explain the presence of cross-subsidization with regulators setting policy to pay off different interest groups.

Private Interest theorists have moved beyond the industry regulatory policies, which were so formative of this analysis, and now look at other public policies as influenced by concentrated societal interests. Particular to this paper, McChesney and Shughart (1995) extend the Public Choice perspective to antitrust policy--a public policy realm historically less scrutinized by Private Interest analysis--in an edited volume of work. The management literature on corporate political activity falls firmly within the private interest tradition, as political pressure is necessary for effective corporate political activity.

B. Public Interest Tradition

Public Interest theorists argue against a focus on societal groups. Instead, they give government institutions a powerful and independent policy formulation role, and deem public officials willing and able 'public welfare' guardians. Strong institutions insulated from societal pressure are crucial for the validity of Public Interest analysis. Governments less subject to direct and concentrated political pressure are better able to secure public welfare (Schumpeter, 1950; Evans, 1995). The public officials of Public Interest theory appear altruistic, as they are motivated to do the 'right thing' and promote social welfare (Kalt &

Zupan, 1984). Pressure groups may have particular interests opposed to national welfare, but public officials are able to resist the pleas of noisy pressure groups.

The Public Interest approach has received less attention by management scholars (and particularly public choice scholars). Mitnick (1983, ch.4, p.92) states that the norm has been to identify the "so-called public interest theories of regulation as strawmen to be discarded in favor of 'economic' or 'private interest theories' ". The premise that governments promote national welfare when faced with international economic and political constraints is fundamental to much of the IPE literature. Odell (1982) capsulized this IPE hypothesis in observing that when market conditions change and make current policy irrational from a national welfare perspective, governments change policy and yield to market forces. IPE scholars influenced by Public Interest theory find that foreign economic policies are national-welfare-maximizing[2] responses to international economic conditions. These theorists recognize a pivotal role for national institutions in securing public interest driven policies. Krasner (1978), Katzenstein (1978), and Lake (1988) all consider the state's ability to resist societal pressure as crucial for international economic policy makers to advance national interest.

B. Integration Literature: Public and Private Interest

Much political scholarship assumes or argues for the pre-eminence of one or the other approach, yet neither Private nor Public Interest theory independently accounts for the range of public policy outcomes. Political outcomes at times fit a Private Interest perspective and at other times fit a Public Interest perspective. Two examples bear the fallacy of sticking to one approach. First, Private Interest theory successfully explained inefficient regulation policies, but found it difficult to explain the proliferation of deregulation that began in the late 1970s (Derthick & Quirk, 1985). In fact, deregulation occurred soon after Private Interest analysis gained scholarly and public acceptance. It appears that public interest support better explains the deregulation phenomenon, while private interest pressure better explains the regulation phenomenon (Keeler, 1984). Second, Schattschneider (1963) finds that private interest forces best explain the onset of high tariffs in the 1930's US. However, Bauer, Pool and Dexter

(1972) find public interest forces best explain the post WW-II free trade ascendancy.[3] Private interest and public interest political forces both appear to determine trade policy; hence, both political forces must be considered in order to understand trade policy outcomes.

Integration scholars reconcile variation in Private and Public Interest theory effectiveness by considering when public or private interest forces dominate. Keohane and Milner's *Internationalization and domestic politics* (1996) prods political theorists to recognize the explanatory power of societal actors as well as the effect of institutions on altering societal pressures. Katzenstein (1978) states that societal actors have the greatest public policy impact during periods of minimal hegemony, and little public policy impact during periods of maximum hegemony; note that hegemony refers to stable international systems where a significantly strong nation ensures international order. Becker (1983) and Jarrell (1984) unify Private and Public Interest approaches by bringing deadweight costs into a model of political competition; deadweight costs reflect public interest concerns and counter private interest pressure. Kalt and Zupan (1984) empirically support the promotion of government official's self-defined notions of public interest. They find public interest support powerful during periods when politicians are not diligently overseen (non-election years), and private interest pressure powerful during high oversight periods (election years). Defining the political economic conditions which favor private or public interest political forces allows these theorists to explain the inconsistent record of Private and Public Interest approaches.

The Integration literature norm is to explain when opposing private and public interest forces best explain public policy outcomes; the assumption being that political forces push policy in different directions. However, policies supported by significant societal actors may also improve national welfare, or more simply put--private interest and public interest forces may concur. Integration theorists generally agree that a public policy will be far more successful when private interest and public interest forces concur: Becker (1983) states that efficiency enhancing policies are more likely to be adopted than efficiency lowering policies; Mansfield and Busch (1994) found non-tariff barriers highest when private and public interest political forces converged. Integration theorists believe that public policies supported by both private and public interest political forces are more successful and more fully implemented than policies supported by only one political force.

Integration theorists focus on which political approach is most powerful when private and public interest forces are opposed, and have set political economic conditions which favor private or public interest political forces. However, Integration theorists have not significantly explored the concurrence of political forces beyond the expectation for public policy to be more successful and fully implemented. I am aware of no work that offers economic conditions, which promote the concurrence of private and public interest pressure. If one can expect more successful public policy when private interest and public interest forces concur, then it befits scholars to understand when these political forces concur.

III. The Role of Institutions in an Integration Theory Approach

Understanding an Integration theory approach to antitrust-review outcomes helps bridge the gap between general Integration theory and the specific hypothesis tailored to antitrust political competition. This section acts as an intermediate step between the previous section's theoretical review (section II) and next section's elaboration of the main contention (section IV). Combining private and public interest political forces, accounting for when one political force is dominant, and understanding when these political forces concur--are all crucial to an Integration theory approach.

Integration theory holds that both private interest pressure and public interest support determine political outcomes, though the determining power of these political forces will vary. Political outcomes reflect Private Interest theory at times, and Public Interest theory at other times. According to many theorists, the relative explanatory power of private and public interest forces depends on the institutional framework (Krasner, 1978; Katzenstein, 1978; Kalt and Zupan, 1984; Lake, 1988; Hillman and Keim, 1995). Strong and independent institutions reduce the effect of private interest pressure and allow the pursuit of public interest policy. Conversely, private interest pressure is most effective when institutional structures are relatively weak. Variation in institutional independence helps explain the mixed prediction record of analysis based strictly on either Private or Public Interest theory.

Integration theory's emphasis on institutional independence can be fit to the political economy of antitrust. In this case, antitrust institutional independence determines the relative explanatory power of private interest pressure and public interest support. These insights can be summed up by two simple propositions:

Proposition 1: The more (less) independent the antitrust institution, the less (more) private interest pressure will affect antitrust-review outcomes,

Proposition 2: The more (less) independent the antitrust institution, the more (less) public interest support will affect antitrust-review outcomes.

Hence, merging firms best manipulate the political process when they face non-independent antitrust institutions. Unifying Public and Private Interest approaches with an understanding of antitrust institutional independence helps explain variation in antitrust policy outcomes.

Institutional independence is a difficult concept to specify, but differences in antitrust institutional independence are discernible across nations. A World Bank study on antitrust policy indicates cross-national differences, and allows for some categorization (Boner and Krueger, 1991). The study finds the following: the US, Germany, and the post 1990 European Community/Union have strong antitrust institutions; Japan and Italy have weak antitrust institutions; and the United Kingdom and Canada have institutional antitrust commitments somewhere between a strong and a weak ideal. These differences in antitrust institutional independence imply cross-national variation in private interest pressure effectiveness.

Nations also experience changes in institutional independence over time. Canada changed past policy and increased antitrust vigilance in the mid 1980's. Other nations have stepped up antitrust enforcement over the last two decades to ensure positive welfare effects from deregulation (Boner and Krueger, 1991). While this section focuses on general antitrust policy, an example from US aviation antitrust history illustrates how a nation's institutional independence may change over time. From the beginning of 1985 until the end of 1988, the Department of Transportation (DOT) had final antitrust authority over the airline industry, and the Department of Justice (DOJ) gained final authority beginning in 1989. All twenty-two airline mergers reviewed for antitrust by DOT were approved, but under DOJ authority some airline mergers were impeded (U.S. Congress, 1992). It appears then that the antitrust outcomes reflect the DOJ having greater institutional independence than DOT.

Integrating Private and Public Interest theories with institutional independence allows for more accurate understanding and prediction of antitrust outcomes. Figure 1 presents a taxonomy of antitrust policy outcomes. This taxonomy illustrates the policy impact of private and public interest forces concurring, and the importance of institutional independence. Differences in institutional independence and the national welfare merits of mergers elicit different antitrust policy outcomes.

Institutional independence affects the relative explanatory power of private and public interest forces. Propositions 1 and 2 imply that private interest pressure will be more (less) powerful than public interest support when antitrust institutions have weak (strong) independence. Antitrust institutions may also lie somewhere between a strong or weak ideal (hereafter moderate), and both political forces will be significant in this case. Predicting whether public interest support or private interest pressure most powerfully determines antitrust outcomes under moderate antitrust institutions is difficult.

A merger's national welfare merit elicits differences in the concurrence of private and public interest political forces. Private interest pressure is behind all the cases in figure 1, as firms seek only beneficial mergers. However, public interest support backs accommodating antitrust policy only when mergers enhance national welfare. Private interest and public interest political forces are opposed (concur) when the merger decreases (increases) national welfare. An analysis of the various scenarios reflected within the figure follows.

Figure 1: Taxonomy of Antitrust Outcomes

	ANTITRUST INSTITUTIONAL INDEPENDENCE		
MERGER'S NATIONAL WELFARE	Weak *Private Interest Driven Policy*	Moderate *Private & Public Interest Driven Policy*	Strong *Public Interest Driven Policy*
Negative *Private & Public Interest Opposed*	**Merger Approved**	**Merger Uncertain**	**Merger Rejected**
Positive *Private & Public Interest Concur*	**Merger Approved**	**Merger Approved**	**Merger Approved**

In the left-hand column cases, private interest forces drive antitrust policy due to weak (non-independent) antitrust institutions. Merging firms secure antitrust approval, even when the merger decreases national welfare. Public interest is served when the merger is welfare improving, however merging firms are the agents of antitrust determination.

In the right hand column cases, public interest support determines policy due to strong and independent antitrust institutions. Antitrust authorities are able to serve public interest by rejecting national welfare decreasing mergers and by approving national welfare enhancing mergers. Private interest pressure is answered when mergers enhance national welfare, but antitrust authorities are the determining agents behind antitrust policy.

In the middle column cases, both public and private interest political forces have explanatory power. Institutions are of moderate strength, with neither merging firms nor antitrust authorities overtly controlling the political process. When a merger enhances national welfare, both private and public interest forces concur and the merger is approved. Antitrust rulings are uncertain when the merger threatens national welfare as private and public interest forces are opposed; antitrust policy outcomes will depend on the relative strength and intensity of these political forces.

The Integration literature holds that a public policy will be more successful when private and public interest forces concur. For instance, Mansfield and Busch (1994) find non-tariff barrier levels highest when private and public interest forces backed trade barriers.[4] Figure 1 illustrates this observation in an antitrust policy context. The lower row has private and public interest forces concurring because the merger improves national welfare: antitrust approval is granted in all of these cases. The upper row has private and public interest forces opposed because the merger does not improve national welfare: antitrust approval is less consistent in these three cases. A simple proposition can be generated from this observation:

Proposition 3: When private interest and public interest political forces concur (contradict) behind a merger, then successful antitrust review is assured (in doubt).

This proposition underscores that private interest supported mergers which improve national welfare will be more readily approved than national-welfare decreasing mergers.

IV. International Competitive Effects of Domestic Mergers

This section narrows the analysis and focuses on political competition for antitrust review outcomes when international competitive effects are involved. The contention here is that domestic mergers with international competitive effects improve national welfare more than domestic mergers with strictly domestic competitive effects. Consequently, domestic mergers with international competitive effects are more likely to earn antitrust approval because they draw upon significant private and public interest forces. International competitive effects (also referred to as international effects) include change in merging firm's international profit, in non-merging firms' international profit, and in international consumer surplus. Note that national welfare does not include foreign firms or consumers; any reference to firm profit or consumer welfare is equivalent to home-nation firm profit or home-nation consumer welfare, unless denoted as foreign.

To repeat, the main contention is that domestic mergers with international effects are more likely to marshal both private and public interest forces than mergers limited to domestic competitive effects--international effects enhance both private interest pressure and public interest support for antitrust approval. Private interest pressure is enhanced as firms intensify their political pressure when international market gains are possible. Public interest support is also enhanced as international effects further the national welfare merits of domestic mergers. A more detailed analysis follows.

A. Public Interest in an International Context

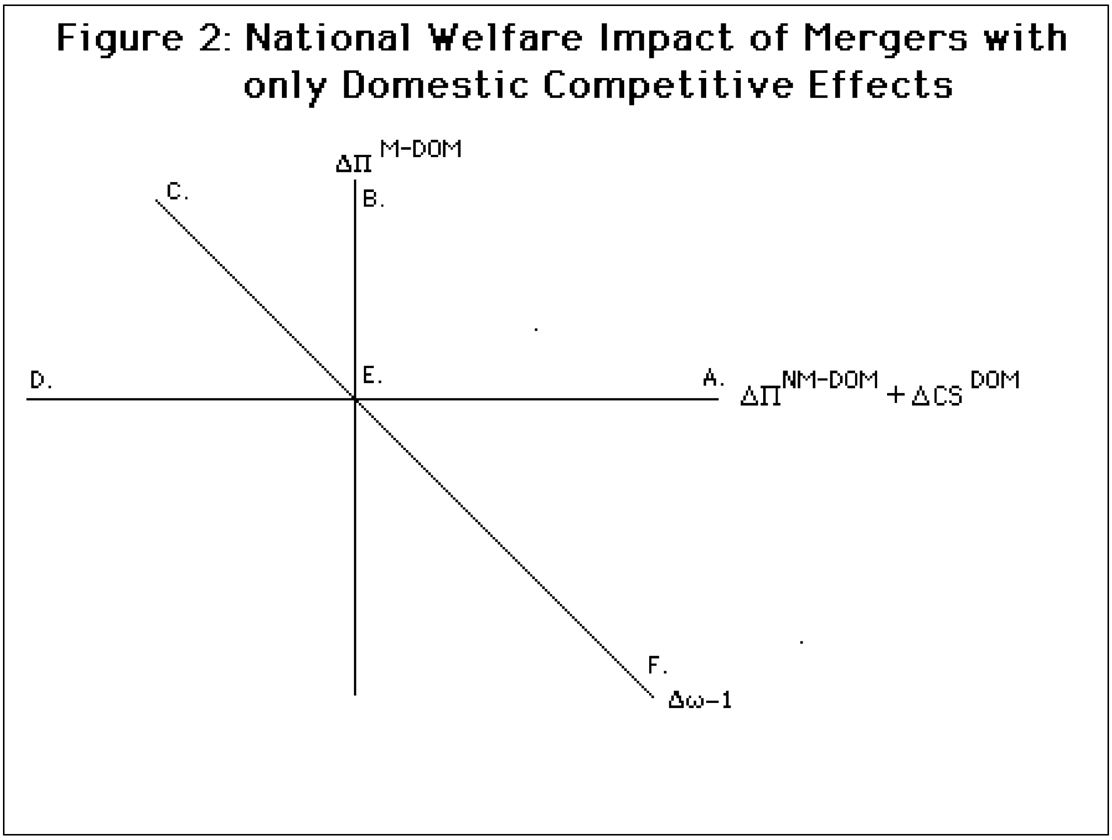
A political explanation of antitrust outcomes where government officials approve national welfare improving mergers and reject national welfare decreasing mergers is consistent with a Public Interest approach. This section relies on Farrell and Shapiro's (1990) framework for evaluating the national welfare of a horizontal merger; however, national welfare analysis depends on the perspective of government regulators and what they are maximizing.[5] While antitrust authorities may not be concerned with international competitive effects, a comprehensive national welfare analysis of a merger should include international effects. The argument here is that these international effects increase the national welfare merits of domestic mergers; consequently, furthering public interest support for lenient antitrust policy. Three market scenarios are used to elaborate on this point: first, when mergers have no effect on international markets; second, when mergers have an international effect but international and domestic markets are not segmented; and third, when mergers have an international effect but international and domestic markets are segmented.[6] I assume two economic conditions—imperfectly competitive markets and economies of scale or scope—to be present in all-three market scenarios; thus, ensuring that strategic behavior determines market outcomes.

Scenario # 1: National Welfare without International Competitive Effects

The national welfare effect of a merger with only domestic competitive effects is equal to the change in domestic profits for merging firms ($\Delta\Pi^{M\text{-}DOM}$), the change in domestic profits for non-merging firms ($\Delta\Pi^{NM\text{-}DOM}$), and the change in domestic consumer surplus (ΔCS^{DOM}). Equation 1 measures the national welfare effect of a domestic merger without international competitive effects.

$$\Delta W = (\Delta\Pi^{M\text{-}DOM}) + (\Delta\Pi^{NM\text{-}DOM}) + (\Delta CS^{DOM}) \tag{1}$$

Equation 1 appears a simple summation problem; however, evaluating the national welfare merits of a merger is difficult both theoretically and in practice. Farrell and Shapiro (1990) differentiate between internal merger and external merger effects, and provide a useful framework to factor the national welfare merits of horizontal mergers between Cournot competitors. External effects include the change to non-merging firms' profits ($\Delta\Pi^{NM\text{-}DOM}$) and the change to domestic consumer surplus (ΔCS^{DOM})--the net external effect is measured on the horizontal axis in figure 2. The internal effect is simply the change to merging firms' domestic profit ($\Delta\Pi^{M\text{-}DOM}$)--the internal effect is measured on the vertical axis in figure 2. All mergers represented as points northeast of line CF improve national welfare ($\Delta W > 0$). Mergers within triangle AEB are clear candidates for public interest approval as both internal and external merger effects are positive. Mergers within triangle BEC are also in the public interest as the positive internal effect (change to merging firms' profits) outweighs the negative net external effect (change to domestic consumer surplus and non-merging firms' profits). Mergers within triangle AEF improve national welfare, but are not likely to occur as merging firms' profits decrease post-merger. This first scenario acts as a benchmark upon which the next two scenarios can be compared.



Scenario #2: National Welfare with International Competitive Effects & Non-Segmented Markets

The Farrell and Shapiro framework is useful but must be extended to accommodate a scenario that involves domestic mergers invoking international competitive effects. This is the case when domestic mergers affect both merging firms and non-merging firms' international profits, but do not affect domestic-consumers international welfare. No international consumer welfare effect exists because markets are non-segmented--domestic consumers do not purchase specific products in international markets, they only purchase products in the domestic market (may they be from home or foreign producers). This scenario, with firms competing in global-scope markets, is akin to the already mentioned airline manufacturing industry. Adding an international effect to Farrell and Shapiro's domestic internal and domestic external merger effects allows differentiation between domestic and international competitive effects. Again, the net international effect of domestic mergers has two components when markets are non-segmented: change in merging firm's international profit ($\Delta\Pi^{M\text{-}INTL}$), and change in non-merging firms' international profit ($\Delta\Pi^{NM\text{-}}$

^{INTL}). Note that these two international effect components are simply an accounting device we use to differentiate between the national welfare of domestic mergers with and without international competitive effects; actual firms are probably most concerned with overall profitability in global markets. Equation 2 measures the national welfare merit of a domestic merger with domestic and international competitive effects.

$$\Delta W = (\Delta\Pi^{M\text{-}DOM}) + (\Delta\Pi^{M\text{-}INTL}) + (\Delta\Pi^{NM\text{-}DOM}) + (\Delta\Pi^{NM\text{-}INTL}) + (\Delta CS^{DOM}) \quad (2)$$

Note that equation 2 reduces to equation 1 when domestic mergers have no international competitive effects. The greater claim here is that domestic mergers with international effects improve national welfare more than similar mergers with only domestic competitive effects (i.e. $\Delta W^{2} > \Delta W^{1}$); thus the following proposition is offered:

Proposition 4: Domestic mergers in non-segmented markets that invoke international competitive effects are more likely to draw public interest support than domestic mergers that do not invoke international competitive effects.

The net international effect must sum positive for this proposition to hold. The net international effect sums positive when merging firm's international profit increases ($\Delta\Pi^{M\text{-}INTL}$) dominate potential non-merging firm's international profit losses ($\Delta\Pi^{NM\text{-}INTL}$). It is highly likely to find merging firm's international profits increasing post-merger; however, non-merging firms may find substantially lower post-merger international profits. In the realm of strategic competition, anything is possible; hence, non-merging firm's international losses may outweigh merging firm's gains. Farrell and Shapiro (1990) support, however, the unlikeness of this scenario. They point out that more often than not, non-merging firms find increased profits when two of their competitors merge. Simply put, while non-merging firms face a more competitive competitor, this effect is often dominated by reduced market competition—the market equilibrium becomes more monopolist. The real driver of lower national welfare is most often large consumer surplus losses; hence, in this hypothetical scenario, domestic consumer welfare losses may outweigh the benefits of mergers that invoke both international and domestic competitive effects. The key point here, nevertheless, is that domestic mergers in non-segmented markets with international competitive effects are more likely to enhance national welfare than mergers without international competitive effects.

Scenario #3: National Welfare with International Competitive Effects & Segmented Markets

The third market scenario considers domestic mergers with international competitive effects in a world with segmented markets. This scenario is similar to the already mentioned example of airline service markets, where markets have real geographical bounds. In this scenario, the net international effect of domestic mergers has three components: change in merging firm's international profit ($\Delta\Pi^{M\text{-}INTL}$), change in non-merging firms' international profit ($\Delta\Pi^{NM\text{-}INTL}$), and change in international consumer surplus (ΔCS^{INTL}). Equation 3 adds the change in international consumer surplus, because home consumers purchase both domestic (domestic flight service) and international (international flight service) products. Note also that international profits for merging and non-merging firms become more than just an accounting device as firms face actual competitive differences in the domestic and international markets they compete in. Equation 3 measures the national welfare merit of a domestic merger with domestic and international competitive effects.

$$\Delta W = (\Delta\Pi^{M\text{-}DOM}) + (\Delta\Pi^{M\text{-}INTL}) + (\Delta\Pi^{NM\text{-}DOM}) + (\Delta\Pi^{NM\text{-}INTL}) + (\Delta CS^{DOM}) + (\Delta CS^{INTL}) \qquad (3)$$

Note that equation 3 also reduces to equation 1 when domestic mergers have no international competitive effects. The greater claim here is that domestic mergers with international effects in segmented markets improve national welfare more than similar mergers in non-segmented markets, and more than similar mergers with only domestic competitive effects (i.e., $\Delta W^3 > \Delta W^2 > \Delta W^1$) thus the following proposition is offered:

Proposition 5: Domestic mergers that invoke international competitive effects in the context of segmented markets are more likely to draw public interest support than domestic mergers in the context of non-segmented markets.

The net international effect must again sum positive for this contention to hold, and will sum positive in the majority of domestic merger cases when international and domestic markets are segmented. The change to merging firms' international profits ($\Delta\Pi^{M\text{-}INTL}$) and the change to home-nation international consumer surplus (ΔCS^{INTL}) are both likely to sign positive. The change to non-merging firms' international profits ($\Delta\Pi^{NM\text{-}INTL}$) will likely sign negative, but this component should not overpower the two positive components of the international effect.

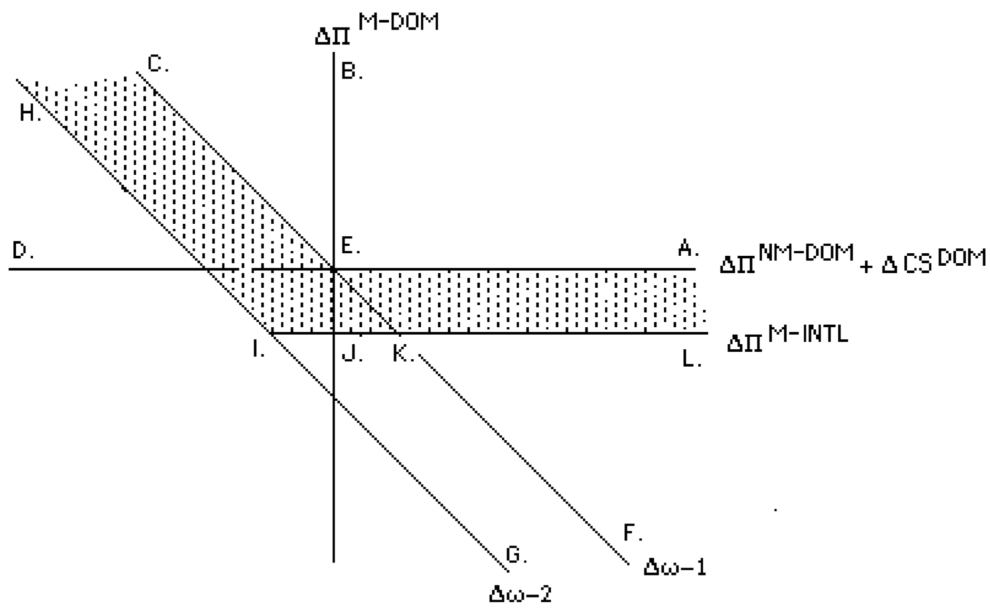
Most domestic mergers will result in positive international competitive effects provided firms compete in Cournot fashion. The first international effect component, change to merging firms' international profits ($\Delta\Pi^{M\text{-}INTL}$), is very likely to be positive. Merging firms' international competitive position improves post-merger, and increased international profits should follow an improved competitive position. The second international effect component, change to international consumer surplus (ΔCS^{INTL}), is also likely to be positive. International prices should drop as the more efficient merged firm induces a more competitive international market. The third international effect component, change in international profits for non-merging firms ($\Delta\Pi^{NM\text{-}INTL}$), is likely to be negative. Non-merging firms that compete against merging firms in international markets will experience a decline in their competitive position and profits.

The decline in non-merging firms' profits should not overwhelm the increases to merging firms' profits and international consumer welfare. Improving the competitive nature of international markets moves the competitive equilibrium down the standard demand curve; deadweight costs have been recovered and one can safely assume that the net international effect is positive. An example from the segmented airline industry may better illustrate this point. PanAm and TWA competed in the trans-Atlantic markets in the 1980's, but PanAm sold many of its trans-Atlantic route rights to United Airlines in 1991 (Meyer & Strong, 1992, p.17). TWA's trans-Atlantic profits surely decreased when faced with United and its more extensive domestic network. However, United improved upon PanAm's trans-Atlantic profitability and trans-Atlantic consumers were treated to lower fares. Although TWA's trans-Atlantic profitability suffered with United's replacement of PanAm, the net international effect will surely be positive.

There are competitive circumstances that can result in a negative net international effect. The two scenarios presented here illustrate the pivotal role of international consumer surplus in ensuring a positive net international effect. First scenario: if merging firms compete in international markets, then a domestic merger may reduce international consumer welfare. A reduction of international competitors would likely decrease the international consumer surplus component. The net international effect would likely decrease in this case unless there were strong efficiency gains by merging firms akin to Williamson's (1968) observation. Second scenario: if home-nation firms serve predominantly foreign nationals in the international markets, then the home-nation international consumer surplus component will not be significant. The international profit gains of merging firms must outweigh non-merging firms' losses for the international effect to sum positive. These scenarios that promote a negative international effect are important to consider. In these cases, domestic mergers that improve the international competitive equilibrium do not automatically indicate a positive net international effect. Merging firms' international profit gains must outweigh non-merging firms' international profit losses for the net international effect to sum positive.

The preceding discussion using the three market scenarios suggests that mergers with international competitive effects in both segmented and non-segmented markets are more likely to improve national welfare than strictly domestic mergers. Figure 3 illustrates how a positive international effect increases the set of national welfare maximizing mergers. All points northeast of line CF (the merger merit demarcation line) improve national welfare when the merger is between strictly domestic firms. The demarcation line shifts left when domestic mergers include a positive international effect, such a shift is represented by line HG. The larger the international effect, the further the merger merit demarcation line shifts left. In the figure 3 case, all points northeast of line HG improve national welfare; the set of national welfare improving domestic mergers is expanded. Line IJ demarcates the new border for merging firm acquisition interest. Acquisitions which decrease merging firms' domestic profits ($\Delta\Pi^{M\text{-}DOM}$) may still be in the merging firms' interest due to international profit increases ($\Delta\Pi^{M\text{-}INTL}$). The shaded area represents mergers that are now approved based on public interest criteria but would not have been approved without positive international effects. Note that the national welfare improving mergers in triangle (JIG) will not be proposed as they reduce merging firms' profit.

Figure 3: National Welfare Impact of Mergers with International Competitive Effects



In summary, a political explanation that focuses on mergers being weighed on their national welfare merits is consistent with Public Interest theory. By considering the international effects of domestic mergers, mergers become more attractive from a national welfare standpoint. Some mergers that fail public interest criteria in a strictly domestic sense pass public interest criteria once international competitive effects are considered. Domestic mergers with international effects are more likely than domestic mergers without international effects to improve national welfare; consequently, these mergers are more likely to draw public interest support.

B. Private Interest in an International Context

Generating a political explanation of antitrust review outcomes based on Private Interest theory is a straightforward task. This approach focuses on the political pressure merging firms apply on government regulators and antitrust authorities. Merging firms pressure for antitrust approval as long as the seek (lobby) cost is less than the expected merger benefits. Domestic competitive gains are an obvious draw for seeking mergers. An improved international competitive position is an additional incentive to seek domestic mergers. These international competitive gains are in addition to domestic competitive gains and increase the attractiveness of domestic mergers. By increasing the attractiveness of domestic mergers, international competitive gains spur greater political pressure by merging firms. Boddewyn and Brewer (1994) similarly hypothesize that firm's political behavior intensity is greatest when the stakes are higher. A simple proposition captures this dynamic:

Proposition 6: International competitive effects intensify the private interest pressure of merging firms.

Private Interest analysis does not end with merging firms' political pressure for accommodating antitrust policy. Societal actors opposed to domestic mergers are part of the political competition for antitrust policy. Countervailing interests such as domestic consumers and non-merging firms have incentive to lobby against merger approval. However, international competitive effects also appear to limit countervailing political pressure.

Domestic consumers suffer higher prices from mergers if domestic efficiency gains are negligible. Domestic consumers, however, find it difficult to maintain effective countervailing pressure due to their obvious collective action problem in politically expressing their opposition. In addition to this collective action handicap, a tradeoff mitigates consumer losses and consequently mitigates consumer merger opposition. Domestic mergers threaten domestic consumer surplus (higher domestic prices), but mergers also increase international consumer surplus (lower international prices). These international consumer welfare gains limit the incentive for home-nation consumers to oppose domestic mergers when markets are segmented. A simple propositions follows from this observation:

Proposition 7: International competitive effects reduce the countervailing political pressure against positive antitrust reviews.

Non-merging firms oppose mergers that threaten their competitive position and profits, and can surmount collective action problems more readily than diffuse consumers. A primary concern of non-merging firms is the effect of a merger on their domestic competitive position; hence, domestic mergers which threaten their international competitive position draw even further opposition. However, international competitive effects limit the countervailing interest of consumers and thus limit the net-countervailing interest.

In summary, the international competitive effects of domestic mergers intensify private interest political pressure behind antitrust approval. Merging firms intensify their lobbying effort when domestic mergers bring international competitive gains in addition to the obvious domestic competitive gains. Consumers and non-merging firms attempt to countervail the increased political pressure. However, consumers face collective action problems and are less interested in countervailing domestic mergers when markets are segmented because international price reductions offset domestic price hikes.

V. Conclusion

Successful mergers require antitrust policy approval; hence, domestic mergers are a political economic as well as a market phenomenon. Two broad political traditions are identified as fundamental to this analysis: Private Interest theory and Public Interest theory. Integration theory combines these two political traditions to better explain political outcomes, and this analysis falls firmly within Integration theory by considering that both private interest pressure and public interest support determine antitrust policy outcomes.

Integration theorists expect more responsive public policy when private and public interest forces concur. This paper argues that the international competitive effects of domestic mergers promote private and public interest concurrence. Private interest pressure is enhanced as merging firms intensify their political pressure when international competitive gains are possible. Public interest support is also enhanced as international effects further the national welfare merits of domestic mergers. Consequently, domestic mergers with international competitive effects are more likely to marshal both private and public interest forces.

This analysis contributes to the Management literature in three ways. First, by suggesting a political economy dimension to the vast management literature on M&As. Second, by opening up antitrust policy as an appropriate realm for analyzing corporate political activity, and moving corporate political strategy beyond the limits of regulatory, macro-economic, and social-economic public policies. Third, by offering propositions based in the Political Economy and Industrial Organization literatures that lead to further theoretical work and eventual empirical testing.

This analysis also generates some practical implications for managers. Managers may be well served by choosing acquisition targets that invoke significant international competitive effects. International competitive effects favor the concurrence of private and public interest political forces; thus, favoring positive antitrust review outcomes. Hence, when antitrust review outcomes are in jeopardy or questionable, managers can choose acquisition targets that have international competitive effects. The simple prediction of this analysis is that M&As with international competitive effects will find greater antitrust success than M&As without international competitive effects.

VII. References

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VIII. Endnotes

[1] It should be noted that many mergers pass antitrust review with very little government involvement. In 1997, some 3,702 transactions were reported to US antitrust authorities as mandated by the Hart-Scott-Rodino Act; of these, some 277 investigations were launched; of which 31 transactions were either restricted or prevented (OECD, 1998). Negative antitrust reviews are an important phenomenon that merit attention, but by no means a common phenomenon for US companies.

[2] IPE scholars consider national welfare in a broader sense than a neoclassical economics summation of consumer and firm welfare. For instance, IPE theorists may consider international power as a component of national welfare.

[3] While there is substantial debate over the accuracy and interpretation of both of these findings, revisionists must contend with these established explanations.

[4] Economics holds that tariff barriers seldom improve national welfare; however, Mansfield and Busch (1994) base public interest backing non-tariff barriers on the fact that large nations suffer less from these barriers than small nations. Consequently, non-tariff barriers have a greater public interest rationale in large nations than in small nations.

[5] For this reason, Kalt and Zupan (1984) consider self-defined notions of public interest as determining political voting patterns during periods of low private interest pressure.

[6] Non-segmented markets refer to the fact that there is a world-market for the product—for instance the commercial airline manufacturing business (with Boeing and Airbus the current competitors) is a world market with prices set in the world market. Segmented markets refer to the fact that markets are more geographically based—for instance competition in the commercial airline service industry is based on the number of competitors in a specific city-pair market (prices in the Los Angeles to New York city-pair market have little to do with the prices set in the New York to London city-pair market).