

Raffles Institution
H2 Economics 2023
Remedial Worksheet 2 & 3

Case Study 1: Merger

Extract 1: Nike will be facing a pumped-up rival

When Herbert Hainer sat down for a drink with Paul Fireman during the Athens Olympic Games last summer, the conversation drifted, as it often does with people in the athletic-shoe trade, to the vast American market, which is dominated by Nike. "We talked about what's good, what's bad," said Hainer, the chief executive of Adidas-Salomon, of the chat with Fireman, the chairman of Reebok International. "There was a natural sympathy between us." On Wednesday, that sympathy gave birth to a \$3.8 billion deal, in which Adidas of Germany will acquire Reebok, creating a formidable competitor to Nike for the first time in more than a decade.

With sales of \$11 billion, and a glittering roster of endorsement contracts, ranging from Allen Iverson and the National Basketball Association to David Beckham and World Cup soccer, the merged company will be close to Nike in size and arguably more powerful in its links to star athletes and teams. "It's been like Snow White and the three dwarves," said John Horan, publisher of Sporting Goods Intelligence, referring to Nike's competition with Adidas, Reebok, and another German company, Puma. "What Adidas has done is to become the clear No.2 in the U.S. market."

Shares of both companies surged, with Reebok's stock rising some 30 percent, to \$57.25 a share. The jubilant investor reaction bewildered some analysts, who noted that the cost savings and additional sales generated by the merger were likely to be modest. Adidas and Reebok will continue to have their own sales forces, distribution channels, marketing campaigns, and brand identities. "There is very little in the way of old-fashioned synergies," said Gavin Finlayson, an analyst at Commerzbank in Frankfurt.

Hainer said he viewed the merger as a way to fuel growth rather than save money. Adidas and Reebok, he said, complement each other: Reebok has been quicker to seize on cultural trends, like hip-hop, while Adidas has had a stronger tradition of technological innovation. That combination could be powerful in growing markets like China. Adidas has a well-established presence in the Chinese market, having set a goal of generating \$1.2 billion in sales there by 2010. But Reebok has the most sought-after Chinese athlete: the basketball star Yao Ming. Adidas, Hainer said, will use its sales network in China to help Reebok use its star to the greatest effect.

Even after the merger, Nike, which has sales of \$12.2 billion, will have the largest market share in the United States, at 36.3 percent. But Adidas's share will jump to 21.1 percent, from 8.9 percent. And in global market share, the gap between the two will be narrower: 32.9 percent for Nike versus 26.3 percent for Adidas-Reebok, according to Horan. Size will also give Adidas leverage in dealing with powerful retail chains like Footlocker. "You're confronting the retail community with two huge companies, with 60 percent of the market," Horan said. He said the merger would put pressure on the industry's smaller players, among them Puma and New Balance.

Source: *The New York Times*, 04 Aug 2005

Extract 2

On August 3rd, [Adidas] said it will buy Reebok, an American rival, for €3.1 billion (US\$3.8 billion). If all goes to plan, this joining of the industry's numbers two and three will enable them to mount a serious challenge to the now undisputed leader, Nike.

Now with 35% of the market, Nike has dominated the industry for years. It is the hippest of sneaker makers, using Michael Jordan, Tiger Woods and other sports celebrities with global appeal to market its brand. With its solid, but more pedestrian, reputation Adidas has won 15% of the market. Reebok, in third place, has long tried (not terribly effectively) to outcool Nike, not least in its trainers for women.

Being bigger should help Adidas in price negotiations with manufacturers in Asia, and in negotiations about shelf space and other sales issues with retailers in America. Reebok's main attraction is its 12% share of the market in America, where it also has deals to supply all the major sports leagues.

Yet most analysts are sceptical about the deal. Adidas is buying a firm with lower profit margins, lower returns and a tired image. The analysts think the price is too high and the synergies too small, especially as the two firms seem reluctant to generate some obvious ones. Mr Hainer says he expects to cut costs by €125m in the next three years by sharing information technology, synergies in sales and distribution, and cheaper sourcing. Yet the new combined company will continue to run separate headquarters and sales forces, and keep most distribution centres apart.

As for Adidas becoming the industry leader, Nike is unlikely to be quaking in its Air Jordans. Size has helped, says Margaret Mager of Goldman Sachs, because Nike has used it smartly, concentrating its vast resources behind a single brand.

Nike is unlikely to launch a rival bid for Reebok because of likely antitrust objections from regulators in America. But it could be tempted to buy Puma, another German rival.

Source: *The Economist*, 04 Aug 2005

Table 1: Athletic Footwear Market Share in USA for First Quarter of 2000

1. Nike		39.2%
2. Adidas	15.1%	
3. Reebok		10.9%
4. New Balance		9.4%
5. K-Swiss		3.6%
6. Timberland		2.9%
7. Asics	2.1%	

Source: *SportsTrend.Info*

Figure 1



Questions

(ai) Using Table 1, calculate the 3-firm concentration ratio for the athletic footwear market in the USA in the first quarter of 2000? [1]

(aii) What sort of market structure is the athletic footwear market in the USA? [1]

(aiii) How do economists expect firms to compete in such a market? [4]

Explain how the key feature in this market structure will result in preference for non-pricing competition over price competition with the use of relevant examples.

(b) With the aid of a diagram, analyse the likely impact on Nike's profits if a 'formidable competitor' is created by the Adidas-Reebok deal. [4]

Explain the effect of the competition from Adidas- Reebok on Nike's demand and hence effect on its profits.

(c) How can smaller players, such as Puma and New Balance, survive in the face of such 'formidable' competitors? [5]

Clarify the term "survive" from the firm's context → earning at least normal profit, $TR=TC$

How → refers to strategies Puma & New Balance can adopt → explain cost & revenue strategies using examples

(d) With reference to the data, assess whether the proposed merger should be welcomed. [10]

Thesis-Anti-Thesis Format

Clarify "merger", "welcomed" → "welcomed" from whose perspectives?

Can consider firms, consumers, employees, society etc...

Can examine effects on econ efficiency, dynamic efficiency, equity and choice and link to the relevant stakeholders

Thesis: merger should be welcomed due to the various advantages ...

Explain the advantages of merger to the selected stakeholders i.e. firms, consumers, employees

Anti-Thesis: merger should not be welcomed due to the various disadvantages ...

Explain the disadvantages of merger to the selected stakeholders i.e. firms, consumers, employees

Conclusion/evaluation

1. Take a stand and justify using **W E S T strategy**
2. Make a recommendation

W – Weigh the factors, i.e. which is more important and why?

E – Examine assumptions in theory. Explain its limitations/ flaws in reality.

S – Suggest alternatives.

T – Time period: Short run vs Long run effects

For this question, can justify stand by using "W" in weighing the advantages and disadvantages.