

3.1.3 Demergers

Definition

A demerger is when one firm splits into two or more separate firms. This usually happens by selling off, or “spinning off”, at least one part of the business.

For example **eBay & PayPal** . eBay split from PayPal to allow the payment platform to **partner with eBay’s rivals** (like Amazon).

Why do firms demerge?

Reduce diseconomies of scale

As firms grow, long-run average costs (LRAC) can rise due to coordination problems, slower decision-making, and bureaucracy. A demerger can reduce the size of the organisation, making it easier to manage.

Remove loss-making divisions

Some parts of a business may consistently reduce overall profit. A firm can spin off or sell that division so the remaining company looks stronger financially.

Raise funds, increase liquidity, or pay dividends

Selling part of a business can generate cash. That money can be used for investment, to reduce debt, or to pay dividends to shareholders.

Respond to competition regulation

Regulators may force a firm to break up if its market power is judged to be anti-competitive. Some firms choose to demerge early to avoid stricter regulation later. For example **Google** is considering a demerger of its **AdTech business** to prevent regulators from forcing a total breakup of the company.

Stakeholder impacts

Impacts on businesses

A demerger can improve efficiency if it reduces diseconomies of scale. Increased competition may reduce monopoly power, pushing prices closer to allocative efficiency. Competitive pressure can also reduce waste, raising X-efficiency.

However, splitting a firm can mean losing economies of scale, which may push LRAC up.

Impacts on consumers

Consumers may benefit if more competition lowers prices and increases consumer surplus. A market with more firms can also lead to better choice and quality, because firms must compete harder to keep customers.

But if economies of scale were important, costs may rise after a demerger and firms may pass this on through higher prices.

If profits fall and firms invest less in R&D, quality improvements may slow over time. If the demerger is poorly managed, customer service and product range could worsen.

Impacts on workers

Cost-cutting may lead to redundancies.

If the original firm had monopsony power and a demerger increases competition for labour, wages may rise,