A Theory of Political Acquisitions*

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Abstract

I study a dynamic model where a firm can grow in size by acquiring competitors and lobby office-seeking politicians. When the firm is distressed, the incumbent politician loses the office with some probability. Larger firms are less likely to experience distress but their distress has more severe political consequences. To prevent these, politicians can offer political support to the firm. I show that, in equilibrium: (i) the level of political support is non-monotone in the firm's size; (ii) the firm can complete acquisitions just to extract political rents. Moreover, the number of these "Political Acquisitions" is: (iii) non-monotone in the strength of politicians' re-election incentives, (iv) and in the extent of information misalignment between politicians and the firm.

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1 Introduction

Markets and politics are interconnected. Politicians set the rules of the game for firms. Firms play by these rules, but try to influence them to their advantage. In this context, Zingales [2017] warns against the risk of a "Medici Vicious Cycle," wherein market power begets political power and vice-versa.[1] Recent research supports this concern. Callander et al. [2022] propose a dynamic model where an incumbent firm can invest in innovation and lobbying. A feedback loop effect emerges. Firms with market power have more profits to invest in politics, thereby further increasing their market power. Empirical research confirms these findings. Cowgill et al. [2024] show that US firms lobby more after mergers and acquisitions. Moshary and Slattery [2024] find a similar result in the US car retail industry.

These papers think about lobbying as a *quid pro quo* exchange. Firms share part of their profits with politicians in exchange for favors. One implication is that lobbying can be measured in dollars. Indeed, many researchers have used lobbying data to understand the causes and consequences of firms' influence (see Bombardini and Trebbi [2020] for a review). A well known fact is that, at least in the US, firms spend very little money in politics (Zingales [2017], Ansolabehere et al. [2003]). For instance, in 2024, Apple spent *only* USD 7.82 Millions in lobbying, which accounted for approximately 0.00205% of their revenues. Does this mean that there is no evidence of the risk of a Medici Vicious Cycle? Firms do not need politics to build market power?

In this paper, I propose a dynamic model of the interaction of market power and political power where large firms can obtain political favors without spending a single dollar in lobbying.

In each period, a firm operates in the market and can *talk* with office-seeking politicians. The firm's market revenues are stochastic. If revenues are sufficiently low, the firm is *distressed* and it bankrupts by the end of the period. If the firm is not

[1] According to Zingales [2017], several secondary sources claim that the motto of the Medici Family, who ran Florence during the Renaissance, was: "Money to get power. Power to protect money."

distressed, it can acquire another firm upon paying a one-time re-organization cost. If the acquisition goes ahead, the firm grows in size. Acquisitions have market value. Larger firms are more efficient. This simultaneously increases the firm's per-period profits and its probability of surviving across periods. The firm then completes an acquisition if its net present value outweighs the re-organization cost.

There is an infinite population of politicians. Each politician can stay in office for at most two periods. The firm's distress has political consequences. Whenever the firm bankrupts, the office-holder politicians loses re-election with some probability. I assume that the larger the distressed firm's size, the higher the probability that the politician loses re-election. This assumption captures the following intuition. When larger firms bankrupt, more workers lose their job, more firms lose a trading partner, and more consumers lose access to a product or service. This negative economic shock arguably results into stronger political pressure for politicians.

In each period, the firm and the incumbent politician play a lobbying game. In the lobbying game, the firm self-reports its per-period revenues to the politician, who then decides on the level of political support. In practice, political support takes various forms (e.g., subsidies, tax reliefs, regulation, etc). In my model, this is captured by a transfer which increases the firm's per-period revenues. The firm's and the politician's incentives are only *partially* aligned. This is the key tension between the two players. Higher political support is always good for the firm. On the contrary, politicians prefer to offer support only to the extent necessary to prevent the firm's distress. Lobbying comes at no cost for the firm. The firm does not transfer part of its profits to the politician.

I consider three different information structures. In the baseline model, politicians observe whether the firm is distressed or not, but do not know *how much* distressed the firm eventually is. Then, politicians know *when* their intervention is necessary to prevent the firm's bankruptcy (and its political consequences), but do not know *how* to intervene. Then, I consider the case of Perfect Information (politicians perfectly observe the firm's financial condition) and the case of Coarse Information (politicians

have no information).

My first result is that the equilibrium level of political support is inverted-U shaped in the firm's size. When the firm is small, acquisitions increase its political power. This happens along two channels. First, larger firms' distress have more severe political consequences. When a larger firm is distressed, the incumbent politician loses re-election with higher probability. This gives them an incentive to be more *generous* with larger firms. The second is an information channel. Politicians know that larger firms are less likely to be distressed. Therefore, when they observe a large firm being distressed, they infer that the firm must have suffered a very severe economic shock, and thus that stronger political support is needed to prevent distress. However, these effects are bounded. Politicians never grant more political support than what is needed to prevent the firm's bankruptcy with probability one. Since larger firms are more cost-efficient, this upper bound also decreases with the firm's size. As a result, once the firm reaches a certain size, political support begins to decline with further acquisitions.

Whenever the firm has more information than the politician, it can obtain strictly positive *Political Profits*. When politicians do not exactly observe the firm's financial condition, they need to rely on the firm's self-reported information. However, in the lobbying game, the firm has no incentives to truthfully report its financial condition, so that any message is just cheap talk. Politicians know this. Therefore, they may over-provide support to sufficiently large firms, allowing them to earn positive profits even in periods of distress.

The core results of the paper concern how the firm's political power shapes the equilibrium market structure. First, I show that the prospect of obtaining political support can induce the firm to complete acquisitions that would not be profitable absent lobbying. These *Political Acquisitions* follow from the firm's objective to become large enough to extract political rents. As in Callander et al. [2022], a feedback loop dynamics emerges. As the firm grows in size through acquisitions, its market power (which we can measure with its per-period expected margin) increases. Since larger

firms' distress has stronger political consequences, increased market power increases the firm's political influence. Politicians offer more support to larger firms. In turn, stronger political support improves the firm's profitability and survival probability, increasing the probability that further acquisitions are completed. However, this feedback loop is bounded. Once the firm is sufficiently large, additional acquisitions no longer generate additional political rents. Political power stops increasing with size, and any further acquisition is driven by purely market effects.

Second, counter-intuitive comparative statics result emerge. The equilibrium number of Political Acquisitions is non-monotone in the strength of politicians' re-election incentives. When politicians attach low value to re-election, the threat posed by the firm's distress is not concerning. Politicians do not offer political support to the firm. In this case, acquisitions are driven purely by market incentives. On the contrary, when politicians attach very high value to re-election, they are *scared* by the distress of relatively small firms. This allows the firm to obtain strong political support while still being relatively small.

Moreover, the equilibrium number of Political Acquisitions is non-monotone in the extent of information misalignment between the firm and politicians. When politicians have no information at all, the equilibrium level of political support is lower than in the baseline model with observable signals, albeit support is granted more often (unconditionally on the firm's type). This happens because signals of distress provide useful information to politicians. When politicians can target support only to distressed firms, they are more generous. This makes the equilibrium level of political support peak at higher sizes under no information, increasing the profitability of further Political Acquisitions. Interestingly, a similar result holds when politicians have perfect information. The intuition, however, is opposite. In this case, politicians can tailor political support to the firm's needs. The firm is not able to extract rents. This reduces over-provision of political support. Again, the equilibrium level of political support peaks at higher sizes than under imperfect information, increasing the profitability of further Political Acquisitions.

This paper contributes to a growing literature at the intersection of Industrial Organization and Political Economy. The most closely related paper to mine is Callander et al. [2022]. They show the existence of a feedback loop between market power and political power. In their model, a politician internalizes a share of the value generated by political protection for an incumbent firm. When the incumbent firm has enough market power, political protection has no more value. Anticipating this, the politician stops protecting after a certain threshold is reached. As in my model, the loop is bounded.

Broso and Valletti [2024] show that mergers between incumbent firms increases their incentives to lobby. This happens because mergers mute price competition which would partially dissipate firms' returns from lobbying. The theoretical model in Cowgill et al. [2024] has a similar flavor. Instead, the model in Moshary and Slattery [2024] assume that lobbying is a public good. In this context, market consolidation increases lobbying as it mitigates free riding problems. Kang [2016] adopts a similar assumption to study the private returns from lobbying in a structural model of the US energy sector. Callander et al. [2024] study a dynamic model of mergers and acquisitions where pro-competitive reforms' effects can be offset by firms' incentives to acquire their competitors.

This paper also speaks to a broader literature on the non-price effects of market concentration. For instance, Cunningham et al. [2021] show that incumbent firms can acquire startups to dismantle their pipeline projects and preempt future competition. Bar-Isaac et al. [2025] show that firms can acquire competitors to gain monopsony power in tight labor markets.

To the best of my knowledge, my paper is the first to study the relationship between market power and political power in an informational lobbying model rather than in quid pro quo contexts.

The remainder of the paper is organized as follows. In Section 2, I present the model. In Section 3, I characterize its equilibrium. Finally, Section 4 concludes. Proofs are relegated to the appendix.

2 Model

Time is discrete and runs over an infinite horizon. Let $t = 1, 2, \ldots$ index the time periods.

Players. There are infinitely many politicians and $N + 1$ firms, with $N \in \mathbb{N}$. There is an acquirer firm (A) and N possible target firms ($i = 1, 2, \ldots, N$).[2] The acquirer firm can grow in size by acquiring the target firms. The acquirer firm's time discount factor is $\delta \in (0, 1)$. Politicians' time discount factor is $\delta' \in (0, 1)$. In each period t, each firm $j \in \{A, 1, 2, \ldots, N\}$ has size $S_j^t \in \mathbb{N}$. All firms start with the same size, so that $S_j^0 = S^0$ for all j. For simplicity, let $S^0 = 1$. Target firms cannot complete acquisitions.

Politicians want to be re-elected. However, they can stay in office for at most $\kappa \in \mathbb{N}$ periods. For simplicity, let $\kappa = 2$. When a politician ends their term (either because of an electoral defeat or because the term limit is hit), a new politician takes the office. I discuss causes of electoral defeats below. Let $e^t \in \{1, 2\}$ denote politicians' tenure. Politicians' order of play is exogenously determined.[3]

The acquirer firm starts each period t by drawing its type θ^t from the uniform distribution $U[0, 1]$. Draws are i.i.d. across periods. I think of θ^t as the firm's per-period revenues. The firm is *ex-ante* distressed when:

$$\theta^t < \phi\left(S_A^t\right),$$

where $\phi\left(S_A^t\right)$ captures the firm's costs.[4] Let $\phi(1) = \frac{1}{2}$, $\phi \in C^2$, $\phi' < 0$, $\phi'' \leq 0$, and $\phi(s') = 0$ for all $S_A^t \geq s'$, with $s' \in \mathbb{N}$.[5] The larger the firm, the lower its costs. Therefore lower realizations of θ^t are required to cause the firm's distress.

[2] Throughout the paper, I often refer to the acquirer firm as *the* firm.

[3] Suppose that $w = 1, 2, 3, \ldots$ indexes politicians. Then, in period t, politician $w = t$ takes the office whenever the office-holding politician in period $t - 1$ is either defeated or they have hit the term limit.

[4] A possible interpretation is as follows. Suppose that the firm produces one unit of output. Then, θ^t can be interpreted as the market's (stochastic) price, and $\phi\left(S_A^t\right)$ as the firm's marginal cost. The assumptions of price-taking behavior and fixed output are not consequential for my results.

[5] I assume $s' < N$.

Actions and Timing. In each period t, the game runs in two key steps. First, the acquirer firm has a *lobbying opportunity*. When the lobbying opportunity starts, the firm (with size S_A^t) sends a message $\mu_t \in [0,1]$ to the office-holding politician, self-reporting its type θ^t. Then, the politician chooses a policy $g_t \in \left[0, \bar{g}\right]$, with $\overline{g} \geq \frac{1}{2}$.[6] The policy g_t captures the level of political support granted to the firm. In practice, political support takes various forms (e.g., subsidies, tax reliefs, or *ad-hoc* regulation). Political support helps the firm survive periods of distress. The firm is *ex-post* distressed when:

$$\theta^t + g_t < \phi\left(S_A^t\right) .$$

Second, if the acquirer firm is not ex-post distressed, it has an *acquisition opportunity*. It can acquire one of the N target firms. The order of possible acquisitions is exogenously determined.[7] I say that $\alpha_t = 1$ if the period t acquisition goes ahead, and $\alpha_t = 0$ otherwise. If $\alpha_t = 1$, starting the next period, the acquirer firm grows in size:

$$S_A^{t+1} = S_A^t + \alpha_t .$$

Each acquisition implies a one-time re-organization cost $\epsilon \geq 0$ for the acquirer firm. For instance, the cost ϵ can be interpreted as the cost of managerial integration (frictions that arise when the two firms must unify their management). [8]

Finally, if the acquirer firm is not ex-post distressed, the game proceeds to the next period. If the acquirer firm is ex-post distressed, the game ends. I interpret this outcome as the acquirer firm's bankruptcy or off-shoring. As we will see later, this negative economic shock has political consequences.

[6] As it will become clear later, $\bar{g} \geq \frac{1}{2}$ guarantees that politicians always have enough resources to save the acquirer firm from distress.

[7] Formally, there exists a mapping which assigns to each period t a possible target firm i. Since $N < \infty$, the acquirer firm may acquire all possible competitors before the end of the game.

[8] I assume that whenever an acquisition is optimal for the acquirer firm, it is also optimal from the target's perspective. This would be the case whenever the re-organization cost ϵ is entirely beard by the acquirer firm.

Payoffs. The per-period payoff of the acquirer firm is:

$$\pi^t = \theta^t + g_t - \phi\left(S_A^t\right) \ .$$

By increasing in size, the firm becomes more efficient ($\phi\left(S_A^t\right)$ reduces), and thus more profitable. Higher political support g_t is always optimal for the firm.

This is not the case for politicians. I assume all politicians share the same utility function. Politicians' per-period payoff is:

$$u^t = k - \frac{1}{2}g_t^2 \ .$$

I interpret $k \geq 0$ as the value of the office, and $\frac{1}{2}g_t^2$ as the opportunity cost for politicians of spending public money (or designing ad-hoc regulation) to help firms.

The acquirer firm's distress has political consequences. In particular, I assume that if the firm is ex-post distressed (in which case it bankrupts or off-shores), the office-holding politician loses the office with probability $\gamma\left(S_A^t\right)$. Let $\gamma(1) = 0$, $\gamma \in C^2$, $\gamma\left(S_A^t\right) > 0$ for all $S_A^t > 1$, $\gamma' > 0$, and $\gamma'' \geq 0$. Therefore, politicians are willing to offer political support to the acquirer firm if and only if this is necessary to avoid its distress.

The key assumption is that the larger the size of the distressed firm, the higher the probability that the office-holder politician loses the office. This assumption captures the following intuition. When larger firms bankrupt or off-shore, more workers lose their job, more firms lose a trading partner, and more consumers lose access to a product or service. This negative economic shock arguably results into stronger political pressure for incumbent politicians. When a politician loses the office, they earn a per-period payoff of zero for the remainder of their lifetime.

Payoffs are realized before the end of each period. Figure 2.1 summarizes the timing of the game from the acquirer firm's perspective.

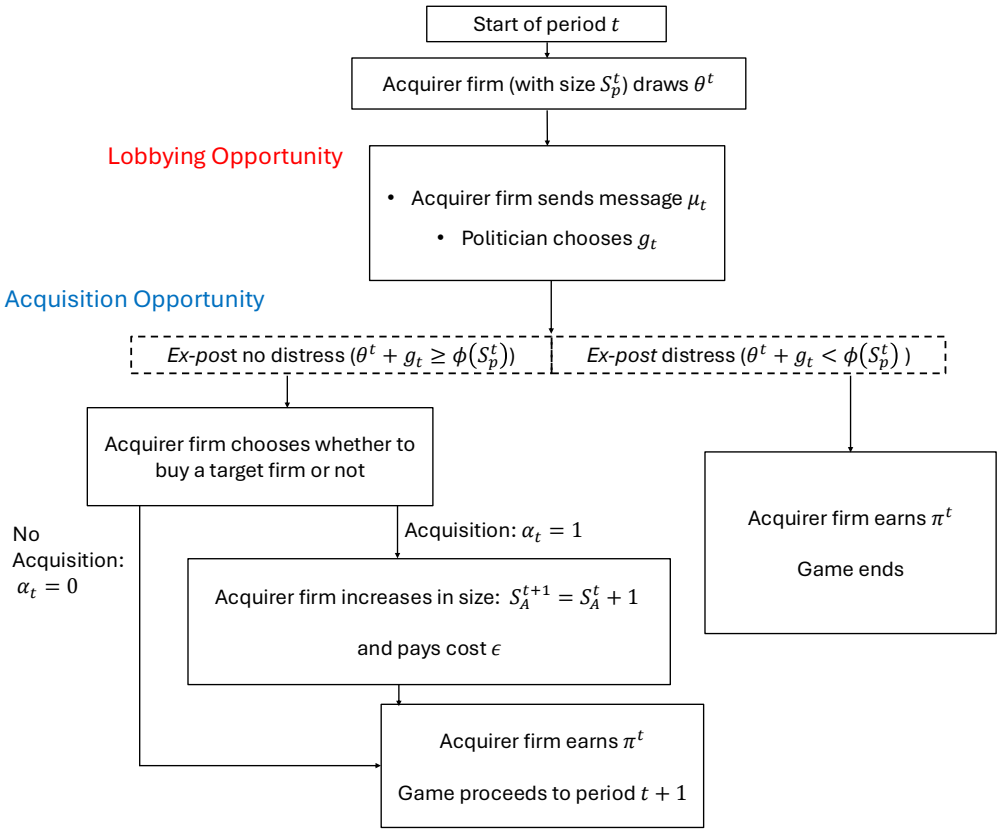


Figure 2.1: **Timing of the Game from the Acquirer Firm's Perspective.**

Information Structure and Equilibrium Concept I assume that politicians do not observe θ^t. However, they observe an imperfectly informative signal. They observe with probability one whether the firm is ex-ante distressed or not. Let

$$\chi^t = \mathbf{1}_{\{\theta^t < -\phi(S_A^t)\}} \in \{0, 1\}$$

denote the office-holder politician's signal.[9] The concept of equilibrium is Sequential Equilibrium in pure strategies (Kreps and Wilson [1982]).

[9] I do not make any assumption on off-path beliefs because they do not play a role in sustaining equilibrium behavior.

3 Equilibrium

3.1 Market Acquisitions

To distinguish acquisitions which are driven by political forces rather than market ones, I start my analysis by focusing on a simple benchmark. To begin, I assume that politicians are not office-seeking ($k = 0$). As we will see, this makes politicians always deny political favors to the acquirer firm. Therefore, any acquisition follows from market forces.

Proposition 1 (Market Acquisitions)**.** *Assume $k = 0$. In equilibrium,*

(i) Politicians never grant political support: $g_t^* = 0$.

(ii) There exists $\bar{\epsilon}_m > 0$ such that, in each period t, the acquirer firm completes an acquisition ($\alpha_t^* = 1$) if and only if

$$S_A^t + 1 \leq s' \quad \text{and} \quad \epsilon \leq \bar{\epsilon}_m \ .$$

When $k = 0$, politicians attach no value to being re-elected. Then, the acquirer firm's risk of distress, and the associated risk of electoral defeat, does not worry politicians. Providing political support to the firm would help politicians to mitigate this risk upon paying a cost. When politicians seek no re-election, paying this cost cannot be optimal as it brings no benefits. This is the intuition behind Statement (i).

Even if lobbying is not effective, and the acquirer firm cannot obtain political favors, acquisitions can be profitable. By increasing in size, the acquirer firm becomes more efficient. The cost function $\phi\left(S_A^t\right)$ reduces. This has two positive effects. First, from a *static* perspective, the cost reduction increases the firm's per-period expected profit

$$\mathbb{E}\left[\pi^t\right] = \frac{1}{2} - \phi\left(S_A^t\right) \ .$$

Second, from a *dynamic* perspective, when $\phi\left(S_A^t\right)$ decreases, the firm's ex-ante probability of distress

$$\Pr\left(\theta^t < \phi\left(S_A^t\right)\right) = \phi\left(S_A^t\right)$$

decreases. The firm finds it optimal to complete acquisitions whenever these benefits are sufficiently high to outweigh the re-organization cost ϵ. This is the intuition behind Statement (ii).

The Proof of Proposition 1 shows that the acquirer firm's problem is convex. The value of each acquisition increases in the acquiring firm's size.[10] Provided that the re-organization cost ϵ is sufficiently low that the first acquisition (from size $S_A^t = 1$ to size $S_A^{t+1} = 2$) is optimal, then all further acquisitions (from size $S_A^t > 1$ to size $S_A^{t+1} = S_A^t + 1$) are also optimal. This follows from the concavity of ϕ.

However, a counter-effective effect emerges. Stopping acquisitions at a larger size guarantees a higher stream of profits and a higher survival rate. However, the former effect dominates the latter. As expected, the positive value of acquisitions exhaust as soon S_A^t reaches s'. This is because $\phi\left(S_A^t\right) = 0$ for all $S_A^t \geq s'$. Figure 3.1 summarizes the results from Proposition 1.

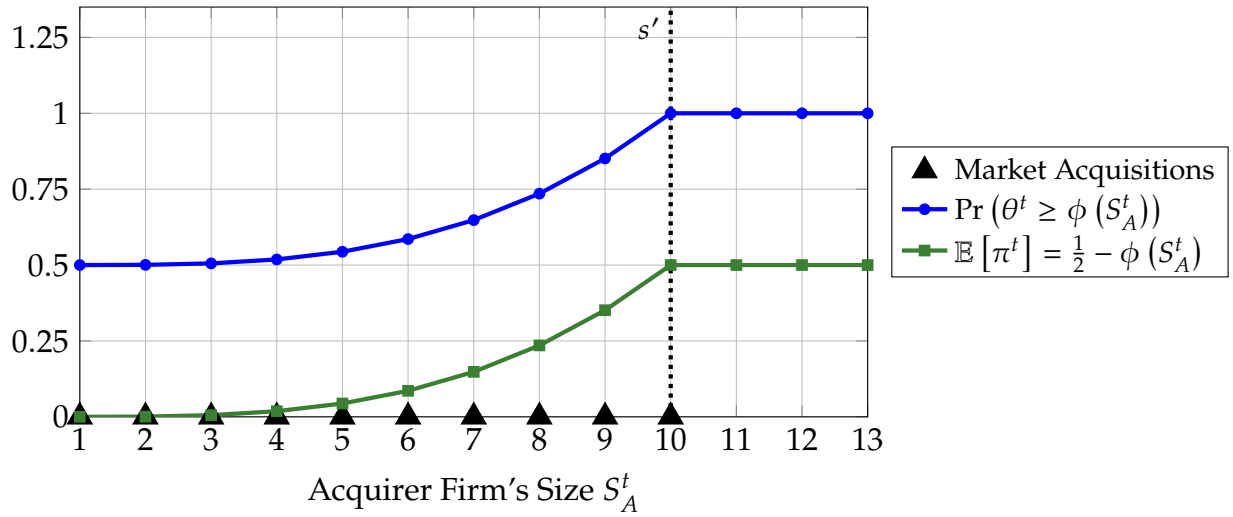


Figure 3.1: **Market Acquisitions.**

Note: The plot is obtained by setting $1 - \phi(x) = \frac{1}{2} + \frac{1}{2}\left(\frac{x-1}{9}\right)^3$.

[10] An analogous result emerges in the Cournot model, as shown by Callander et al. [2022]. In a Cournot oligopoly, each firm's equilibrium profit is decreasing and convex in the total number of firms.

3.2 Political Acquisitions

Let us now consider the case of office-seeking politicians ($k > 0$). I start by considering players' incentives in the lobbying game.

Proposition 2 (Lobbying Equilibrium)**.** *In any equilibrium, the following statements hold.*

(a) All types of acquirer firm send the same message.

(b) Politicians' optimal level of political support is:

$$g_t^* = \begin{cases} 0 & \text{if } e^t = 2 \text{ or } e^t = 1 \text{ and } \chi^t = 0 \\ \min\left\{\phi\left(S_A^t\right), \dfrac{\delta' k\, \gamma\left(S_A^t\right)}{\phi\left(S_A^t\right)}\right\} & \text{if } e^t = 1 \text{ and } \chi^t = 1 \end{cases}.$$

Office-seeking politicians grant political support ($g_t^* > 0$) to the acquirer firm when they are up for re-election ($e^t = 1$), the firm is distressed ($\chi^t = 1$), and it has completed at least one acquisition ($S_A^t > 1$).[11] In this case, the office-holding politician knows that if they do not grant political support, the firm will not survive the period, and they will then lose the office with probability $\gamma\left(S_A^t\right) > 0$. Politicians trade-off the opportunity cost of using public resources to help the firm against the risk of losing re-election. When the firm is not ex-ante distressed ($\chi^t = 0$), the incumbent politician is sure to be re-elected, and the optimal level of political support is $g_t^* = 0$. The same is true when the politician cannot be re-elected ($e^t = 2$). As in Proposition 1, when politicians have no re-election incentives, using public resources to help the firm brings no benefits but only costs.

In the lobbying game, the acquirer firm's and the politicians' incentives are only *partially* aligned. This is the key tension between the two players. Higher political support is always good for the firm. On the contrary, politicians prefer to offer support only to the extent necessary to prevent the firm's distress. That is, politicians' optimal level of political support is: $g_t = \left|\theta^t - \phi\left(S_A^t\right)\right|$. However, they do not observe θ^t,

[11] When $S_A^t = 1$, $\gamma(1) = 0$ so that $g_t^* = 0$.

and thus need to rely on the firm's self-reported information. Unluckily for them, the firm has no incentives to convey information and truthfully report its type. Any equilibrium message is just cheap talk.

Figure 3.2 shows that the equilibrium level of political support is inverted-U shaped in the firm's size.

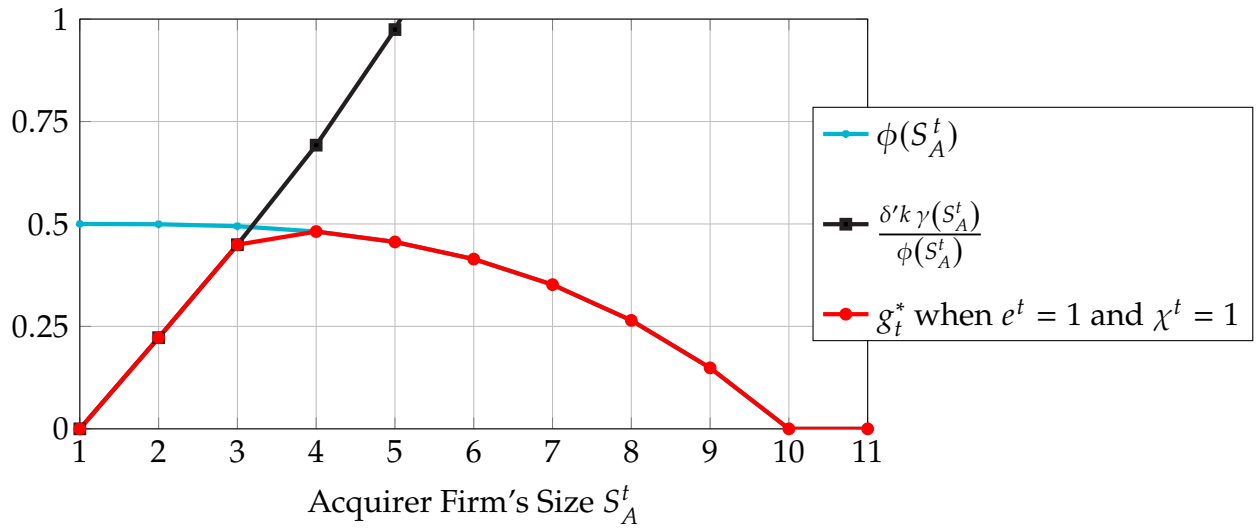


Figure 3.2: **Equilibrium Political Support**.

Note: The plot is obtained by setting $1 - \phi(x) = \frac{1}{2} + \frac{1}{2}\left(\frac{x-1}{9}\right)^3; \gamma(x) = \frac{x-1}{9}$ and $\delta' k = 1$.

The acquirer firm's size shapes the equilibrium level of political support along three margins. First, larger firms' distress have stronger political consequences. This is captured by the function $\gamma\left(S_A^t\right)$. When a larger firm is ex-post distressed, the office-holder politician loses re-election with higher probability. This gives them an incentive to be more generous and grant stronger political support to the ex-ante distressed firm.

Second, size conveys *some* information. Larger firms are less likely to be distressed. Thus, when a politician observes $\chi^t = 1$ and S_A^t is large, they infer that the firm must have suffered a very low realization of θ^t. This makes higher levels of political support needed for the firm to survive the period of distress.

Third, size limits the acquirer firm's ability to obtain political support. Political support is *bounded*. Suppose that in period t the firm has no revenues ($\theta^t = 0$). To save such a firm from distress, the politician would have to cover the totality of the

firm's costs $g_t = \phi\left(S_A^t\right)$. It follows that any $g_t > \phi\left(S_A^t\right)$ cannot be optimal. Since larger firms are more efficient ($\phi\left(S_A^t\right)$ decreases in S_A^t), the cap (which then binds only when S_A^t is large enough) is decreasing in S_A^t.

Political support, and the fact that this is given by politicians who do not have perfect information, allows the firm to make additional profits (even in periods of distress). To show this, I now compute the firm's per-period expected profit. When politicians are not eligible for re-election ($e^t = 2$), they never grant political support. Then, the firm's expected profit is simply:

$$\mathbb{E}\left[\pi^t \mid e^t = 2\right] = \mathbb{E}\left[\theta^t\right] - \phi\left(S_A^t\right) = \frac{1}{2} - \phi\left(S_A^t\right) \ .$$

When politicians are eligible for re-election ($e^t = 1$), they grant political support ($g_t^* > 0$) to distressed firms ($\chi^t = 1$). Then,

$$\begin{aligned}
&\mathbb{E}[\pi^t \mid e^t = 1] = \\
&\int_0^{\phi\left(S_A^t\right)} \left(\theta + g_t^* - \phi\left(S_A^t\right)\right) \, d\theta + \int_{\phi\left(S_A^t\right)}^1 \left(\theta - \phi\left(S_A^t\right)\right) \, d\theta = \\
&\frac{1}{2} - \phi\left(S_A^t\right)\left(1 - g_t^*\right) \ .
\end{aligned}$$

Because of political protection, the firm makes additional profits:

$$\mathbb{E}\left[\pi^t \mid e^t = 1\right] \geq \underbrace{\mathbb{E}\left[\pi^t \mid e^t = 2\right]}_{=\mathbb{E}[\pi^t \mid k=0]} \ .$$

I call these "Political Profits" (see Figure 3.3). Moreover, notice that an ex-ante distressed firm can also end up making positive profits because of political support:

$$\begin{aligned}
&\mathbb{E}\left[\pi^t \mid e^t = 1, \chi^t = 1\right] = \\
&\int_0^{\phi\left(S_A^t\right)} \left(\theta + g_t^* - \phi\left(S_A^t\right)\right) \, d\theta = \phi\left(S_A^t\right)\left(g_t^* - \phi\left(S_A^t\right)\right) + \frac{\phi\left(S_A^t\right)^2}{2} \lessgtr 0 \ .
\end{aligned}$$

For instance, $\mathbb{E}\left[\pi^t \mid e^t = 1, \chi^t = 1\right] > 0$ whenever g_t^* is high enough.[12] Thus, because of its political power, the firm can earn positive profits even in periods of distress. This would not be the case if politicians could observe θ^t directly, in which case $g_t^* = \phi\left(S_A^t\right) - \theta^t \Rightarrow \mathbb{E}\left[\pi^t \mid e^t = 1, \chi^t = 1\right] = 0$.

When the firm's size is high enough, the equilibrium level of political support g_t^* decreases in the firm's size. However, in this region, $\mathbb{E}\left[\pi^t \mid e^t = 1\right]$ is still increasing in S_A^t. This happens because of market rather than political effects. The reduction in the firm's costs more than offsets the reduction in g_t^*. Moreover, political profits remain positive. This happens because when lobbying is effective ($e^t = 1$), the firm has a strictly higher probability of survival.

To make these additional political profits, the acquirer firm needs to complete at least one acquisition. Therefore, the prospect of extracting these rents gives the firm an additional incentive to complete a sequence of acquisitions. When $k > 0$, the threshold cost up to which acquisitions are optimal is higher than under purely market incentives ($\bar{\epsilon}_m$). I show this formally in Proposition 3.

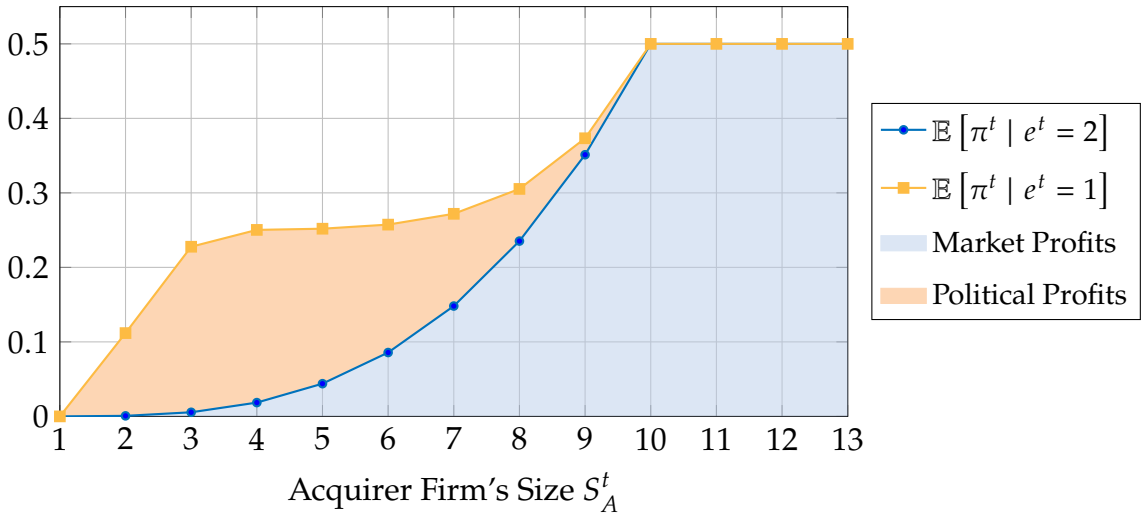


Figure 3.3: **Market vs. Political Profits**.

Note: The plot is obtained by setting $1 - \phi(x) = \frac{1}{2} + \frac{1}{2}\left(\frac{x-1}{9}\right)^3; \gamma(x) = \frac{x-1}{9}$ and $\delta' k = 1$.

[12] Note that $g_t^* = \phi\left(S_A^t\right)$ implies $\mathbb{E}\left[\pi^t \mid e^t = 1, \chi^t = 1\right] > 0$.

Proposition 3 (Political Acquisitions). *There exists $\bar{\epsilon}_p(k) > 0$ such that, in each period t, the acquirer firm completes an acquisition ($\alpha_t^* = 1$) if and only if*

$$S_A^t + 1 \leq \hat{s}(k) \quad \textit{and} \quad \epsilon \leq \bar{\epsilon}_p(k),$$

where $\hat{s}(k) := \max\left\{x \in \mathbb{N} \mid g_t^* < \phi(x)\right\}$. Moreover,

$$\bar{\epsilon}_p(k) \geq \bar{\epsilon}_m, \quad \bar{\epsilon}_p(0) = \bar{\epsilon}_m, \textit{ and } \quad \bar{\epsilon}_p(k) > \bar{\epsilon}_m \ \ \forall\ k > 0\,.$$

Market consolidation can result from politicians' re-election incentives. There exists a region of the parameter space wherein the acquirer firm completes acquisitions if and only if this allows it to obtain political protection. I call these "Political Acquisitions." It is important to notice that $\epsilon \leq \bar{\epsilon}_p(k)$ does not guarantee that acquisitions beyond size $\hat{s}(k)$ are optimal. When $S_A^t = \hat{s}(k)$, the firm's expected profit and survival probability may no longer be convex in S_A^t. As Figure 3.3 shows, the marginal value of acquisitions flattens beyond $\hat{s}(k)$, breaking the convexity of the firm's value function.[13]

On the equilibrium path, as in Callander et al. [2022], a feedback loop effect emerges. Market power increases political power. Each acquisition (until size $\hat{s}(k)$ is reached) increases the firm's market power, measured by the firm's margins $\theta^t - \phi\left(S_A^t\right)$. In each period, the firm has some probability of being distressed. Since politicians do not observe θ^t and larger firms' distress has stronger political consequences, increased market power results into stronger political influence. Politicians grant more support to larger firms. Furthermore, political power increases market power. First, from a static perspective, stronger political support increases the firm's margins (see Figure 3.3). Second, from a dynamic perspective, stronger political support today increases the firm's probability of survival tomorrow. On the equilibrium path, this increases the probability that further acquisitions are completed.

[13] However, if the acquisition from $\hat{s}(k)$ to $\hat{s}(k) + 1$ is completed, convexity is back. Therefore, if the firm finds it optimal to complete an acquisition when its size is $\hat{s}(k)$, it will complete all further acquisitions up to size s'.

This feedback loop, however, is bounded. Once the firm is large enough, political support is decreasing in the firm's size. Politicians cannot offer more support than what would be needed to prevent the firm's distress with probability one. As the firm grows in size, its costs decrease. Therefore, this upper bound decreases accordingly. As soon as it is hit, acquisitions no longer generate political rents. The feedback loop breaks. Political power stops growing with size, and acquisition decisions simply follow market incentives.

3.3 Comparative Statics

In this Section, I focus on the role of politicians' re-election incentives and on the role of information.

3.3.1 The Impact of Politics on the Market Structure

When politicians attach more value to be re-elected (k is high), they are more generous with the firm. The firm has more political power. How does this affect the equilibrium market structure?

On the one hand, when the firm can leverage its size to extract political rents, it is more likely that market consolidation occurs. This is captured by the fact that $\bar{\epsilon}_p(k) > \bar{\epsilon}_m$ for all $k > 0$. It is also easy to see that $\bar{\epsilon}_p(k)$ is increasing in k. The intuition is simple. Politicians fear large firms' distress. To prevent this, they are willing to grant political support. Since politicians do not know exactly *how much* political support it is needed to prevent the firm's distress, the firm can extract rents. Moreover, since the political cost of the firm's distress increases with size, acquisitions help the firm extracting these rents. When k is high, politicians fear losing re-election more, and they grant more political support. Therefore, the firm is more likely to start a sequence of acquisitions in an attempt to obtain this support.

On the other hand, when the firm has more political power, it may complete less acquisitions. This happens along two margins. First, when k is higher (and politicians grant more political support to the acquirer firm), the size level which maximizes

the firm's political rents is smaller.[14] Since the firm might stop the sequence of acquisitions at this size (see Proposition 3), the equilibrium number of acquisitions may decrease in k.[15]

Second, the likelihood that the firm stops the sequence of acquisitions at this size is itself increasing in k. We can see this as follows. Once the firm reaches size $\hat{s}(k)$, further acquisitions no longer generate political profits (while still decreasing costs and increasing market profits). When S_A^t is sufficiently large that $g_t^* = \phi\left(S_A^t\right)$, the firm's profit and probability of survival do not depend on k. When politicians are eligible for re-election ($e^t = 1$), the acquirer firm survives each period with probability one and (conditional on $\chi^t = 1$) earns a political revenue of $g_t^* = \phi\left(S_A^t\right)$. When politicians cannot seek re-election, the firm's profit and survival probability only depend on $\phi\left(S_A^t\right)$. However, the value of stopping the sequence of acquisitions at size $\hat{s}(k)$ increases in k. At this size, g_t^* increases in k, increasing both the firm's profits and probability of survival.[16]

The impact of politicians' re-election incentives on the equilibrium market structure is non-monotone. Stronger re-election incentives can make the acquirer firm start a sequence of Political Acquisitions, that is, acquisitions which would not have been profitable had lobbying not be possible. However, the same incentives simultaneously reduce the likelihood that the firm completes the entire sequence of possible acquisitions, thereby limiting market concentration.

The number of acquisitions in equilibrium can be inverted-U shaped in k. I show this in Figure 3.4. Suppose $\epsilon > \bar{\epsilon}_m$, so that any acquisition is driven by political effects.[17] If k is low, politicians' support is too weak for the firm to benefit from lobbying, so no acquisition is undertaken. As k increases, politicians grant more political support. Political rents are large, and the firm starts a sequence of

[14] Formally, recall that g_t^* peaks as soon as $\delta' k \gamma\left(S_A^t\right) \geq \phi\left(S_A^t\right)^2$. Because the LHS increases in k while the RHS is constant in k, the maximizer is decreasing in k.

[15] In particular, g_t^* is either maximized at $\hat{s}(k)$ or at $\hat{s}(k) + 1$.

[16] Formally, there exists a threshold $\bar{\epsilon}_{\hat{s}}$ such that the firm completes the acquisitions from $\hat{s}$ to s' if and only if ϵ is lower than this threshold. As discussed above, it is not guaranteed that $\bar{\epsilon}_{\hat{s}}$ is greater or lower than $\bar{\epsilon}_p(k)$. However, $\bar{\epsilon}_{\hat{s}}$ is decreasing in k. Then, when k is higher, it is less likely that these further acquisitions are performed.

[17] When $\epsilon \leq \bar{\epsilon}_m$, politicians' incentives play no role in shaping the firm's acquisitions decisions.

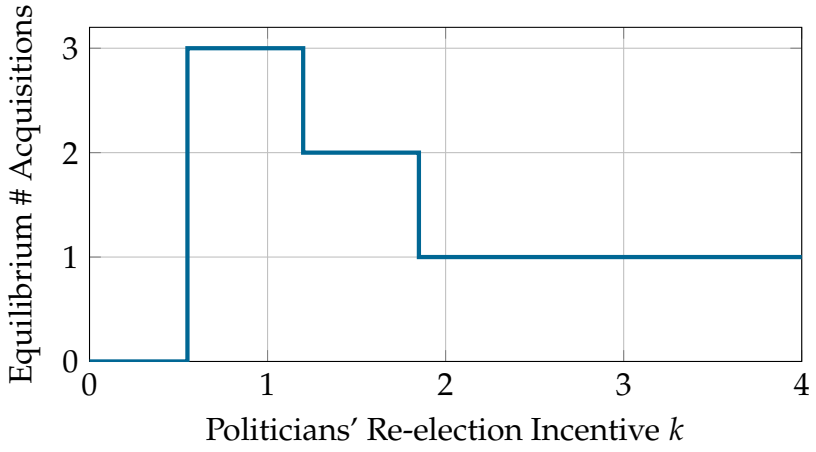


Figure 3.4: **Non-monotone Effect of Politics on the Market Structure**.

Note: The plot is obtained by setting: $\phi(x) = \frac{1}{2}e^{-1.1(x-1)}$, $\gamma(x) = 0.30(x-1)^{2.8}$, $\delta = 0.95$, $\delta' = 0.90$, and $\epsilon = 0.40$.

acquisitions to extract such rents. However, when k is sufficiently high, politicians' are so generous that fewer acquisitions are needed for the firm to extract large political rents. This is the key take-away from this Section.

3.3.2 The Role of Information Misalignment

I now discuss how the extent of information misalignment between the politicians and the firm shapes the equilibrium market structure. To this end, I compare the main results presented so far with two alternative benchmarks.

Coarse Information I start by considering the case that politicians do not observe whether the firm is ex-ante distressed or not (*Coarse Information*). That is, politicians do not observe the signal χ^t. As in the baseline model, the firm has no incentive to convey information to politicians in the lobbying stage. In every period, politicians end up with a posterior belief over θ^t which equals their prior. Let g_t^{CI} denote the optimal choice of political support. When the office-holder politician runs for

re-election, g_t^{CI} follows from:[18]

$$g_t^{CI} = \arg \max_{g \in [0, \bar{g}]} \left\{ k - \frac{1}{2} g^2 + \delta' k \left(1 - \gamma \left(S_A^t \right) \underbrace{\Pr \left(\theta^t + g < \phi \left(S_A^t \right) \right)}_{\phi(S_A^t) - g} \right) \right\} \Rightarrow$$

$$\tilde{g}_t = \min \left\{ \phi \left(S_A^t \right), k \delta' \gamma \left(S_A^t \right) \right\} .$$

This alternative information structure reduces politicians' level of political support in equilibrium with respect to the baseline model: $g_t^{CI} \leq g_t^*$. Signals of distress provide valuable information to politicians. When $\chi^t = 1$, politicians know that the firm's revenues are low, and the electoral risk of a defeat is real. As a result, politicians know that a high level of political support is needed to save the firm from distress (and ensure re-election). This channel is muted when no signals are available.

However, when signals are not available, politicians offer political support more often (unconditionally on θ). This allows the firm to extract more political profits. Let π_{CI}^t denote the firm's profit under coarse information. Then,

$$\mathbb{E} \left[\pi_{CI}^t \mid e^t = 1 \right] = \frac{1}{2} + g_t^{CI} - \phi \left(S_A^t \right) \geq \frac{1}{2} - \phi \left(S_A^t \right) \left(1 - g_t^* \right) .$$

It follows immediately that:[19]

[18] If $e^t = 2$, politicians never grant political support.

[19] The proof of Corollary 2 is analogous to the proof of Proposition 3. In particular, by convexity of g_t^{CI}, the firm's value function is convex in $S_A^t \in [1, s_{CI}]$. Then, the optimality of the first acquisition guarantees that all further acquisitions up to size s_{CI} are also optimal. Since these acquisitions generate more political profits than in the baseline model, $\bar{\epsilon}_{CI} \geq \bar{\epsilon}_p (k)$. Since $g_t^* \geq g_t^{CI}$, then $s_{CI} \geq \hat{s} (k)$.

Corollary 1. *Under Coarse Information, there exists $\bar{\epsilon}_{CI} > 0$ such that, in each period t, the acquirer firm completes an acquisition ($\alpha_t^* = 1$) if and only if*

$$S_A^t + 1 \leq s_{CI} \quad \textit{and} \quad \epsilon \leq \bar{\epsilon}_{CI},$$

where $s_{CI} := \max\left\{x \in \mathbb{N} \mid g_t^{CI} < \phi(x)\right\}$. Moreover,

$$\bar{\epsilon}_{CI} \geq \bar{\epsilon}_p(k) \quad \textit{and} \quad s_{CI} \geq \hat{s}(k) \ .$$

Perfect Information I now study the benchmark case of *Perfect Information*. That is, politicians perfectly observe θ^t. In this case also, office-seeking politicians ($e^t = 1$) grant political support only to distressed firms ($\theta^t < \phi\left(S_A^t\right)$). Politicians' optimal level of political support is: $\phi\left(S_A^t\right) - \theta^t$. Any other $g_t > 0$ cannot be optimal. However, for this to be optimal it must be that a strictly positive level of political support is optimal. That is,

$$\delta' k - \frac{1}{2}\left(\phi\left(S_A^t\right) - \theta^t\right)^2 \geq \delta' k\left(1 - \gamma\left(S_A^t\right)\right) \Rightarrow$$

$$\phi\left(S_A^t\right) - \delta' k\gamma\left(S_A^t\right) \leq \theta^t \leq \phi\left(S_A^t\right) + \delta' k\gamma\left(S_A^t\right) \Rightarrow$$

$$\phi\left(S_A^t\right) - \delta' k\gamma\left(S_A^t\right) \leq \theta^t \leq \phi\left(S_A^t\right) \ .$$

The politician saves the firm from distress if and only if the firm's revenues are neither too high nor too low. When the firm's revenues are high, political intervention is not needed to prevent distress. When the firm's revenues are too low, distress is too severe, and political intervention is too costly. Let us now take the firm's perspective before drawing θ^t. Both the lower $\phi\left(S_A^t\right) - \delta' k\gamma\left(S_A^t\right)$ and the upper bound $\phi\left(S_A^t\right)$ are decreasing in S_A^t. Then, the firm knows that it will obtain political support if and only if it is neither too small to not generate enough political pressure in case of distress, nor too large to be never be distressed. Conditional on $S_A^t < s' \Rightarrow \phi\left(S_A^t\right) > 0$, only large enough firms obtain political support.

As already discussed, when the firm's perfectly observes θ^t, there are no strictly positive political profits. From the firm's perspective, the expected (before drawing θ^t) equilibrium level of political support, g_t^{PI}, is:

$$\mathbb{E}\left[g_t^{PI} \mid \theta < \phi\left(S_A^t\right)\right] = \int_{\max\left\{0,\phi\left(S_A^t\right)-\delta' k\gamma\left(S_A^t\right)\right\}}^{\phi\left(S_A^t\right)} \phi\left(S_A^t\right) - \theta \, d\theta =$$

$$\begin{cases} \frac{1}{2}\left(\delta' k\gamma\left(S_A^t\right)\right)^2 & \text{if } \delta' k\gamma\left(S_A^t\right) \leq \phi\left(S_A^t\right), \\ \frac{1}{2}\left(\phi\left(S_A^t\right)\right)^2 & \text{if } \delta' k\gamma\left(S_A^t\right) > \phi\left(S_A^t\right). \end{cases}$$

It is interesting to note that $\mathbb{E}\left[g_t^{PI} \mid \theta < \phi\left(S_A^t\right)\right]$ peaks at an higher size than g_t^*. The intuition is as follows. In the baseline model, politicians only know whether the firm is distressed, not *by how much*. To insure against the risk of failing re-election, they grant a level of political support which is sufficient to save even severely distressed firms. This makes political support *high* even when the firm is small. Therefore, the cap, $\phi\left(S_A^t\right)$, quickly binds as the firm grows in size. In contrast, under Perfect Information, politicians observe θ^t directly and can tailor their political support to the firm's needs. This reduces the firm's ability to extract rents, and it avoids excessive support at small sizes. It is then immediate to see that the following Corollary holds.

Corollary 2. *Under Perfect Information, there exists $\bar{\epsilon}_{PI} > 0$ such that, in each period t, the acquirer firm completes an acquisition ($\alpha_t^* = 1$) if and only if*

$$S_A^t + 1 \leq s_{PI} \quad \textit{and} \quad \epsilon \leq \bar{\epsilon}_{PI},$$

where

$$\bar{\epsilon}_{PI} \leq \bar{\epsilon}_p(k) \quad \textit{and} \quad s_{PI} \geq \hat{s}(k) \ .$$

The Role of Information The key take-away from this Section is that the equilibrium number of acquisitions can be non-monotone in the extent of information misalignment between the firm and politicians. Compared to the baseline model,

both decreasing and increasing politicians' information about the firm's financial condition can increase the equilibrium number of acquisitions. The intuition, however, is different for the two cases.

Under Coarse Information, politicians do not observe whether the firm is distressed or not. Observing such signals provides useful information to politicians. It informs them that the firm's revenues must be low. This information channel makes politicians grant stronger political support. When this channel is muted, politicians cannot update their priors over the firm's revenues θ^t and thus provide lower support. As a consequence, the equilibrium level of political support peaks at higher firm sizes. To maximize political support, the firm needs to complete more acquisitions.

Under Perfect Information, political support grows more slowly than in the baseline model. When the firm is small, and politicians observe $\theta^t < \phi\left(S_A^t\right)$, they know that the risk of losing re-election is low. In the same way, small firms are costlier to save due to their relative inefficiency ($\phi\left(S_A^t\right)$ is high). To maximize political support, the firm needs to complete more acquisitions. Figure 3.5 summarizes the results from this Section.

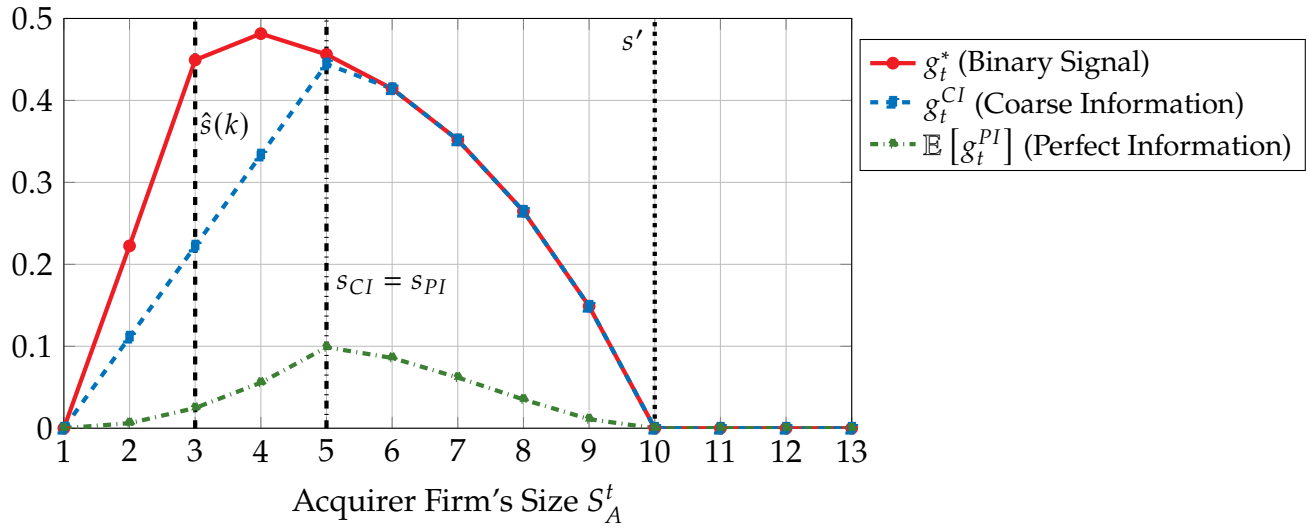


Figure 3.5: **Equilibrium Political Support under Different Information Structures**.

Note: The plot is obtained by setting $1 - \phi(x) = \frac{1}{2} + \frac{1}{2}\left(\frac{x-1}{9}\right)^3$; $\gamma(x) = \frac{x-1}{9}$ and $\delta' k = 1$.

4 Conclusions

In this paper, I propose a dynamic model in which a firm grows through acquisitions and lobbies politicians for support. I show that the firm may complete acquisitions not only for market reasons but also to extract political rents. Political acquisitions emerge when politicians fear the political consequences of firms' distress. In equilibrium, the number of Political Acquisitions is non-monotone in the strength of politicians' re-election incentives and in the degree of information misalignment between politicians and the firm.

This is work in progress. I now aim to study more deeply the role of information. In particular, I plan to extend the current setup by modeling the politician's signal as a noisy continuous signal about the firm's type, with a precision parameter which would allow for smoother comparative statics and a more precise analysis of how the informativeness of the signal affects political support and equilibrium market structure.

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A Appendix - Proofs

Proof of Proposition 1. Assume $k = 0$. This proof follows three steps.

Step 1 In this step, I show that when $k = 0$, given any μ_t, politicians never grant political support to the acquirer firm.

The politician's life-time payoff, $U\left(S_A^t, e^t\right)$, can be written as:

$$U\left(S_A^t, e^t\right) = \begin{cases} k - \frac{1}{2}g^2 + \delta'\left(1 - \gamma\left(S_A^t\right)\right)k & \text{, if } \theta^t + g^t < \phi\left(S_A^t\right) \text{ and } e^t = 1 \\ k - \frac{1}{2}g^2 + \delta' k & \text{, if } \theta^t + g^t \geq \phi\left(S_A^t\right) \text{ and } e^t = 1 \\ k - \frac{1}{2}g^2 & \text{, if } e^t = 2 \end{cases} .$$

When $k = 0$, $U\left(S_A^t, e^t\right) = -\frac{1}{2}g_t^2$ for all e^t and S_A^t. Then, $g_t^* = 0$. This completes the proof of (i).

Step 2 In this step, I show that no acquisition after $S_A^t = s'$ can be optimal.

Suppose $S_A^t = s \geq s'$, $\phi(s) = 0$. Any additional acquisition has a cost of ϵ but leaves both the firm's per-period profit ($= \frac{1}{2}$) and its survival probability ($= 1$) unchanged. Then, these acquisitions cannot be optimal.

Step 3 In this Step, I show that there exists $\bar{\epsilon}_m \geq 0$ such that:

$$\alpha_t^* = 1 \quad \forall \; S_A^t + 1 \leq s' \Leftrightarrow \epsilon \leq \bar{\epsilon}_m \; .$$

Politicians never grant political support to the acquirer firm. The firm solves a stochastic dynamic programming problem. Moreover, the problem's state is one-dimensional. Politicians' tenure e^t plays no role. The state variable is the firm's size S_A^t.

Suppose the state is $S_A^t = s$, for some $s \in \{1, \ldots, s' - 1\}$. The Bellman Equation

reads:

$$V(s) = \frac{1}{2} - \phi(s) + \delta\left(1 - \phi(s)\right) \max\left\{V(s+1) - \frac{\epsilon}{\delta}, V(s)\right\} . \tag{A.1}$$

For all $s \geq s'$,

$$V(s) = \frac{1}{2} + \delta V(s) \Rightarrow V(s) = \frac{1}{2(1-\delta)} > 0 . \tag{A.2}$$

When the firm faces an acquisition opportunities it asks whether it is better to pay the re-organization cost $\epsilon \geq 0$ today and start the next period with size $S_A^{t+1} = s+1$, or pay nothing today and start the next period with size $S_A^{t+1} = s$.[20] Formally,

$$\alpha_t^* = 1 \Leftrightarrow \delta V(s+1) - \epsilon \geq \delta V(s) \Leftrightarrow \frac{\epsilon}{\delta} \leq V(s+1) - V(s) . \tag{A.3}$$

Now, from (A.1), notice that $V(s)$ is the sum of convex functions of s. This follows from the concavity of ϕ.[21] Then,

$$\frac{\epsilon}{\delta} \leq \underbrace{V(2) - V(1)}_{:=\delta\ \bar{\epsilon}_m} \leq V(3) - V(2) \leq \ldots V(s') - V(s'-1) , \tag{A.4}$$

which completes the proof.

□

Proof of Proposition 2. Consider a lobbying opportunity in period t. The state is the pair $\left(S_A^t, e^t\right)$, where S_A^t is the acquirer firm's size and e^t is the politician's tenure.

Proof of Statement (a) The acquirer firm's continuation value solves:

$$V\left(S_A^t, e^t\right) = \mathbb{E}\left[\pi^t\right] + \delta\left[1 - \Pr\left(\theta^t + g_t < \phi\left(S_A^t\right)\right)\right] \max\left\{V\left(S_A^t + 1, e^{t+1}\right) - \tfrac{\epsilon}{\delta}, V\left(S_A^t, e^{t+1}\right)\right\} .$$

[20] I assume that indifference is broken in favor of acquisitions.

[21] The Bellman operator is convex because it is constructed from the sum and maximum of convex functions. Since both $\mathbb{E}\left[\pi^t(s)\right] = \frac{1}{2} - \phi(s)$ and the survival probability $1 - \phi(s)$ are (weakly) increasing and convex in s, the value function $V(S)$ that solves Equation (A.1) is increasing and convex in s.

Since the probability of ex-post distress,

$$\Pr\left(\theta^t + g_t < \phi\left(S_A^t\right)\right) \ ,$$

is (weakly) decreasing in g_t, and the per-period profit function π^t is strictly increasing in g_t, then $V\left(S_A^t, e^t\right)$ is strictly increasing in g_t.

Suppose, toward a contradiction, that two types of acquirer firm, θ and $\tilde{\theta}$, send two different equilibrium messages, μ and $\tilde{\mu}$, inducing $g_t > \tilde{g}_t$. The firm of type $\tilde{\theta}$ can profitably deviate and improve upon its equilibrium payoff by sending the on-path signal μ. This concludes the proof of (a).

Proof of Statement (b) I now distinguish three cases.

Case (i). Suppose $e^t = 2$. The politician's lifetime ends by the end of the period. Then, their lifetime utility is:

$$k - \tfrac{1}{2} g_t^2 \ ,$$

which is maximized at $g_t^* = 0$.

Case (ii). Suppose $e^t = 1$ and $\chi^t = 0$. Because $\theta^t \geq \phi\left(S_A^t\right)$, then

$$\Pr\left(\theta^t + g_t < \phi\left(S_A^t\right)\right) = 0 \ .$$

The politician's problem is analogous to the previous case. So that $g_t^* = 0$.

Case (iii). Suppose $e^t = 1$ and $\chi^t = 1$. From the politician's perspective, $\theta^t \sim U\left[0, \phi\left(S_A^t\right)\right]$. For $g_t < \phi\left(S_A^t\right)$, the probability of ex-post distress is

$$\Pr\left(\theta^t + g_t < \phi_t\left(S_A^t\right)\right) = \frac{\phi_t\left(S_A^t\right) - g_t}{\phi_t\left(S_A^t\right)} \ . \ .$$

The politician's lifetime payoff is:

$$k - \frac{1}{2}g_t^2 + \delta' k\left(1 - \gamma\left(S_A^t\right) \cdot \frac{\phi\left(S_A^t\right) - g_t}{\phi\left(S_A^t\right)}\right).$$

The first-order condition is:

$$-g_t + \frac{\delta' k\,\gamma\left(S_A^t\right)}{\phi\left(S_A^t\right)} = 0 \Rightarrow g_t = \frac{\delta' k\,\gamma\left(S_A^t\right)}{\phi\left(S_A^t\right)} := g^{\dagger}$$

Among all $g^{\dagger} < \phi\left(S_A^t\right)$, $g^{\dagger}$ is optimal.

Notice that $\phi\left(S_A^t\right)$ is the level of political support which saves even the most unlucky firm ($\theta^t = 0$) from ex-post distress. Higher level of political support cannot be optimal. This completes the proof.

□

Proof of Proposition 3. This proofs follows the same argument presented in the Proof of Proposition 1. First, I define the highest integer such that political support is not bounded, i.e.,

$$\hat{s}(k) := \max\left\{x \in \mathbb{N} \mid g_t^* < \phi(x)\right\}.$$

Now, notice that g_t^* is strictly convex (by concavity of ϕ and convexity of γ) in the interval $[0, \hat{s}(k)]$.[22] To see this, compute the second order partial derivative of g_t^* with respect to S_A^t: [23]

$$\frac{\partial^2}{\partial (S_A^t)^2}\left\{\delta' k \frac{\gamma\left(S_A^t\right)}{\phi\left(S_A^t\right)}\right\} =$$

$$\frac{\delta' k\left(\phi\left(S_A^t\right)^2 \gamma''\left(S_A^t\right) - \phi\left(S_A^t\right)\left(2\gamma'\left(S_A^t\right)\phi'\left(S_A^t\right) + \gamma\left(S_A^t\right)\phi''\left(S_A^t\right)\right) + 2\gamma\left(S_A^t\right)\phi'\left(S_A^t\right)^2\right)}{\phi\left(S_A^t\right)^3} \geq 0.$$

[22] $\hat{s}(k)$ is a function of k since g_t^* is a function of k.
[23] Convexity may fail for $S_A^t > \hat{s}(k)$ as shown by Figure 3.3.

Hence, the firm's profit and survival probability functions are also convex. This ensures that, inside this interval, the firm's value function is strictly convex in S_A^t. Then, assuming $\hat{s}(k) > 2$, the firm completes the first $\hat{s}(k) - 1$ acquisitions whenever

$$\epsilon \leq \delta \left[V\left(2, e^{t+1}\right) - V\left(1, e^{t+1}\right) \right] := \bar{\epsilon}_p(k) \ .$$

Now, recall that

$$\bar{\epsilon}_m = \delta \left[V(2) - V(1) \right]$$

as from equation (A.4). We want to prove that, for all k,

$$\bar{\epsilon}_p(k) \geq \bar{\epsilon}_m \ , \tag{A.5}$$

with strict inequality for $k > 0$. The condition (A.5) can be re-written as

$$V\left(2, e^{t+1}\right) - V\left(1, e^{t+1}\right) \geq V(2) - V(1) \ .$$

Let us define

$$\Delta(s) = V\left(s, e^{t+1}\right) - V(s)$$

as the political premium that the firm obtains when its size is $S_A^t = s$. The condition (A.5) can be re-written as:

$$\Delta(2) \geq \Delta(1) \ , \tag{A.6}$$

with strict inequality for $k > 0$.

At size $S_A^t = 1$, the firm obtains no political protection because $\gamma(1) = 0$ so that $g_t^* = 0$. The firm's per-period profits and survival probability are identical to the case of $k = 0$. Therefore, the premium $\Delta(1)$ does not come from any current-period gain. It is entirely *prospective*: it represents the discounted value of the political benefits the firm might receive in the future, should it grow to size $S_A^t = 2$.

At size $S_A^t = 2$, the firm obtains political protection because

$$\gamma(2) > 0 \Rightarrow g_t^* > 0$$

when $e^{t+1} = 1$ and $\chi^t = 1$. This support provides an *immediate*, per-period benefit through higher expected profits and a higher probability of survival (whenever $k = 0$). The premium $\Delta(2)$ is therefore composed of this immediate benefit plus the discounted value of all future political benefits.

The comparison is now clear. The premium at size 1, $\Delta(1)$, is the discounted *prospect* of future gains. The premium at size 2, $\Delta(2)$, is the *realization* of those gains. Therefore, since $\delta < 1$, $\Delta(2) > \Delta(1)$ for any $k > 0$.

When $k = 0$, no political support is ever given, so $\Delta(s) = 0$ for all s. This completes the proof. □