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CONGLOMERATE MERGERS: THE MYTH AND THE REALITY

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"Conglomerate enterprise does not have a well-defined place either in public policy or in economic theory."[1]

USUAL DISCLAIMER

As a member of the moderate group — one extreme group maintaining that conglomerate mergers are inherently anticompetitive and the other extreme group suggesting that fear of conglomerate mergers is unfounded — which holds that generalizations about conglomerates are unwarranted and that each case must be judged on its own merits, I wondered initially if it would be possible for me to shed any light on the controversy.[2] However, I finally succumbed to the view that it is precisely this controversy which virtually mandates a continued exploration and examination of the economic consequences of the conglomerate merger. Ideally then, I suppose this paper should discuss the fact and fiction of conglomerates. I won't try to convince anyone that this will happen. For quite clearly intermixed into the discussion of what I consider are the myth and the reality of conglomerates

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I am once again indebted to Richard L. Wallace for his valuable help and suggestions. However, I assume the burden for all errors.

1 *Hearings on Economic Concentration Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary* [hereinafter cited as *Concentration Hearings*], 88th Cong., 1st Sess., pt. 1, at 37 (1965) (remarks of Corwin D. Edwards) [hereinafter cited as *Concentration Hearings Part 1*].

2 Of course, it is hard to find examples of people that hold these extreme positions without qualification. However, on occasion John M. Blair, see note 11 *infra*, has come close to espousing the first view, and George J. Stigler, see note 28 *infra*, the second position. Other scholars have been quick to point out the assumptions involved in such extreme positions. *See, e.g.*, THE ORGANIZATION OF INDUSTRY (G. Stigler ed. 1968), *reviewed*, Dewey, 7 J. ECON. LIT. 854 (1969):

> Stigler cannot understand why anyone should become agitated by a conglomerate merger since, in its pure form, it does not change the concentration ratio in any market. But it is only in the static model that size bears no relation to power over price. In an uncertain world, where rival managers act on the basis of different information, wealth perforce increases power to act on the basis of one's own information. To say the obvious, in an uncertain world, size *per se* increases alternatives. Monopoly power and market power are interchangeable labels only when the discussion assumes decision-making under conditions of perfect certainty (which, as Frank Knight used to remind us, is practically a contradiction in terms).

For some excellent reading on conglomerate mergers, which also helps to "shoot down" extreme positions, see the entire issue of 2 ANTITRUST L. & ECON. REV. (1968), especially William G. Shepherd's paper *Conglomerate Mergers in Perspective*, and the accompanying comments by J. Fred Weston and David D. Martin, at 15-52; ECONOMICS OF CONGLOMERATE GROWTH (L. Garoian ed. 1969).

are my own speculations about certain aspects of conglomerates.[3] However, I do promise that I shall try to make it rather obvious when I leave the hard surface of facts to take off into the clouds on heretofore undocumented speculations.

SOME BASIC DEFINITIONS

Before examining the empirical evidence on mergers it is worth reviewing the three basic forms of business consolidations — vertical, horizontal, and conglomerate. On this count, I make no claims of originality. I think Ansoff made as clear a distinction as anyone when he stated:

> A vertical consolidation builds the firm's capabilities either "forward" toward its markets or "backward" toward the sources of supply. A horizontal consolidation rounds out the firm's product line by increasing the line of goods sold to its customers. A conglomerate is the complement of the above two to the complete set; it describes "all other" mergers and in popular parlance describes them as "unrelated."[4]

For some purposes it is useful to subdivide conglomerate mergers. For instance, after defining horizontal mergers as involving companies producing competing products and vertical mergers as involving companies having a buyer-seller relationship, the Staff of the Cabinet Committee on Price Stability defined conglomerate mergers as involving companies which are neither direct competitors nor have a buyer-seller relationship. They then argued that these conglomerate mergers fall into three broad classes:

> [G]eographic *market extension* conglomerates involve companies making the same product but operating in different geographic markets, e.g. a cement company in New York merging with a cement company in Los Angeles; *product extension* conglomerates involve companies making different but related products, e.g. a company making household detergents and a company making other household products sold in food stores; all

[3] Perhaps I should do as I saw a recent pitchman at the Wisconsin State Fair do. He first gave everyone a free (needless to say inexpensive) gift — a ballpoint pen. He then argued, however, that to "accumulate you must speculate." At this point he suggested those getting the gift should give him two dollars in return for which he promised them "nothing." He repeated several times he was promising "nothing." However, after getting their two dollars, he did give them another equally inexpensive item. I believe it was several refills for their pens. Of course, after promising "nothing" his "followers" could hardly accuse him of false advertising!

[4] Ansoff, *Issues in National Policy on Growth of Firms*, in PUBLIC POLICY TOWARD MERGERS 202-03 (J. Weston & S. Peltzman eds. 1969) [hereinafter cited as Weston & Peltzman]. The Wall Street Journal, July 25, 1969, at 6, col. 2, describes how men who do not like the word say "conglomerate" is a rock. That is, "conglomerate" is a geological term meaning a mass of heterogeneous materials. However, it is widely used in business parlance and some firms describe themselves as "emerging," "mature," or even "junior" (*e.g.*, Rajac Industry of Tucson) conglomerates. One New York company now calls itself Conglomerates, Inc. (changed from Gold Canyon Mining Company!). Executives of some conglomerates dislike the term. For instance, George T. Scharffenberger, Jr., President of City Investing Company, says the word reminds him of "cold congealed oatmeal." Dr. Roy Ash, President of Litton Industries, complains that current usage of the term reminds him of a Lewis Carroll definition: "It means what I choose it to mean, neither more nor less."

other conglomerates are those not included among the above categories and therefore involve unrelated products, e.g. a meat packer and a petroleum company.[5]

One of the basic questions to which this *Symposium* is directed is whether the present antitrust statutes can be constructed to prohibit the conglomerate merger. Clearly, under fairly well defined circumstances, antitrusters can and have attacked the vertical and horizontal merger forms.[6] There is some indirect evidence, slender and inconclusive though it is, that at least the investment community thinks the classic *FTC v. Procter & Gamble Co.* (*Clorox*)[7] case and other things suggest that conglomerates will start to feel the effects of more vigorous antitrust enforcement. At the time this was written (September, 1969), although there had been a general downturn in the market in recent months, the giant and even the so-called mini-conglomerates had suffered much more severe losses. Some firms were even claiming they were not "conglomerates," but instead used entirely new terms — such as synergy, multi-industry, or multi-market — to describe their activities.[8] Included in the conglomerate downturn were such firms as FMC, AMK, ITT, GE, LTV, Gulf and Western, Litton, Ogden, Rexall, Textron, Lockheed, *etc.* Obviously, there are always a number of factors explaining the fall (or rise) of any group of securities. However, I do not think it is unreasonable to speculate that fear of a more liberal interpretation of existing antitrust laws (as well as fear of new legislation) is one of the more important variables precipitating the fall in the price of conglomerate securities.

The Current Merger Movement

There is no question that the United States economy is in the midst of an unusually large period of acquisition, consolidation, and merger. One very careful and enlightened study of mergers contained some very strong comments in this regard:

> Mergers, more than any other single economic factor, explain the existing structure of many American industries. Most contemporary big businesses owe their *relative* size to merger-accelerated growth, and current levels of concentration in many industries are directly linked to one or more of the merger movements that have swept through Amercian industry.[9]

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[5] Staff of Comm. on Price Stability, Cabinet Studies, Study Paper No. 2, Industrial Structure and Competition Policy 75-78 (Jan. 1969) [hereinafter cited as Study Paper No. 2].

[6] How effective these "attacks" have been is, of course, another question too detailed and involved to be taken up here. *See, e.g.*, Elzinga, *The Antimerger Law: Pyrrhic Victories*, 12 J. Law & Econ. 43-78 (1969).

[7] 386 U.S. 568 (1967). In this case the Federal Trade Commission challenged the merger of Procter & Gamble with Clorox Chemical under section 7 of the Clayton Act. The government's case to a large extent depended on the existing television rate structures. Peterman, *The Clorox Case and the Television Rate Structures*, 11 J. Law & Econ. 321-422 (1968), reviews the case and its implication in considerable detail.

[8] *See* discussion at note 4 *supra*.

[9] Study Paper No. 2, at 69. We are indebted to this source for many of our factual

Of course, this statement covers all the big merger movements — 1897-1903, 1920's — and not just the third movement which started in the latter years of World War II. This latter movement has two distinct phases: (1) the 1943-1947 period which was directed at particular industries, *e.g.*, distilling; and (2) the 1954-today cycle which, like the movement of the 1920's, involves distributive as well as manufacturing firms.

Disproportionate Growth in Conglomerate Mergers

Suprisingly, the current consolidation movement has had little direct impact on market concentration. This is because vigorous antitrust enforcement has severely arrested the growth both in horizontal and vertical mergers.

> Whereas horizontal mergers comprised 41 percent of the assets of all large mergers in 1948-51, this percentage had fallen to 2.5 percent by 1968. Vertical mergers also have declined in relative importance, falling from 20.5 percent of the assets in 1948-51 to 6.8 percent in 1968. The great increase has occurred in the "other" conglomerate category, which had grown to 45.0 percent of the total by 1968.[10]

In a different study, the Federal Trade Commission found that conglomerate mergers accounted for 71.0 percent of the assets of all "large" companies (*i.e.*, with assets of over $10 million) acquired during 1960-1964.[11] In short, while the Celler-Kefauver amendment to section 7 of the Clayton Act[12] (signed into law by President Truman on December 29, 1950) has been a fairly effective restraint against horizontal and vertical mergers, there is a "consensus that it has not been a significant deterrent to conglomerate mergers."[13] Although the antitrust agencies have challenged over 800

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comments on merger movements in this section. Perhaps the situation described in the text is changing. After this paper was virtually completed, the *Wall Street Journal* contained an article in which W.T. Grimm & Company, a Chicago-based merger and acquisition consultant, reported that corporate merger activitity declined 15 percent in the third quarter from a year earlier. Wall Street Journal, Oct. 2, 1969, at 9, col. 3. Carl A. Neumann, director of research for the company, suggested that this decline was probably the first "in many years." Grimm attributed the slower merger pace to "the stock market slump, the Federal Government's stiffer antitrust attitude and soaring interest rates, which curbed borrowing for acquisitions." It is likely, however, that there will be a record set for all of 1969 as the July 2, 1969 issue reported an increase of 65 percent for the first six months of 1969 over the same period in 1968. Although about 91 percent of the current mergers are of a conglomerate variety, the 10 largest conglomerates made only 63 acquisitions in the first 6 months of 1969 as opposed to 134 acquisitions over the same period in 1968.

10 STUDY PAPER NO. 2, at 78. "Large" in this quote refers to firms with assets of $10 million or more. In the Appendix of this paper are four tables upon which some of the comments in this paper are based.

11 *Concentration Hearings*, 89th Cong., 1st Sess., pt. 2, at 516 (1965) (remarks of Dr. Willard Mueller), quoted in Blair, *Conglomerate Mergers — Theory and Congressional Intent*, in Weston & Peltzman, *supra* note 4, at 179.

12 38 Stat. 731 (1914), *as amended*, 15 U.S.C. § 18 (1964).

13 Blair, *supra* note 11, at 179. My statement that present antitrust policy has been fairly effective is based on several different types of study. For instance, one type found

mergers since its passage in 1950, almost none of these have been conglomerate mergers. For example, over the 1950-1966 period the agencies challenged 27 percent of all horizontal mergers between "large" companies but challenged fewer than 2 percent of the conglomerate type (this figure includes product-extension as well as "pure" conglomerate mergers, although none of the latter were challenged). While the agencies have issued merger guidelines, many think much more is needed (for instance it might be better to tell firms which mergers are permitted rather than which are forbidden). In fact, the Staff of the Cabinet Committee on Price Stability stated that the "Act [Celler-Kefauver] is inadequate to cope with the massive industrial restructuring from current conglomerate merger activity."[14]

There have been two significant effects of the current merger movement: (1) an enlarged share of manufacturing assets held by the 200 largest corporations, and (2) a greatly reduced number of "medium sized" companies in the economy.[15] Between 1948-1967 (1960-1967) the top 200 corporations' share of total manufacturing assets rose from 48.1 (54.2) to 58.7 (58.7) percent. Over the same periods the number of "medium sized" firms ($25-250 million in assets) did not grow proportionately; in fact there was no absolute growth after 1967.

Intermixed in the overall growth in conglomerate activity is enormous growth by particular industrial groups. For instance, it has been estimated that almost 90 percent of the entries of the "large" food manufacturers into new industries occurred by merger.[16]

Reasons for Merger

To help understand this massive merger movement, it is useful to review why firms merge. There has been a number of erroneous notions that have grown up concerning these motives. It is also worth examining these different motives carefully since many people are concerned that financial

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the deleterious effect of monopoly on the economy in terms of resource allocation to be quite small. The studies of Harberger, *Monopoly and Resource Allocation*, 44 AM. ECON. REV. 77-87 (1954), and Schwartzman, *The Effect of Monopoly on Price*, 67 J. POL. ECON. 352-62 (1959), *The Effect of Monopoly: A Correction*, 69 J. POL. ECON. 494 (1961), and *The Burden of Monopoly*, 68 J. POL. ECON. 627-30 (1960), estimated the welfare loss to be less than 1/10 of 1 percent of the national income. Rees, *The Effects of Unions on Resource Allocation*, 6 J. LAW & ECON. 69-78 (1963), found a similar order of magnitude of loss emanating from the effect of unionization. Kamerschen, *A Critique of the Status Quo Approach*, 9 ANTITRUST BULL. 747-60 (1964); *American Antitrust Policy: At the Halfway House*, 10 ANTITRUST BULL. 879-96 (1965); and *An Estimation of the 'Welfare Losses' from Monopoly in the American Economy*, 4 W. ECON. J. 221-37 (1966), placed the losses at a somewhat higher level. D. WORCESTER, MONOPOLY, BIG BUSINESS AND WELFARE IN THE POST-WAR UNITED STATES (1967) summarizes and extends this type of approach. I now have serious reservations about the usefulness of this type of inquiry.

14 STUDY PAPER NO. 2, at 86.

15 We have followed STUDY PAPER NO. 2 in calling these firms "medium size" here when they have assets between about $25 million and $250 million although this is inconsistent with the rest of this paper, as well as their study, where "large" refers to $10 million or more in assets.

16 FTC, THE STRUCTURE OF FOOD MANUFACTURING 118 (1966).

and speculative motives, rather than economic efficiency and growth motives, are the main forces in the current merger movement. "Firms may wish to grow for a variety of reasons: to achieve economies of large-scale production or distribution, to attain market power, or simply to grow larger because doing so promises to enrich management or contribute to the overall prestige of the firm and its management."[17]

It is useful to begin by pointing out that it is possible, though rather uncommon, for mergers to raise concentration and "competition" simultaneously.[18] The acquisition and expansion of a small firm, which is inefficient and destined to financially "die," operating in a highly concentrated industry, could be healthy. However, the exact circumstances in which a conglomerate merger may enhance competition may be rare. It is worth adding, however, that vertical integration may also not be monopolistic in its results if every stage of production is competitive. Some writers give the erroneous impression that vertical integration necessarily is associated with greater monopoly power.

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[17] STUDY PAPER NO. 2, at 70. A capable and comprehensive discussion of the motives is found in *Concentration Hearings Part 1* at 181-202 (remarks of Irwin Stelzer). Attorney General Mitchell, 115 CONG. REC. 6659-61 (daily ed. June 18, 1969), among others, questions most of these arguments. While admitting that the large corporation is needed in some industries because of capital-investment requirements, he took exception to most of the other arguments. For instance, he argues that giantism does "not necessarily increase efficiency and profits, corporate bigness doesn't necessarily stimulate the most imaginative scientific research." He claimed that recent studies show that "the medium-size firm tends to be more productive in its research precisely because it isn't dominant." Further, he said that the leading companies in the auto and razor blade industries — "two of our most highly concentrated industries," offered consumers new products only "in response to aggressive foreign competition."

[18] Some of the comments in this section draw on Kamerschen, *Recurrent Objections to the Theory of Imperfect Competition*, in ZEITSCHRIFT FUR DIE GESAMTE STAATSWISSENSCHAFT 1-7 (1969). Of course the Government recognizes that mergers can improve competition. Mergers, per se, are not illegal under federal law. However, they are illegal when their probable effect will be a substantial lessening of competition in any line of commerce in any section of the country. Wolf, *Conglomerate Mergers and Competitive Affect*, 5 TENN. SURVEY 5 (1969), on the basis of an examination of the "decided cases, complaints filed, published statements of enforcement officials, and academic writings," suggests cases where conglomerate mergers would probably be illegal:

> (1) mergers between the top 200 manufacturing firms, or firms of equivalent size in other sectors; (2) mergers between a member of the top 200 manufacturing firms, or its equivalent in other sectors, and another smaller firm but one holding a monopolistic, dominant or strongly oligopolistic position in one or more of the markets in which it operates; and (3) mergers between two firms each of which, while not among the top 200, does have a position of significant market power in one or more of the lines in which it operates.

Wolf's comments follow closely the position taken by Attorney General Mitchell in his speech reported in 115 CONG. REC. 6659-61 (daily ed. June 18, 1969). Appendix Table IV is a list of some of the companies that the *Wall Street Journal* thought would fall under Mitchell's suggested guidelines, based on 1968 *Fortune* data on assets. This list is meant to be suggestive and by no means definitive. Probably the economist most influential in calling our attention in recent years to the threat of the leading firms is Willard Mueller, the FTC's chief economist who, *e.g.*, in the Wall Street Journal, April 6, 1967, at 1, col. 6, predicted that if the then present merger pace continued that the nation's 200 largest firms likely would control two-thirds of all manufacturing assets by 1975. He went on to state that "while this isn't necessarily bad, the bits and pieces of evidence we have suggest that there are real reasons for concern over this."

It is entirely possible for a merger to be profitable even if there is free entry, provided long-run equilibrium is not reached too quickly. The early monopoly "gains" may, in present-value terms, exceed the latter "losses" from such policy. Similarly, it is conceivable — some might argue likely — that it is more profitable to merely retard the rate of entry of competitors rather than prevent it altogether.

Regarding the possibilities of merger to achieve economies of scale, a number of students have registered extreme skepticism.[19] It is, of course, entirely possible that the combining of two or more enterprises under one corporate roof could result in greater economic efficiency than if the firms continued to operate independently. But what have been the actual facts?

A recent study by Collins and Preston bears at least indirectly on this question. After documenting that price-cost margins are correlated with firm size, they state:

> [I]n some industries the margin advantages of the largest firms may be due to cost advantages associated with scale and/or continuity of operations. However, the failure of concentration to increase more frequently in these industries than in industries in which the margin differences are reversed, throws some doubt on the cost hypothesis. Rather, it may well be that the margin advantages of the largest firms are due to less elastic demand, resulting from prominent market positions, extensive distribution networks, long-term patronage loyalties, and other characteristics based upon and associated with large-scale advertising. A second point worth emphasis in this connection is that even if the largest firms do possess cost advantages, the margin data indicate that such advantages often lead to greater profits (i.e. margin advantages) rather than to lower final goods prices and corresponding increases in output.[20]

A second bit of evidence that deals with this matter is two recent studies relating mergers to profitability. One study found that although merging companies grow faster than nonmerging ones, on the average they tend to be less profitable.[21] A second study[22] examined the 500 largest manufacturing corporations and found a negative correlation between the intensity of merger activity and profitability. This was true for manufacturing as a whole and for most major industrial groupings.

The evidence regarding economies of scale in distribution, especially advertising, is also relevant. There have been several studies demonstrating a statistically significant relationship between advertising, particularly television advertising, and increases in industry concentration.[23] In a wide

19 *See, e.g.*, STUDY PAPER No. 2; Barron's, July 15, 1968, at 1; *id.* July 1, 1968, at 9; Blair, *supra* note 11.

20 Collins & Preston, *Price-Cost Margins and Industry Structure*, 51 REV. ECON. & STATS. 285 (1969).

21 E. KELLY, THE PROFITABILITY OF GROWTH THROUGH MERGERS (1967).

22 *Concentration Hearings*, 89th Cong., 2d Sess., pt. 5, at 1913-40 (1966) (testimony of Samuel R. Reid).

23 Some of these are cited in Blair, *supra* note 11, at 185 n.14. One of the best and most recent of these studies is Wilson, *Advertising, Market Structure and Performance*, 49 REV. ECON. & STATS. 423-40 (1967).

variety of industries, concentrated television advertising led to sharp increases in concentration.

From this it is often argued that conglomerates have a distinct advantage. Presumably, expanding conglomerates are able to afford the high cost of TV advertising and thus use monopoly profits secured in one market to enhance their market position in other markets. According to Blair, "common observation suggests that this is exactly what has been taking place in differentiated-product, heavily promoted consumer goods industries. In the majority of such industries the leading firms are themselves conglomerates."[24]

It must be noted, however, that there is some conflicting evidence to the alleged ubiquity of this phenomenon. For instance, you will recall that the *Clorox* case was decided primarily on the basis of the presumed cost advantages in advertising which Procter & Gamble enjoyed. For instance, television advertising was said to cost 25 to 30 percent less for Procter & Gamble than for smaller producers. However, Peterman, in his exhausting study of the evidence, argues thusly:

> [T]o the extent the case rests on television rate structures, it is based on a fundamental misconception of their character (and of the markets for time); that these rate structures are not (nor were they) discriminatory according to the buyer's size; and that to the extent discounts are based on cost differences, they do not seem sufficiently large to cause the FTC concern. Once this is understood, there is little left upon which the FTC's case might legitimately rest. If there is, it cannot be discovered by the evidence and arguments presented.[25]

In addition to the above evidence, there are two other recent studies which show that mergers in general,[26] and bank mergers in particular,[27] tend to be more to managers' interests than to the profit maximization interests of shareholders. However, one must also be careful with studies of this kind. The facts must be examined thoroughly. An excellent example of a folklore which continued for a long time without anyone giving it sufficient study is U.S. Steel's consolidation in 1901.[28] One of the important motives that is often given for mergers is the greed of investment bankers. The basic idea is for promoters to reap enormous fees by selling the "watered" stock of the combined firm to "untutored" investors at exorbitant prices. The classic example that is usually given for this is the Morgan syndicate's write-up of the book value of the constituent firms in

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24 Blair, *supra* note 11, at 185.

25 Peterman, *supra* note 7, at 396.

26 J. BOSSOMS, K. COHEN & S. REID, MERGERS FOR WHOM—MANAGERS OR STOCKHOLDERS? (Carnegie Institute of Technology, Working Paper No. 14, 1966).

27 Cohen & Reid, *The Benefits and Costs of Bank Mergers*, 1 J. FIN. & QUANTITATIVE ANALYSIS, Dec. 1966, at 15-57.

28 Several of the ideas discussed in this section are indebted to the always stimulating George J. Stigler. *See* his omnibus entitled, THE ORGANIZATION OF INDUSTRY (G. Stigler ed. 1968) [hereinafter cited as STIGLER].

the formation of U.S. Steel from $700 million to $1.4 billion. Yet, a careful examination of the facts shows that even though the Morgan syndicate was paid $62 million in stock, the investor was better off purchasing U.S. Steel than any other steel concern (except Bethlehem Steel) over the years 1901 to 1925. In fact, the accumulated market value of the shares of "Big Steel" was twice that of the average of other steel companies over this period.

Another bit of folklore worth emphasis concerns Rockefeller's Standard Oil. It is often felt that firms generally do better by engaging in predatory pricing ("cutthroat competition") rather than by merging. Standard Oil is often given as the classic example of getting ahead by decreasing prices in selected markets in order to force rivals to their knees before selling out at bargain prices. Yet a careful study by McGee[29] has shown that in fact Standard Oil usually bought out its competitors at attractive prices rather than engaging in predatory pricing. Apparently, Aaron Director at the University of Chicago has been demonstrating to his students for many years the rather simple theoretical foundations as to why it generally is true that an acquisitive policy yields a higher return than "cutthroat competition." Lester Telser summarized the oral tradition at Chicago regarding this point when he wrote: "Although reasonable men would not engage in predatory pricing, the threat of such cutthroat competition sets limits to the price of merger, and the share of monopoly return going to the successful entrant."[30]

Possible Consequences of Conglomerate Mergers

J. Fred Weston summarized the consensus of the participants in a recent symposium on conglomerate mergers as to a number of potential abuses that might result from the developing conglomerate movement.[31] I think his five undesirable effects are worth discussing, inasmuch as I for one would take exception to some of them. They include: (1) inadequate reporting,

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29 McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case*, 1 J. LAW & ECON. 137 (1958).

30 Telser, *Cutthroat Competition and the Long Purse*, 9 J. LAW & ECON. 259-77 (1966).

31 Weston, *Summary of Discussions on Conglomerate Mergers*, in Weston & Peltzman, at 219-24. Wolf, *supra* note 18, at 5, in a similar vein, suggests five reasons why conglomerate mergers of firms of the size or market position described in Wolf's statement reproduced at note 18 *supra*, might be likely competition:

> First, such mergers create a community of interest among large firms leading to less vigorous competition when the firms meet as rivals in various markets, knowing that aggressive moves in one market invite retaliatory measures in another. Second, smaller firms competing with their enlarged rivals become more cautious especially in regard to price competition, not wishing to invite disciplinary actions. Third, potential competitors shy away from otherwise attractive markets, not willing to take on a large conglomerate. Fourth, such mergers eliminate independent sources of potential competition, firms whose resources would enable them to enter concentrated industries without merger. Fifth, such mergers enlarge the opportunities of the merged firms to use against their less diversified rivals such restrictive devices as business reciprocity, tie-in sales and subsidization.

(2) cross-subsidization, (3) non-price competition, (4) the raising of entry barriers, and (5) reciprocity.

It is well-known that "creeping conglomeration" has reduced the usefulness of the public financial statements of these firms. The consolidation of sales, profits, costs, *etc.* makes it impossible to get an accurate idea as to a conglomerate's doings in its various markets. While Weston only discusses this (lamentable) situation, the Staff of the Cabinet Committee on Price Stability also presents an imaginative and practical program for amelioration.[32] The reader is urged to peruse their recommendations.

The problem of cross-subsidization is implemented by the aforementioned practice of inadequate financial reporting. Weston claims it also encourages predatory pricing. Our foregoing critical comments on the likelihood of such a practice apply here.

The problems of non-price competition and entry barriers can be considered together. Weston claims the "deep-pocket" theory, which states that large firms bear ephemeral losses better than smaller concerns, is one reason non-price competition is important. Thus, it is claimed that large concerns can resort to frequent style and model changes and heavy advertising by digging into their "deep-pocket" resources. In short, Weston claims that cross-subsidization, non-price competition and other factors create substantial entry barriers for small firms. I would have several reservations regarding Weston's comments on the "deep-pocket" theory. First of all, it is not yet unequivocally established that large firms have the scale advantages in distribution that many people think. Peterman's careful reconsideration of the *Clorox* case is evidence that this is still an open question. Secondly, and more importantly, I think Weston is guilty of the rather common error in economics of using a sloppy and sometimes inconsistent definition of "barriers to entry." Stigler defines a barrier to entry as "a cost of producing (at some or every rate of output) which must be borne by a firm which seeks to enter an industry, but is not borne by firms already in the industry."[33] This concept should properly be distinguished from economies of scale (or plant) and its (internal) costs of production. Thus, entry can be free into an industry, *i.e.*, involve no entry barriers, even if capital requirements are high. For example, it does require considerable sums of money to enter the automobile or aluminum industry, but this is not proof of a barrier to entry unless the cost of acquiring such funds differs for existing and potential firms in the industry. Similarly, product differentiation is a barrier to entry only if the costs of differentiation are different for potential firms than they are for existing firms. Proof that a given industry involves considerable expenditures on advertising is not the same thing as demonstrating there are barriers to entry into the industry. There may be barriers but the final verdict would require additional information, *viz.*, as to relative advertising costs

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[32] STUDY PAPER NO. 2, at 86-88.
[33] STIGLER at 67.

for potential versus existing firms. In short, economies of scale and barriers to entry are not the same thing. Thirdly, I think Weston also makes the common error in economics of a priori assuming non-price competition is less efficient than price competition. Yet, as Stigler has demonstrated, in the end this turns out to rest upon an empirical judgment.[34] That is, for price competition to be more efficient than non-price competition marginal production costs must rise less rapidly than marginal nonproduction costs where the latter includes outlays on advertising, product differentiation, and other non-price variables. While this is certainly a plausible assumption, it is worth reiterating that it is required for the hypothesis to hold.

Finally, Weston claims that conglomeration lends itself to reciprocity by increasing the potentials and opportunities of such arrangements. Unfortunately, he provides the reader with no rigorous demonstration as to why this would necessarily be the case. While it would be easy to intuit along these lines, this is a poor substitute for systematic economic logic. Clearly, more work is required along these lines.[35]

Unlikely Consequences of Conglomerate Mergers

Some people have expressed some fears with regard to "creeping conglomeration" that seem extremely remote. Two of these presumed consequences stem from the belief that conglomeration is likely to lead to greater monopoly power. We have already suggested that this has not been true in American society. That is, the current merger movement has had very little direct impact on the degree of market concentration. But let us grant for the moment that the assumption is correct and examine the two proposals.

One idea is that conglomeration will lead to greater managerial inefficiency — where inefficiency means more pecuniary (nonpecuniary) income could be earned with no loss in nonpecuniary (pecuniary) income — as monopolists are more inefficient than competitors.[36] The crux of the argument is that mismanaged competitive firms face insolvency, whereas mismanaged monopolist firms only face reductions in the profit level. However, this conclusion does not accord with standard economic theory. If input markets are competitive, management is as likely to be just as alert and aggressive in monopoly as in competition. Alchian and Kessel argue that "competition in the capital markets will allocate monopoly rights to those who can use them most profitably. Therefore, so long as free capital markets are available, the absence of competition in product markets does not imply

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[34] STIGLER ch. 3.

[35] I think the most sophisticated analysis that has been done heretofore is the excellent paper by Ferguson, *Tying Arrangements and Reciprocity: An Economic Analysis*, 30 LAW & CONTEMP. PROB. 552 (1965).

[36] It should be noted that some writers make the opposite claim. For instance, John H. Rubel, Vice President, Litton Industries, Inc., in Weston & Peltzman, at 208-18, suggests that conglomerates are likely to result in greater efficacy since they are more likely to apply a systems approach to corporate problems.

a different quality of management in monopolistic as compared with competitive enterprises."[37]

The second idea that is sometimes advanced is that monopoly and hence conglomeration has special relevance to inflation. Again, orthodox economic theory does not support this assertion. The monopolist is not interested in raising prices per se but only in obtaining the profit-maximizing price. Usually, however, the argument is presented in a slightly more sophisticated form than this. It runs as follows: as the American economy becomes more concentrated as a result of conglomeration, there will be an inflation of prices relative to competitive conditions (given the money stock). First of all, the evidence is at best ambiguous with regard to whether concentration has been increasing.[38] Secondly, the evidence is definitely contrary regarding the alleged association between concentration of production and the amplitude of price changes.[39] Thus the association of monopoly power (and hence conglomeration according to the proposed thesis) and inflation lacks both a theoretical rationale and an empirical basis.

Parenthetically, I might add here that Jesse W. Markham, in his statement at the Economic Concentration hearings, expressed much the same skepticism as I have regarding such things as the efficiency of monopolist managers and the nexus between conglomeration and monopoly power. For instance, he commented that "conglomerateness and nothing more raises no public policy issue; the term is simply a synonym for industrial diversification and bestows on the business entity to which it is frequently applied no more nor no less special significance than that of a group of independent firms competing in the same markets."[40]

Conclusions

It would be nice if I could end this paper by proposing some imaginative method of dealing with "creeping conglomeration." However, the relative newness of the phenomenon has meant that neither economic theory nor public policy has been able to provide the means for effectively dealing with it. Unfortunately, I do not have any such public proposal to offer.

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[37] Alchian & Kessel, *Competition, Monopoly, and the Pursuit of Pecuniary Gain*, in Aspects of Labor Economics 156 (Nat'l Bur. Econ. Research ed. 1962). Naturally, this statement must be qualified in the case of nontransferable assets, *e.g.*, human monopoly rights and powers such as those commanded by Raquel Welch.

[38] *Study Paper No. 2* definitely argues that there has been no upward trend in concentration. *See also* Kamerschen, *An Empirical Test of Oligopoly Theories*, 76 J. Pol. Econ. 615-34 (1968); Kamerschen, *Market Growth and Industry Concentration*, 63 J. Am. Stat. Ass'n 228-41 (1968); Kamerschen, *The Determination of Profit Rates in Oligopolistic Industries*, 42 J. Bus. 293-301 (1969).

[39] *See, e.g.*, Selden & de Podwin, *Business Pricing Policies and Inflation*, 71 J. Pol. Econ. 116-27 (1963), who found no relationship between concentration and price movements in the United States economy in the 1950's.

[40] *Concentration Hearings*, 89th Cong., 1st Sess., pt. 3, at 1269-71 (1965) (remarks of Jesse W. Markham). A similar view, held by Stigler, was already discussed at note 2 *supra* and accompanying text.

It does seem apparent that the old standbys — the Sherman and Clayton Acts — are not well suited for this task.

I do think Professor Walter Adams' idea for handling the task is worthy of further consideration. He suggests that we

> explore the feasibility of adapting the Public Utility Holding Company Act provisions to conglomerate bigness in manufacturing. Such a statute should emphasize corporate reorganizations which would not only lessen unwarranted concentrations of economic power, but which would also enhance corporate efficiency. It should be a constructive, not punitive, statute — a selective instrument, not a general "death sentence." It should automatically exempt companies with assets of less, say, than $100 million; and place as much reliance as possible on voluntary compliance. But, most important, the new law should make a start in curbing this less defensible form of private socialism in America.[41]

To repeat: it would be desirable to close on a positive note, containing some novel proposal. Unfortunately, I have none. Instead, I shall only repeat, inasmuch as I concur with much of it, Willard F. Mueller's (Director, Bureau of Economics, Federal Trade Commission) conclusion regarding the present state of our knowledge of conglomerates:

> [I]t is easier to pose problems with respect to the conglomerate enterprise, than it is to chart effective public policy designed to cope with these problems. Certainly no one would argue seriously that it is either feasible or desirable to dismantle all existing positions of conglomerate power, either in food retailing or elsewhere in the economy. Nor are existing antitrust laws designed to cope with anticompetitive conduct entirely adequate to deal with problems of the misuse of conglomerate power.[42]

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41 *Concentration Hearings Part 1* at 251 (remarks of Walter Adams). You will recall that the Public Utility Holding Company Act of 1935 was addressed to the phenomenon of corporate bigness in a single industry in that it

> sought to impose a flexible limitation on the size of utility holding systems by eliminating certain types of corporate structures which had tended to promote the growth of huge sprawling systems without regard to the integration of properties or to economies of operation. It sought to eliminate situations, for example, where an electric company in Oregon, a gas company in Pennsylvania, and a water company in Texas would be jointly controlled by a financial promoter with headquarters in New York City. It sought to deal with a concentration of power over functionally unrelated operations — a conglomerate concentration of power which could not be justified on grounds of superior efficiency or technological progressiveness.

Id. at 250. Adams' full testimony is on pages 248-62. *See also* Adams' draft of some years ago on a proposed holding company act which is included as Appendix 5, at 353-78.

42 *Concentration Hearings*, 89th Cong., 2d Sess., pt. 5, Appendix 1, at 2012 (1966) (testimony of Dr. Willard Mueller). Perhaps the best example of the present state of futility in conglomerate economics is revealed by an October 24, 1969 article in the *Wall Street Journal* by Louis M. Kohlmeier. He reports that the 700-page Federal Trade Commission's study of conglomerate mergers is being called "old hat" even though it wasn't slated to be released for another two weeks. The report and recommendations — including the strong proposal to bar all acquisitions by large companies of leading firms in "other industries" — is to be issued as a staff document with no endorsement or comment by the commissioners. The article reports that some commissioners say that the "staff study is based on old statistics and litigated antitrust cases and that it doesn't attempt to resolve economic questions concerning novel effects of conglomerate mergers on competition or the effects

In short, I find myself in more agreement with the moderate group that argues that each conglomerate case must be judged on its own merits, than with either the extreme group that feels that conglomerate mergers are inherently anticompetitive, or the extreme group that suggests that conglomerate mergers have no impact on competition.

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on the pricing and quality of products." The article also reports that Commissioner Philip Elman, in a speech before the American Bar Association, is already calling for a new investigation of the economic consequences of mergers and concentration including examining "existing concentration" in established corporations, as well as new conglomerate mergers. He suggested, for instance, that companies such as duPont, General Foods, and Minnesota Mining & Manufacturing should be included in any such study because, he said, they are widely diversified concerns. Their diversification resulted from acquisitions made many years ago. He also stated that "even though the Nixon Administration is pressing the application of existing antitrust laws and conglomerate mergers, very little is known about the economic consequences of conglomerates. He noted that businessmen and professional economists as well as antitrust lawyers disagree sharply on whether conglomerate mergers have any long- or short-term effects on competition." Wall Street Journal (Midwest ed.), Oct. 24, 1969, at 8, col. 3.

The actual FTC study itself was reported on in the November 5, 1969 issue of the *Wall Street Journal* by Mr. Kohlmeier, as not presenting any startingly new data. He did report that the study showed

> merger activity during January-September 1969 was nearly 6 percent greater than in the 1968 period, despite a decline in consolidations in the second and third quarters. It added that the country's 200 largest companies at the end of 1968 controlled about 60 percent of the total manufacturing assets. In 1941, it said, the 1,000 largest controlled that proportion.

Three aspects of the merger trend that were brought out in the study are worth repeating:

> [1] It said that contrary to some notions, the great majority of conglomerate mergers aren't between companies in totally dissimilar businesses, but involve companies in related though not directly competitive lines. Acquisitions by petroleum companies of chemical and coal concerns were cited as an example. [2] The study also found that the nation's largest acquisition-minded companies have bought the most profitable concerns and smaller companies generally have acquired less profitable concerns. It asserted that almost all mergers have been motivated by "a variety of tax, financial and personal advantages" rather than by "the requirements of large-scale production, research or innovation." [3] It also produced evidence that conglomerate companies have greater "opportunity and incentive" to deal in reciprocity — which involves purchasing supplies from companies that are customers.

Wall Street Journal (Midwest ed.), Nov. 5, 1969, at 36, col. 1.

APPENDIX

TABLE I

LARGE ACQUISITIONS MADE BY FIRMS CLASSIFIED AMONG THE 200 LARGEST, 1948-1967

Year	Total large acquisitions[1]		Total acquired by 200 largest firms[2]	
	Number	Assets (millions)	Number	Assets (millions)
1948	4	$66	4	$66
1949	5	67	5	67
1950	4	173	2	107
1951	9	201	5	125
1952	13	327	6	187
1953	23	679	17	561
1954	35	1,425	17	906
1955	68	2,129	33	1,412
1956	58	2,037	37	1,527
1957	50	1,472	29	1,104
1958	38	1,107	24	707
1959	64	1,960	36	1,425
1960	62	1,710	33	978
1961	59	2,129	25	1,240
1962	72	2,194	31	1,095
1963	68	2,917	34	1,843
1964	91	2,798	37	1,221
1965	93	3,900	29	2,061
1966	101	4,100	31	2,215
1967	170	8,246	66	5,392
Total	1,087	39,584	501	24,239
1968 estimate	188	12,366	70[3]	6,755[3]

1 Acquired units with assets of $10 million or more.

2 For years 1948-1965, 200 largest firms ranked by 1965 assets; for 1966 and 1967, acquirers are 200 largest firms ranked by 1966 assets, excluding those firms acquired in 1967.

3 Estimate of the 1968 acquisitions by the 200 largest companies of 1967.

SOURCE: Bureau of Economics, Federal Trade Commission.

TABLE II

NUMBER OF ACQUISITIONS AND MANUFACTURING ASSETS ACQUIRED DURING 1948-1967 COMPARED WITH TOTAL MANUFACTURING, 1967

A. NUMBER

Size class of acquired firm (millions)	Companies acquired 1948-1967[1]	Total companies 1967[2]	Acquisitions as percent of total 1967[2]
$10 to $25	593	1,138	52
$25 to $50	227	517	44
$50 to $100	114	297	38
$100 to $250	53	252	21
Over $250	11	249	4
Total	998	2,453	41

B. ASSETS

Size class of acquired firm (millions)	Total assets acquired 1948-1967[1] (in billions)	Total manufacturing assets 1967[2] (in millions)	Acquired as percent of total
$10 to $25	$9	$18	50
$25 to $50	8	18	42
$50 to $100	8	21	36
$100 to $250	7	39	19
Over $250	4	248	2
Total	36	344	11

1 All mining acquisitions have been excluded from these data.
2 1st quarter.
SOURCE: Bureau of Economics, Federal Trade Commission.

TABLE III

DISTRIBUTION OF LARGE MANUFACTURING AND MINING ACQUISITIONS BY SIZE OF ACQUIRING COMPANY, 1948-1967

[Dollar amounts in millions]

Size class of acquiring company[1]	Number of acquisitions	Percent of total	Value of acquired assets	Percent of total
Unknown	26	2.4	$540	1.4
$10 to $25[2]	109	10.2	2,044	5.2
$25 to $50	132	12.4	3,310	8.4
$50 to $100	171	16.0	4,798	12.2
$100 to $250	273	25.6	9,358	23.9
$250 and over	356	33.4	19,183	43.9
Total	1,067	100.0	39,233	100.0

1 Size at time of acquisition.
2 19 of these acquisitions were made by companies with assets of less than $10 million at the time of acquisition.
SOURCE: Bureau of Economics, Federal Trade Commission.

TABLE IV

THESE FIRMS WOULD COLLIDE WITH NEW MERGER GUIDES

While Attorney General Mitchell did not specify which companies would be subject to strict merger controls, here is a list of the 200 largest industrial corporations, as ranked by 1968 assets by *Fortune* magazine.

1. Standard Oil (N.J.)
2. General Motors
3. Ford
4. Texaco
5. Gulf Oil
6. Mobil Oil
7. IBM
8. U.S. Steel
9. General Telephone
10. Standard Oil-California
11. General Electric
12. Standard Oil (Indiana)
13. Chrysler
14. Shell Oil
15. International Tel.
16. Tenneco
17. Du Pont
18. Union Carbide
19. Bethlehem Steel
20. Phillips Petroleum
21. Western Electric
22. Ling-Temco-Vought
23. Eastman Kodak
24. Continental Oil
25. Atlantic Richfield
26. Goodyear Tire
27. RCA
28. Sun Oil
29. Dow Chemical
30. Union Oil-California
31. Westinghouse
32. Alcoa
33. Boeing
34. Gulf & Western
35. International Harvester
36. Monsanto
37. Firestone Tire
38. Cities Service
39. Sinclair Oil
40. Avco
41. Occidental Petroleum
42. Getty Oil
43. International Paper
44. Anaconda
45. W. R. Grace
46. Reynolds Metals
47. Celanese
48. Armco Steel
49. Procter & Gamble
50. Republic Steel
51. Kennecott Copper
52. American Tobacco
53. Caterpillar Tractor
54. Allied Chemical
55. Singer
56. Deere
57. Kaiser Aluminum
58. N. American Rockwell
59. National Steel
60. United Aircraft
61. American Can
62. McDonnell Douglas
63. Northwest Industries
64. Georgia Pacific
65. Glen Alden
66. Signal Cos.
67. Litton Industries
68. Reynolds Tobacco
69. Burlington Industries
70. Inland Steel
71. Minnesota Mining
72. Owens-Illinois
73. Marathon Oil
74. U.S. Plywood-Champion
75. Uniroyal
76. National Cash Register
77. Sperry Rand
78. PPG Industries
79. Continental Can
80. Weyerhaeuser
81. General Foods
82. B. F. Goodrich
83. Boise Cascade
84. Youngstown Sheet
85. Borden
86. Olin Mathieson
87. Honeywell
88. American Cyanamid
89. FMC
90. American Standard
91. Kraftco
92. International Utilities
93. Crown Zellerbach
94. Lockheed
95. Xerox
96. Bendix
97. St. Regis Paper
98. Textron
99. TRW
100. CPC International
101. General Dynamics
102. Control Data
103. General Tire
104. Coca-Cola

TABLE IV *(Continued)*

105. Hercules
106. National Distillers
107. Kimberly-Clark
108. Philip Morris
109. American Metal Climax
110. Borg-Warner
111. Standard Oil (Ohio)
112. Burroughs
113. American Smelting
114. Scott Paper
115. Ashland Oil
116. Pfizer
117. Swift
118. Seagram
119. Norton Simon
120. Mead
121. Allis-Chalmers
122. American Home
123. Gen. Amer. Trans.
124. Phelps Dodge
125. J. P. Stevens
126. Martin Marietta
127. Diamond Shamrock
128. Kerr-McGee
129. United Merchants
130. Ralston Purina
131. Kaiser Industries
132. Eaton Yale & Towne
133. White Consolidated
134. Ingersoll-Rand
135. National Lead
136. Teledyne
137. International Minerals
138. Studebaker-Worthington
139. Wheeling-Pitts Steel
140. Colt Industries
141. Ogden
142. Kaiser Steel
143. Consolidated Foods
144. Armour
145. Campbell Soup
146. Ethyl
147. Dresser
148. Standard Brands
149. GAF
150. U.S. Gypsum
151. Dart Industries
152. Heinz
153. Colgate-Palmolive
154. Cerro
155. Anheuser-Busch
156. Warner-Lambert
157. Bristol-Myers
158. Texas Gulf Sulphur
159. Babcock & Wilcox
160. Time Inc.
161. Liggett & Myers
162. General Mills
163. Combustion Engineering
164. Air Reduction
165. Motorola
166. Hess Oil
167. Merck
168. Fruehauf
169. Del Monte
170. White Motor
171. Union Camp
172. Johns-Manville
173. PepsiCo
174. National Biscuit
175. Amerada Petroleum
176. SCM
177. Squibb Beech-Nut
178. Raytheon
179. Corning Glass
180. American Machine
181. Eli Lilly
182. Carnation
183. Union Tank Car
184. Genesco
185. Armstrong Cork
186. Texas Instruments
187. Stauffer Chemical
188. Johnson & Johnson
189. West Virginia Pulp
190. Pullman
191. Whirlpool
192. Brunswick
193. Jim Walter
194. Coastal States Gas
195. Gillette
196. U.S. Industries
197. Northrop
198. Revere Copper
199. National Gypsum
200. Rohm & Haas

A number of other companies are not classified by *Fortune* as "industrial corporations," but had assets in 1968 at least equal to $391,937,000, the assets of Rohm & Haas, the 200th largest on the industrial list. Among these other companies are:

1. Columbia Broadcasting
2. Ebasco
3. Foremost-McKesson
4. Engelhard Minerals
5. Halliburton
6. United Fruit
7. Amer. Broadcasting
8. Sperry & Hutchinson

TABLE IV *(Continued)*

Stricter merger regulation also may be applied to large concerns outside the industrial field. Here are the 10 largest retailing companies, ranked by *Fortune* by 1968 sales.

1. Sears	6. Marcor
2. A&P	7. Woolworth
3. Safeway	8. Federated Stores
4. Penney	9. Kresge
5. Kroger	10. Food Fair

Here are the 10 largest transportation companies, ranked by *Fortune* by 1968 operating revenue.

1. Penn Central	6. TWA
2. United Air Lines	7. Chesapeake & Ohio Ry
3. Southern Pacific	8. Norfolk & Western Ry
4. Pan American Airways	9. Santa Fe Industries
5. American Airlines	10. Eastern Air Lines

Here are the 10 largest utilities, ranked by *Fortune* by 1968 assets.

1. AT&T	6. Southern Co.
2. Consolidated Edison	7. American Electric Pwr.
3. Pacific Gas	8. Public Service Electric
4. S. Calif. Edison	9. El Paso Natural Gas
5. Commonwealth Edison	10. Columbia Gas System

SOURCE: Wall Street Journal, June 9, 1969, at 14, col. 12.