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THE CHANGING DIMENSIONS OF BUSINESS POWER†

CORWIN D. EDWARDS*

From analysis of an earlier and simpler economy, we have inherited a concept of the nature of the power of a powerful business enterprise. It is derived from a theoretical model appropriate to localized trading between consumers and numerous small specialized handicraft producers. According to this concept, (a) Firms carry on their economic activity in markets, each of which consists of a group of buyers and sellers who are in direct contact with one another in transactions that involve a particular product. (b) A powerful firm is one that monopolizes a market. (c) The monopolist's power is the result of two conditions: first, that he controls so much of the supply of the product or service that the buyers of it have no adequate alternatives¹; and second, that new suppliers desiring to enter the market would encounter obstacles great enough to prevent them from substantially impairing the monopolist's control of supply.

Economic change is sucking the significance from this type of power. The number of large business enterprises has increased, so that several such firms encounter each other in many fields of productive activity. For a single market, oligopoly instead of monopoly has become the characteristic pattern of big business. The boundaries of markets are being obscured as a consequence of the increasing size of firms and the development of technology. Diversification by large business enterprises is reducing significantly the importance of single markets to them. Changes in the way business power is manifested are reflecting the increase in the number of big firms, the blending of markets, and the development of diversification.

The purpose of this essay is to summarize relevant aspects of these changes in economic structure and behavior and to suggest changes in the concept of business power appropriate thereto. The discussion will center

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¹ Originally applied to markets for consumer goods, this theory of power has been extended to markets for commodities and services used by business enterprises as well; and recognition of the possibility that purchases by a large firm might constitute most of the demand for a particular kind of commodity or service has led to development of a concept of monopsony equivalent to that of monopoly. However, since most of the commodities and services used by business enterprises are consumed by a variety of industries, even a firm that monopolizes a single industry is unlikely to have monopsony power over what that industry consumes. Since the monopsony concept has had little practical importance, this essay will ignore it and will discuss only the power of firms as sellers.

upon the United States, both because more information is available about developments there and because I am less familiar with such information as is available about other countries.

I. INCREASE IN THE NUMBER OF LARGE FIRMS: OLIGOPOLY

For various reasons — one being the law against monopoly — big business in the United States no longer takes the form of a firm that controls most of a market or industry and encounters as competitors only firms much smaller than itself. Instead, the typical pattern is one in which several big enterprises, more or less comparable in size, occupy most of a field of activity, while much smaller firms occupy the remainder. This condition, called by economists oligopoly, is not susceptible to economic appraisals as simple and confident as economists have applied to monopoly. Analysis is made difficult by the diversity of oligopoly patterns.

There are many possible combinations of bigness and fewness. The number of oligopolists may range from two to a considerably larger number. The oligopolists as a group may make nearly all of the sales or a smaller part of the total. The relative importance of the firms in the oligopoly group may vary in numerous ways: One firm (or two or three) may be outstanding; all oligopolists may be substantially equal; or size and importance may decline by stair-step gradations. The gap in size between the smallest oligopolist and the next firm may be large or small. Since there is no reason to believe that the behavior of oligopolists will be uninfluenced by their number and their aggregate and relative importance, there is little reason to expect that all oligopolies will have the same power and manifest it by the same performance.

Ignoring many of these complexities, economists have reasoned that certain simple oligopoly patterns are likely to result in business conduct akin to that of monopoly. In one of these patterns, a single firm, larger than its competitors but not large enough to be a monopolist, becomes a price leader, while smaller firms follow its decisions; and thereby the downward pressures on prices that might result from the interaction of individual price decisions are attenuated or destroyed. In other patterns, each of a small number of oligopolists, keenly aware of the nature and likelihood of retaliatory action by the others, refrains from action that will be disadvantageous after the others have retaliated; and thereby the results of oligopoly decisions come to resemble those that would be produced by collective agreement.²

Such analyses tend to understate two serious limitations upon the capacity of a few firms to predict action accurately and respond to it with appropriate restrictions. The first is the fact that the options open to a firm

² There are various slightly different analyses resting upon different views as to the assumptions oligopolists make about the behavior of others. For an analysis that includes an account of these, see W. FELLNER, *COMPETITION AMONG THE FEW* (1949).

are more numerous than the few simple ones recognized in theoretical models. Even in making a price change, a firm alters list prices, applicable discounts, and various terms of sale in ways so complex that an observer sometimes cannot determine whether or not the price was raised or lowered. The cases in which action can be foreseen with accuracy and in which the appropriate response would be identical action are probably not numerous. The second limitation is that technical change increasingly exposes a group of oligopolists to changing and often uncertain degrees of risk that new firms may invade their field of action. When both of these limitations are considered, the probability that oligopolistic price leadership or oligopolistic forbearance will set the dominant tone of an economy is not great.

Nevertheless, public investigations, legal proceedings, and private studies have also indicated that where most activity is carried on by a few large firms, results like those expected from monopoly sometimes appear. Prices may become unresponsive to environmental change. Declining sales may lead to restrictions of output and employment instead of price reduction.³ Price competition may be replaced by expensive competition in sales promotion.⁴ Planned obsolescence may be used to increase sales by reducing the useful life of products.⁵ Whether or not all oligopolists possess economic power that should be publicly supervised or curbed, some apparently do.

The laws that several European countries have adopted since the Second World War, unlike the earlier legislation of the United States, recognize this need. They provide for surveillance over and, where necessary, correction of the activities of dominant firms, and define dominance so that it covers oligopoly. In some instances public authority has explicitly recognized that more than one dominant firm may exist in the same industry; in other instances this view is inherent in the definition given to dominance. In some instances the law can be invoked if competition among dominant firms is absent or if parallel action is present, even though the condition does not arise from agreement.⁶ To varying degrees, these laws give govern-

³ See STAFF OF SUBCOMM. ON ANTITRUST AND MONOPOLY OF THE SENATE COMM. ON THE JUDICIARY, 88TH CONG., 1ST SESS., *ADMINISTERED PRICES: A COMPENDIUM PUBLIC POLICY* 223-24 (Comm. Print 1963); STAFF OF SUBCOMM. ON ANTITRUST AND MONOPOLY OF THE SENATE COMM. ON THE JUDICIARY, 85TH CONG., 2D SESS., *ADMINISTERED PRICES: AUTOMOBILES* 112-15 (Comm. Print 1958).

⁴ See expenditures of leading firms on advertising as reported in *ADVERTISING AGE*, Aug. 31, 1964, at 36. In particular instances such expenditures were as much as 10 percent, 12 percent, 22 percent, and 40 percent of gross revenue from sales.

⁵ In trade publications certain automobile executives have referred candidly to policies of planned obsolescence, using the phrase. A publisher once told me that the ideal binding for a textbook would be one that disintegrated at the end of nine months, but that inability to make sure that disintegration would not come earlier forced him to use somewhat stronger bindings.

⁶ Section 22 (2) of the German Act Against Restraints on Competition, for example, provides that "two or more enterprises are deemed market-dominating insofar as, in regard to a certain type of goods or commercial services, no substantial competition exists in fact between them." The Monopolies and Restrictive Practices (Inquiry and Control) Act of 1948, 11 & 12 Geo. 6, ch. 66, § 3, sched. 2, applies in the United Kingdom where

ment officials discretionary power to correct such "abuses" as exaction of excessive prices, unreasonable discrimination in prices or terms of sale, and unreasonable refusal to sell.

These provisions are recent and have been little used. Their ultimate potential has not yet become clear. But the diversity of law and practice from one country to another justifies certain comments. (a) No consensus has developed as to how dominant power shall be identified. (b) Government policy has not sought to cope comprehensively with that power, but has invoked either an undefined and flexible standard of abuse or more specific curbs focussed upon a very small number of the ways that economic power might be used by its possessor. Thus far, policies toward oligopoly and thought about it have expressed the belief that the monopoly concept is inadequate to cover market power, but have not provided an alternative concept capable of becoming the basis for an alternative public policy. Thought and action have presumed, however, that the problem can be properly analyzed within the context of the market concept.

II. THE SCOPE AND SIGNIFICANCE OF MARKETS

1. *Territorial Markets*

The concept of the territorial market is obsolescent. Improvements of methods of communication and of transport have enabled a seller established at any one point to reach a wide sales area, but at a cost that tends to rise with distance. The costs of such wide-area selling have been deemed acceptable where they enabled suppliers of goods to get, from larger mechanized operations and larger business units, economies and other advantages that exceeded the extra cost of reaching distant markets; and once large overhead costs have been incurred, firms have continued to sell in distant markets so long as, after payment of the direct costs of production and the costs of sale at a distance, the revenues derived from such sales contributed appreciably to the payment of the overhead expenses. The distance over which a firm with wide territorial markets is willing to sell tends to expand or contract as nearby sales use less or more of the firm's productive capacity. Thus the sales territory of a single firm must be conceived, not as an area with exact boundaries, but as one with indefinite and shifting ones.

Meanwhile, for most types of production, the location of productive establishments has become increasingly diffused. Producers in different localities have competed with their nearer rivals in overlapping sales territories, shipping from a distance even to customers adjacent to rival suppliers, but have been prevented by difficulties of transportation and communication from invading similarly the sales territories of more distant

at least one-third of the supply of a particular kind of goods is supplied by two or more persons "who, whether voluntarily or not, and whether by agreement or arrangement or not, so conduct their respective affairs as in any way to prevent or restrict competition" in supplying such goods.

producers. Consequently, the typical pattern of territorial rivalry has become one in which the firms in a group of competing sellers change identity by increments with change in the location of sale. At a place near *M*'s plant, *M* may encounter *J*, *K*, *L*, *N*, *O*, and *P* as rivals. At places successively more distant to the east, *J*, *K*, and *L* may drop out in sequence, but *Q*, *R*, and *S* may appear as additional sellers. Similarly, at places successively more distant to the west, *P*, *O*, and *N* drop out, and *I*, *H*, and *G* may appear.

In this kind of situation, there is no clearly defined territorial market. To conceive any designated segment of the territory as the market is to exclude arbitrarily some sellers who compete with some of those included. To conceive the entire sales territory as the market is to include sellers who do not compete with each other. To conceive each locality as a market escapes these difficulties, but places each supplier in markets as numerous as the areas in which he encounters some difference in the group of his competitors; and it conceives him as operating in each such area under the influence of local market conditions, without effort to establish, for the firm as a whole, coherence as to prices, sales policies, productive activities, and interfirm rivalries.

For such a situation, the sharp territorial segregations involved in the market concept are not appropriate. The interaction of suppliers fills the sales territory, not in well-defined and segregated markets, each like a fenced field, but in the way a fog fills a landscape — as a continuum, of varying density, here thicker, there thinner, without clear boundaries.

In what has been said, there is no intention to deny that in selling some commodities and services some suppliers, *e.g.*, barbers in a small town, interact with one another as a coherent group within a definable territory, so that the market concept can be usefully applied to their activity. Neither is there any intention to deny that territorial continua are sometimes broken by natural obstacles, such as lakes or mountain ranges. The argument is that sharply defined territorial markets are no longer typical and that they are diminishing in frequency and importance.

2. *Commodity Markets*

In important parts of the economy, the concept of the product market is also obsolescent. This is true to a smaller extent than in the case of territorial markets; for whereas the difficulties created by distance affect almost all business, the difficulties created by the interaction of products depend upon technological relationships that, though pervasive, are not universal. For products that have clear identities and important peculiarities in use and that are not part of a joint productive process, the idea of the product market remains useful. But though there are still many such products, commodities that do not have these characteristics constitute a large and growing portion of all goods. Products once made from traditional materials by traditional methods now compete against substitutes made from

different materials by different methods. The range of substitution and the adequacy of the substitutes has been greatly enhanced by the development of synthetic substances and by the development of new technologies applicable to natural substances. Analytical designers have made productive equipment more adaptable and flexible and have developed numerous modifications of the character and performance of end-products. Through such developments a particular end-product may result from a variety of raw materials and productive processes, and what was once a single end-product may be available as a considerable number of products that, to varying degrees, differ from one another in characteristics and in performance.

Where such changes have been carried furthest, a given type of consumer demand may be served by a spectrum of commodities, and the suppliers of many of these commodities may be able to substitute several materials, methods of production, and end-products for one another in the productive process.

Difficulties in applying the market concept to such products are created both by substitution in use and by substitution in the productive process.

Substitution in use creates the possibility that more than one product should be regarded as part of the same market. Where there is competition of substitutes, not all substitutes are equally satisfactory to all who buy for that use. Recognizing that for this reason the boundaries of a commodity market have a fog-like indefiniteness, economists concerned with this matter have conceived the problem of defining a market's boundary as merely one of selecting a cut-off point for a series of progressively less satisfactory substitutions. They have considered that the acceptability of substitutes can be measured by cross-elasticity of demand — that is, by the impact of a change in the price of the substitute upon the sales of the commodity for which it is substitutable. In the light of such relationships, they would define a commodity market as including such substitutes as have a substantial impact, and would admit that reasonable differences of view about what is substantial can leave the boundary inexact.

Though the uncertainty that depends upon the opinions of buyers about the adequacy of substitutes may make market boundaries seem distressingly vague if substitutes are numerous, if their number and nature change frequently, and if consumer attitudes also change often, this is the least of the difficulties involved in substitution. A greater difficulty arises where there is a chain of substitutes for different uses. A synthetic material may be a substitute for wood in one use, for steel in another, for glass in a third, and for another synthetic in a fourth. If, in turn, any of these other materials have multiple substitutes, relationships may exist akin to those described above for territorial competition. The group of competing producers may change in sale for different uses, with particular groups of firms dropping out and other particular groups coming in for each type of use,

and with the body of competitors that interact possessing no single identity.

A still greater difficulty arises when substitution in the productive process is also significant. In such cases, alternative possibilities of substitution, respectively appropriate for the buyers' side of transactions and the sellers' side, are likely to justify widely different conceptions of the field of substitution. To buyers, substitutes are commodities that serve similar uses, whether or not they are made by the same sellers with similar methods from similar materials. To sellers, substitutes in the productive process are the different commodities that sellers can produce with the same productive facilities. A water company buying pressure pipe may regard steel pipe, reinforced concrete pipe, and asbestos pipe as substitutes because they can be used for the same purpose. A steel pipe maker may regard steel water pipe as a substitute for other steel tubular products that can be made from similar steel plate with the same equipment. Just as cross-elasticity of demand might be used to define the market as measured by substitution in use, so cross-elasticity of supply — the effect of a change in the price of one tubular product upon the supply of another — might be used to define the market as measured by substitution in the productive process. Both conceptions of the market would include steel water pipe, but otherwise they would bear no resemblance to each other.

The decisions of a steel water pipe producer cannot be adequately explained with either of the alternative concepts of the market set forth above. Such a producer is affected both by the opportunities that it finds for sale of water pipe in the light of competition from non-steel water pipe and by the opportunities that it finds for other tubular products in the light of competition from producers of those products.

The range of prices at which it is willing to sell water pipe and the amount of water pipe that it is willing to sell depend in part upon the prices and potential sales of the other products it can make. The cost of expansion of facilities for water pipe may be that of new plant capacity if the facilities for other tubular products are fully used, but only that of converting existing capacity if these facilities are partly redundant. To treat the opportunities and competitive checks encountered in water pipe as a complete basis for explaining the producer's behavior in the water pipe market is inadequate.

Similarly, reinforced concrete water pipe could be appropriately conceived as one of a supplier's related concrete products, and asbestos water pipe as one of a supplier's related asbestos products. Presumably the decisions of these producers in the water pipe market are similarly affected by their opportunities in their other product markets.

Relationships of the same general kind probably connect producers of tubular steel products with producers of steel sheet and steel plate, these producers with producers of various other metals, plastics, and ceramics, and so on. Interlinkages of partially non-identical competing groups probably

cover a considerable proportion of all commodities, though at particular terminal points the continuum of relationships is interrupted.

To isolate from such territorial and product continua some particular segment that can be regarded as a self-contained field of competitive interaction has become increasingly difficult. The difficulty has been evident in recent efforts to use market concepts in determining where business power has become or is becoming unduly concentrated. Under the American law that forbids monopolization, one matter relevant to the question whether a firm possesses monopoly power is its percentage of the allegedly monopolized market. In certain recent cases widely different conceptions of market share have been appropriate to alternative definitions of the relevant market.⁷ The problems of definition have been most numerous and difficult, however, in merger cases. Section 7 of the Clayton Act, as amended, forbids corporations to acquire the stock or assets of other corporations where the probable effect of the acquisition would be substantial lessening of competition or a tendency toward monopoly in any line of interstate commerce. In cases involving this provision, evidence that by an acquisition a business enterprise attained a large share of a market, or enlarged a large share already held, has been regarded by the American courts as adequate to show the probability of an anticompetitive effect. Definition of the relevant market and measure of the acquiring firm's market share have thus become important parts of contested proceedings. If markets are defined too narrowly, competitors may be considered to belong to different markets. If markets are defined too broadly, a significant reduction of competition may appear unimportant.

But definition of the market has proved an inherently baffling matter. Confronted with continua such as have been summarized above, the anti-trust agencies and the defendants have usually proposed market concepts that differed widely; and the courts have been thus far unable to develop consistent standards by which relevant markets are determined. Efforts to define product markets have resulted, in particular cases, in emphasis upon (a) distinct characteristics in the group of buyers served or in the uses to which a product can be put, (b) behavior by which firms recognize one another as competitors, (c) similarity in prices or in price changes, (d) effects of a price change upon sales of other products, (e) distinct characteristics in productive facilities, and (f) public recognition that particular firms constitute a significant group.⁸ In one or two cases decisions have recognized that a firm's power in selling a particular product may be significantly

⁷ See, e.g., *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (the cellophane case); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

⁸ The various concepts that the Supreme Court regards as relevant to the definition of the market were summarized in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). A good analysis of the use of relevant concepts in various cases appears in B. Bock, *MERGERS AND MARKETS, A GUIDE TO ECONOMIC ANALYSIS OF CASE LAW* 85-133 (3d ed., National Industrial Conference Board Studies in Business Economics No. 85, 1964).

affected by its position as an important seller of other products in other markets.⁹

Efforts to define territorial markets began with emphasis upon the area in which the sales of rival firms overlap.¹⁰ But overlaps that differ in scope for transactions of different magnitude have been disregarded in search for a simple definition.¹¹ Moreover, some recent decisions have recognized that a firm's competitive strategy in such areas of overlap may be affected by the behavior of its competitors in other areas and by its own resources derived from other areas.¹²

A growing emphasis upon the significance of potential competition is a further indication of the inadequacy of concepts of the relevant market. Of course, economic theorists have long recognized that competition within a market is affected by the size of obstacles to entry; but they have conceived entry merely as a means by which, if prices and profits within a market should become too high, firms that previously had no place or effect in the market might enter it and enhance competition within it. In certain acquisition cases the courts have found that firms not in a market affect behavior there, without entering, merely by the fact that they might enter; and have concluded that market competition is reduced when the possibility that such a firm might enter is diminished.¹³ These decisions imply a conception of the market that includes not only the firms within it but also those that reasonably might enter it. Under this concept a market has a wide but not readily definable extension; for many technologies have expanding and potentially overlapping fields of application, technical skills and rights to patents can be acquired, managerial skills are transferrable, productive facilities can be constructed, and capital can be diverted or raised for promising ventures. Large firms, well-financed and well-managed, can expand in almost any direction they think profitable; and in recent years some of them have expanded into numerous fields for which they possessed neither previous experience nor appropriate productive facilities.

Since such firms can and do often expand in several different directions, enlargement of the market concept to include potential competition gives the enlarged market an increased amount of overlap with other markets. To give importance to potential competition is to strengthen the case for the view that competitive interaction is a continuum that cannot be adequately conceived within the context of a particular market.

⁹ See *United States v. Procter & Gamble Co.*, 386 U.S. 568 (1967); *FTC v. Consolidated Foods Corp.*, 380 U.S. 592 (1965).

¹⁰ In *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962) and in *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963), the Supreme Court emphasized that the relevant geographic market is not where the merging firms do business, but the area in which their competition might be impaired.

¹¹ See *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

¹² See *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966); *In re National Tea Co.*, [1965-1967 Transfer Binder] TRADE REG. REP. ¶ 17,463 (1966).

¹³ See *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

The diminishing significance of the market concept reduces the adequacy of monopoly of a market as a concept of business power. The curbs upon power transcend the market. So do the characteristics of the firm from which power can be derived.

III. DIVERSIFICATION AS THE CHARACTERISTIC PATTERN OF BIGNESS

The concept of the firm as an enterprise that produces a product for a market and makes its decisions upon the basis of conditions in that market is already obsolete for many large firms and is obsolescent for more. Instead of confining itself to a single market, the modern large business enterprise is typically diversified. The essential characteristic of diversification is that, instead of being exposed to one coherent body of forces that express the interaction of a group of firms that supply the product bought, the diversified firm encounters, in different parts of its business activities, different buying groups, different characteristics in their demand, and competitors that differ in number, size, and significance. Its responses to these varying conditions can be appropriately varied. It can take advantage, at any one point, of opportunities that are derived from its activities elsewhere. In other words, the diversified firm is not subject to the discipline of a single market, and can develop company-wide strategies suited to the interrelations among the problems and opportunities presented by its various activities.

Since the significant aspect of diversification is the multiplicity of the firm's fields of action, the effects of diversification can arise, not only when the firm supplies different products, but when it supplies a single product under different conditions of demand and supply. Thus conceived, a firm's diversification has three aspects.

First, the same product is sold to segregated groups of buyers. In some cases the segregation is the effect of distance. Thus a large producer of concrete pipe, who cannot afford to ship it more than about 300 miles, produces in dispersed plants, each of which supplies the surrounding area under conditions of supply and demand that are peculiar to that area. In other cases the segregation is due to difference in the nature of the buyers. Thus a large producer of salt sells his product in bulk to industrial users and in branded packages to the grocery trade. Whatever the source of the segregation, the opportunities of the seller and the competitive checks upon him are likely to differ from one segregated group to another, and to give opportunity for appropriate differences in his business decisions.

Second, the large firm is usually vertically integrated — that is, it performs a series of operations at successive stages of the production and distribution of end-products. It may sell part of what it produces at one or more stages prior to full fabrication. Thus, a rubber manufacturer may produce and sell rubber but also convert that rubber into tires and sell the tires.

Vertical integration often results in a third type of diversification, variety in the end-products sold. Sometimes the vertically related activities take a divergent pattern — that is, a firm such as a lumber mill or a steel producer may make and sell different products that come jointly from common raw materials or productive operations. Sometimes vertical integration is convergent — that is, a firm that serves a body of closely related consumer needs through a particular kind of distributive channel (*e.g.*, a business machine company) chooses to make different kinds of products (*e.g.*, business office equipment) which, though not made jointly, can be sold to the same buyers. The one type of integration results in an enterprise that sells a line of products bought under different conditions of demand. The other type results in an enterprise that sells a line of products produced under different conditions of supply. A firm integrated in either way may encounter different degrees of competition and different kinds of substitute products in selling different parts of its line.

A large firm may also sell products that are not related to one another in either of the foregoing ways. They may be neither jointly produced or complementary nor substitutory in use, but dissimilar in kind, method of production, type of buyer, and end use. Unlike diversified products of the first two types, such a line of products is the result of no common element of production or marketing, and hence is unlikely to be the source of economies in either. The products are merely supplied by the same financial entity and subject to coordinated managerial control.

But whatever the composition of the diversified line of products, the different products in it are likely to differ significantly in physical characteristics, quantities sold, costs of production, competition encountered, the frequency and size of sales transactions, the elasticity of demand, and the degree to which demand can be changed by sales effort.

In the first and most detailed study of diversification available for the United States, the Federal Trade Commission reported in 1957 that in 1950, of the thousand largest manufacturing companies which made about 55 percent of the shipments of all manufacturing companies, only 132 companies were limited to a single establishment, only 243 to as few as three product classes, only 118 to a single industry, only 164 to a single closely related subgroup of industries, and only 334 to a single industry group more broadly defined.¹⁴ Seventeen firms operated more than 75 establish-

¹⁴ FTC, REPORT ON INDUSTRIAL CONCENTRATION AND PRODUCT DIVERSIFICATION IN THE 1000 LARGEST MANUFACTURING COMPANIES: 1950 (1957). Breadth of activity is measured by the Standard Industrial Classification, under which products more or less closely related are grouped together under a five-digit number and called a product group, related product groups are assigned a four-digit number and called an industry, related industries are assigned a three-digit number and called an industry subgroup, and related subgroups are assigned a two-digit number and called an industry group. An example of a five-digit class of steel products is "hot rolled sheets and strip, including tin mill products." An example of a four-digit industry is "blast furnaces and steel mills." An example of a three-digit industry subgroup is "iron and steel foundries." An example of a two-digit industry group is "primary metal industries."

ments; 8 firms shipped products classified in more than 50 product groups; 70 firms shipped products classified in more than 15 industries; 79 firms shipped products classified in more than 10 industry subgroups; and 82 firms shipped products classified in more than 10 industry groups. The degree of diversification increased with the size of the firm.¹⁵ Less markedly, the proportion of the firm's total shipments that consisted of its most important products decreased with size.¹⁶

The multiplicity of products supplied by the largest thousand firms appears to be increasing. According to an official of the Federal Trade Commission, the number of product groups into which the products of the group of companies fell changed as follows from 1950 to 1962:¹⁷

No. of 5-digit Product Groups Shipped by the Company	No. of Companies with Such Diversification in 1962	No. of Companies with Such Diversification in 1950
over 50	15	8
16—50	236	128
6—15	477	432
2— 5	233	354
1	49	78

Recent information derived from the company statistics of the census provides much less detail, but appears to indicate that diversification by large firms has become typical. According to the 1958 census of business, 91,000 companies that operated more than one establishment had a predominant place in sales and employment. They included about 41,000 companies engaged in more than industry and an additional 50,000 companies operating more than one establishment in a single industry. As a whole, they employed nearly 54 percent of all company employees and made nearly 51 percent of all sales (excluding intracompany sales). The

¹⁵ Of the 8 firms that made shipments in more than 50 product classes, 7 were among the largest 15 firms as ranked by total shipments, and the other was among the top 50 firms. Of the 73 firms with shipments in from 21 to 50 product classes, 41 were among the hundred largest firms, 28 more among the 500 largest, and only 4 among the 500 smallest.

¹⁶ Among the largest 50 companies, shipments in the most important industry constituted less than 60 percent of the value of total shipments for 32 companies, and less than 50 percent for 22. For only 4 of them did such shipments constitute more than 90 percent. Among the smallest 50, the most important industry supplied more than 90 percent of the total value of shipments for 23 companies, less than 60 percent for only 11, and less than 50 percent for only 4. For 50 companies ranked at the middle of the thousand the most important industry showed intermediate results — over 90 percent of the value of shipments for 9 companies, less than 60 percent for 21 companies, less than 50 percent for 11.

¹⁷ *Hearings on Economic Concentration Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 88th Cong., 2d Sess., pt. 1, at 157 (1964) (testimony of Harrison F. Houghton) [hereinafter cited as *Concentration Hearings*]. The thousand for 1962 were chosen on the basis of information in the *1962 Plant and Product Directory* issued by *Fortune* magazine. The group was not identical with the Commission's list of one thousand for 1950.

multi-industry companies accounted for most of these percentages — slightly more than 44 percent of all company employment and nearly 42 percent of all company sales.

In manufacturing the importance of diversification was even greater: multi-unit manufacturing companies accounted for more than 67 percent of all manufacturing employment and more than 73 percent of manufacturing sales; and the corresponding percentages for multi-industry companies were 59 percent and 66 percent respectively.¹⁸ All but 14 of the 428 manufacturing industries contained multi-industry companies. In 84 of these industries, the manufacturing employees of the multi-industry companies who worked in establishments classified in other industries constituted more than 50 percent of the total manufacturing employees of these companies; in 275 industries (including the 84 just mentioned) they constituted more than 25 percent. To minimize the problems of classifying companies, 135 broader categories of industry were used in reporting company statistics; but in 71 of these broader categories more than one-fourth of the total manufacturing employment of the multi-industry companies in the category was still in establishments classified in other categories.¹⁹

Since the Second World War, mergers involving large firms have contributed significantly to the size and diversification of such firms. In mining and manufacturing, a total of 720 firms with assets over \$10 million, aggregating over \$23 thousand million, disappeared by merger between 1948 and 1964.²⁰ In only 138 of these 720 cases was the merger merely horizontal and in only 108 cases merely vertical. In 356 cases it involved diversification of products, in 48 cases extension of territorial markets for existing products, and in 70 more cases "other" types of diversification.²¹ Nearly 58 percent of the acquisitions were made by firms with assets of \$100 million or over.²²

¹⁸ BUREAU OF THE CENSUS, ENTERPRISE STATISTICS: 1958, GENERAL REPORT pt. 1, at 22-23, 105-06. The census figures cover mineral industries, manufacturing, wholesale and retail trade, public warehousing, and selected services, estimated to include 53 percent of national income. In the subsequent report for 1963 which became available since this article first appeared, the share of the multi-unit and multi-industry firms increased. The multi-industry firms increased. The figures were: for employment, all multi-unit companies nearly 56 percent, multi-industry companies more than 46 percent; for sales, all multi-unit companies nearly 54 percent, multi-industry companies about 43.5 percent. In manufacturing, multi-unit companies had about 70 percent employment, over 76 percent of sales; multi-industry companies over 62 percent of employment, over 69 percent of sales. See BUREAU OF THE CENSUS, ENTERPRISE STATISTICS: 1963 GENERAL REPORT pt. 1, at 91-92 (1968).

¹⁹ *Id.* at 3-4. The 135 categories covered not only manufacturing (for which there were 91) but also mineral industries, wholesale and retail trade, and public warehousing. An example of a broader category is that for rubber products, which includes tires and inner tubes, rubber footwear, reclaimed rubber, and other fabricated rubber products.

²⁰ *Concentration Hearings*, pt. 2, at 509 (testimony of Willard Mueller, Director of the Bureau of Economics of the Federal Trade Commission). As used here, the term merger includes both amalgamations in which firms lose their separate identity and acquisitions in which one firm acquires control over another or over some substantial part of the capital assets of another.

²¹ *Id.* at 516.

²² *Id.* at 518.

In manufacturing, for which the best figures are available, the 200 largest firms made 387 acquisitions, with a total asset value of nearly \$15 thousand million.²³ The number of manufacturing firms with assets between \$10 million and \$250 million that existed in 1964 was only about three times the number of such firms that had been absorbed, and possessed less than 4½ times the amount of the assets of those absorbed firms.²⁴

Figures like those set forth above indicate the prevalence and importance of diversification, but since considerable diversification can take place even within one industry or product group, they convey an inadequate impression of the variety of new goods supplied by many of the large companies. For example, of the total sales of Olin-Mathieson, which is classified as a chemical company, about 24 percent were chemicals in 1963, about 19 percent metals, nearly 19 percent pharmaceuticals and drugs, 18 percent packaging materials, and 13 percent arms and ammunition. The company's products are estimated at 4500, and include fertilizer, propellants, tools, paper, lumber, natural gas, cosmetics, electric toothbrushes, and filter tips for cigarettes.²⁵

IV. THE RELATION OF DIVERSIFICATION TO POWER

As diversified firms become more prevalent, patterns of business interaction and types of business power are appearing which are new to economic analysis and to government policy.

When a firm produces many products, some of these are likely to contribute large parts of its total sales and profits; others that currently contribute little are likely to be considered probable large contributors in the future; and still others are likely to have little importance in the present aggregate and little promise of greater importance. Decisions about particular products in the line are likely to reflect, not only conditions of demand and supply peculiar to the product, but also the place of the product in the firm's overall effort to attain satisfactory aggregate results. Unlike specialized firms, the diversified firm need not confine its decisions as to one product within limits set by the risks it attributes to expenditures upon that product and by the income it derives from that product. Risks and revenues can be pooled, and action as to any part of the product line can be taken so far as seems desirable, in the light of the risks and resources of the enterprise as a whole.

Similarly, when a firm producing many products encounters competition upon one of them, the significance of that competition to the firm differs from that of competition encountered by a specialized firm. The specialist competes with a particular group of firms in one arena; the diversified firm competes with different groups in numerous arenas, in most of which only a small part of its total revenue is at stake. The conditions of the diversified

²³ *Id.*

²⁴ *Id.* at 512.

²⁵ *Concentration Hearings*, pt. 1, at 168-73; *TIME*, Feb. 10, 1967, at 90.

firm's competition differ widely from product to product. For some products, the competitors are specialists, against whom the diversified firm can use resources derived from other parts of its business without fear of similar retaliation. Some competitors, though also diversified, are encountered only upon a small overlapping part of product lines that are generally different, so that they too have the ability to intensify the competition by using resources from other fields. Some diversified competitors that sell similar lines of products are encountered again and again, and strategy toward them at any one point may be part of a program appropriate to the whole group of encounters. Any of these types of encounter may have consequences that differ with the importance that the firms involved attribute to the products involved — one result if the product is important to each competitor, another if it is important to only one, and still another if it is important to none.

Many patterns of business decision and competitive interaction apparently develop from different types of competition as to products of different degrees of importance and from different conceptions of the overall goals and strategies of diversified firms. Unfortunately for the clarity of analysis, the more common patterns appear to be also the more complex ones, in which a diversified firm, in selling different parts of its product line, encounters specialists and other diversified firms simultaneously, and in which its diversified competitors at any one point differ from one another in the frequency of the competitive overlap, the magnitude of their outside resources, and the importance attributed by them to the products upon which they compete.

This essay will not attempt either to analyze these complex patterns nor to list and analyze all the simpler ones. To do so is a task for a generation of observers and analysts. What will be attempted here is (a) to discuss the nature of the power of a powerful diversified firm as it may appear in competition by that firm against a specialized firm selling a product the diversified firm considers important, and (b) to discuss the curbs upon the power of the diversified firm as they are likely to appear when such a firm competes with one or more others of comparable size and similar diversification.

For convenience, the discussion will be concerned with the relationships involved in product diversification. Similar relationships exist, of course, among firms some of which are local and others territorially diversified.

1. *Competition with a Specialist in Sale of an Important Product*

To become big by diversification is easier than to do so without it. A firm that becomes bigger by producing more of a single product finds its size limited by the total demand for that product; and in the United States it is likely to be curbed by the Government's policy against monopolies while still considerably smaller than the possible maximum.²⁶ Moreover, the field

²⁶ Though American law does not condemn monopoly "thrust upon" a business

of sale for a single product can be dominated only by defeating rivals who resist vigorously. To do so by merging with them is no longer possible because of the anti-merger law.²⁷ A firm that diversifies is free from limits set by the demand for particular products, runs no risk from the monopoly law if it diversifies further, and may diversify by merger with much less risk than attaches to other types of merger. The diversity of its sources of income reduces its business risks and facilitates its access to funds for expansion. Its ability to funnel its liquid resources into the parts of the business where possibilities for growth are greatest gives it special opportunities to grow rapidly.

For these reasons, diversified firms are likely to be bigger and to grow faster than their specialized rivals. The following discussion of a diversified firm's competition with a specialist will assume that the specialist, though possibly a larger producer of the product the firms have in common, is a smaller firm.

Within limits set by the antitrust laws, the fluidity of resources and diffusion of risk that characterize the diversified firm give it advantages over the specialist in the specialist's field of operation. If expansion is desirable, the diversified firm can divert income from other lines of business, whereas the specialist cannot, and probably can borrow money on the basis of its multiple operations and its large size more readily than the specialist, who must ask creditors to put their eggs in its one basket. If expansion is risky, the diversified firm can accept a degree of risk for one part of its activities that is greater than the specialist dare accept for its entire activity. If the venture loses money, the diversified firm can absorb the loss and continue if the long-run prospects justify doing so. The specialist, however, is likely to run short of funds and risk bankruptcy. Hence the diversified firm can outspend, outdare, and outlose its rival.

Because of the multiplicity of the diversified firm's sources of income, such a firm need not base its policy toward any one product upon the profit that can be obtained from that product alone. If, for any reason, sale of the product at an unusually low profit, or at or below cost, appears to be desirable, the operation can be subsidized from other parts of the business. For various reasons, such a policy is often desirable.

(a) In developing new products and in breaking into fields thus far served

enterprise, this immunity applies only to firms that have done nothing to attain or maintain the monopoly; and such otherwise innocent activities as persistent expansion to absorb new demand and offer of the product for lease rather than sale have been held sufficient to prevent such immunity from being successfully claimed. See *United States v. United Shoe Mach. Co.*, 110 F. Supp. 295, *aff'd per curiam*, 347 U.S. 521 (1954); *United States v. Aluminum Co. of America*, 377 U.S. 271 (1964).

²⁷ Section 7 of the Clayton Act, 15 U.S.C. § 18 (1964), formerly ch. 25, § 7, 38 Stat. 631 (1914), empowers antitrust agencies to dissolve mergers where there is reasonable probability that they will substantially lessen competition. For practical purposes, this means that no large firm can acquire a substantial competitor and that it encounters considerable risk if it acquires a small one. See *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

by others, a firm often encounters unusual expenses that for a time exceed the resulting revenue. High sales expenses or low introductory prices may be effective ways of overcoming the initial obstacles.

(b) To supply some products free or at low prices is sometimes an effective way of enhancing the revenue from other products. This is true, not only in the case of products sold as "leaders" and products given away as "premiums" but also in many other cases — for example, so called "convenience goods" sold because buyers expect to find them in the seller's line of products, and repair parts for discontinued models of equipment, which are produced expensively and sold cheaply lest sales of current models be adversely effected. Products are often sold under conditions of joint revenue as well as joint cost, and sellers consider the effect of one product on sales of another where such effects are known.

(c) Within limits set by the antitrust laws²⁸ a competitor can be harassed by a subsidized low price or by subsidized intensive sales effort. Such harassment may limit his growth or make his policies less independent. Equivalent opportunities to subsidize new operations, to exploit the possibilities of joint revenue, and to subsidize harassment are not available to the specialist.

Deliberate subsidization is supplemented by unplanned and often unconscious subsidization. A firm supplying a long line of products cannot expect to make the same rate of profit upon all items in the line. Where it encounters little competition, it can seek high profits, setting its prices as high as its estimate of demand makes desirable. Where competition is stronger, it can and often does reconcile itself to lower prices and to profits too low to be acceptable as an average return for the enterprise as a whole. In other words, it subsidizes the continuance of its more competitive operations from the proceeds of its less competitive ones. Where such conditions change frequently, the firm is likely to see them as differences in profit rates forced upon it by its efforts to meet competition. Where the varying pressures of competition are relatively stable, however, the firm is likely to allocate disproportionate shares of its overhead expenses to the more profitable parts of the business, thus making these parts seem less profitable and obscuring the differences in profitability. Such allocations are relatively easy, and may be made with no intention to misrepresent or conceal; for most overhead costs are joint costs,²⁹ even so-called "direct costs" are not

²⁸ The relevant laws are those forbidding attempts to monopolize, price discrimination, and unfair methods of competition. Harassment indicating a purpose to monopolize or coerce is unlawful. Under the law of price discrimination, a special price in a particular territory is likely to be vulnerable to legal proceedings, whereas a special price upon a particular product is not. The extent of vulnerability under the law of unfair competition is not clear. In practice, subsidization of sales effort is much less risky than subsidization of price cutting, and small but sustained pressures are less risky than dramatic ones.

²⁹ Equipment costs and administrative overheads are joint among all products using the equipment or subjected to the administration. Their allocation over time is clearly

truly ascertainable,³⁰ attribution of costs to particular products is so arbitrary that often it is not even undertaken,³¹ and to consider that costs are incurred where they can be most readily recovered is easy and attractive. The result, however, is that costs by commodities either remain unknown or are computed by arbitrary methods of allocation, and that consequently an unascertainable amount of unconscious subsidy is likely to support the continuance of relatively unprofitable activities. In the words of the president of Standard Oil Company of New Jersey, "Only by making some arbitrary split in the finding and producing cost can we arrive at an arbitrary allocation of profits on oil and gas."³²

The specialist, who cannot shift costs from his product to others, is adversely affected when his diversified competitor subsidizes the competition, whether or not the subsidy is conscious and deliberate.

A diversified firm is also likely to derive advantage over a specialist from particular kinds of advantages of scale. What the specialist can afford to spend in research, management, equipment, selling expense, and legal and political activities is limited by his size in his particular field. Various large expenditures, though desirable, are likely to cost too much per unit of product to make them practicable. So far as the diversified firm, in all its multiple activities, is larger than the specialist, the corresponding limits of the diversified firm's comparable expenditure are likely to be wider. When such expenditures can contribute jointly to the success of more than one of the firm's activities, they can be undertaken if their aggregate effect justifies them, even though the effect in the field shared with the specialist does not. Consequently, a large diversified firm, able to afford more research and pay

arbitrary. Their allocation among products may differ widely, not only if it is deliberately proportioned to relative income received, but also if it is "uniformly" apportioned; for the results can differ greatly between apportionment proportioned to direct cost, labor cost, material cost, machine hours, or labor hours. See J. DEAN, *MANAGERIAL ECONOMICS* 315-17 (1964 ed.).

³⁰ Direct labor expenses per unit vary with output; as costs they are often computed, not at the actual expense rate, but at a standard rate that is supposed to reflect normal or average conditions. Direct material cost is affected not only by similar problems of change with rate of output, but also by decisions about the way changes in material prices shall be reflected in costs. One method is to compute the cost as though the materials used were those that have been longest in inventory; another, to compute it as though the materials used were those most recently placed in inventory; a third, to compute it at some average or normal cost of materials, without regard to fluctuations in prices actually paid. For examples of the uncertainties involved in ascertaining costs of products and cost differences in different types of transactions, see H. TAGGART, *COST JUSTIFICATION* (1959) (especially the chapter on Standard Brands, at 39-80).

³¹ In 1946 the comptroller of the Office of Price Administration reported that only about 15 percent of all industrial companies, with probably not more than 25 percent of total production, were readily able to provide figures of cost by products. The other 75 percent of industrial production came from firms that did not purport to compute the cost of individual products. See ACCOUNTING DEPARTMENT, OFFICE OF PRICE ADMINISTRATION, *A REPORT ON COST ACCOUNTING IN INDUSTRY* iii-iv (1946).

³² STANDARD OIL COMPANY OF NEW JERSEY, *REPORT OF 79TH ANNUAL MEETING* 19 (1961).

more for the less specialized parts of research by others, is likely to have a better chance for sustained technological leadership. Able to pay more for top management, it is likely to be well-managed; though, so far as its managerial problems are more complex than those of the specialist, one cannot be sure whether or not the differential in managerial ability will give it any net advantage. Able to pay more for expensive equipment, it is likely to be better equipped than the specialist with facilities for power production, quality control, and other aspects of operation which are not narrowly designed to produce special products. Able to spend more upon sales effort, it is likely to excel the specialist in advertising in the many ways that are not narrowly designed to sell single products and in wooing the various kinds of distributors that are not narrowly specialized; and thereby it is likely to obtain reputation and prestige that make its selling efforts more effective than those of the specialist when they are designed to sell a single product. Able to spend more upon legal activities, it can assert legal rights more ambitiously and defend them more tenaciously. Able to spend more upon contacts with government, it is more likely than the specialist to have a wide network of friendly association with government officials, to be informed promptly about government activities, and to be able to influence government decisions; but a part of this advantage may be offset by its need to be concerned about segments of governmental action wider than are important to the specialist. Able to spend more upon politics, it is more likely than the specialist to be able to influence the formulation of political issues, the selection of candidates for public office, and the extent and direction of governmental intervention in business affairs. In governmental contacts and political activities, large diversified firms and a few of the larger specialists can undertake singly types of activity that smaller firms can undertake only through associations.

The scale advantages that have just been summarized include some that improve the relation between production and cost for society as well as for the firm, and some that merely serve the firm, with offsetting disservice to others. In economic language, they include both economies of scale and attainment of bargaining advantages. Since the purpose of this essay is to describe the changing nature of business power rather than to appraise the changes, no effort will be made to disentangle economies from advantages where the distinction is not self-evident.

So far as the diversified firm, in its aggregate activities, is larger than the specialist, it can also undertake more readily such vertical integration as may be thought desirable. Since raw materials often have multiple uses, its need for them will often be sufficient to justify self-supply where, in producing a particular product, neither its own need nor that of the specialist would justify such action. For such raw materials as are exhaustible, it can assure itself of supply by acquiring their sources, thus leaving to the specialist the disadvantage of possible later shortages. Where shortages are

already imminent, it may be able, by acquisitions somewhat more ambitious than its own needs might suggest, to confront specialists who need the material with the alternative of purchase from it or purchase under conditions of severe scarcity.

Similarly, since a considerable variety of diversified products often move through the same channel of distribution, a firm that produces all or most of them may be able to establish its own distributive outlets when a specialist cannot. It may thus attain better control over the marketing of its products, and greater assurance that when goods are plentiful its own products will be vigorously marketed.

The capacity to integrate vertically is a source of possible advantage even when vertical integration is not undertaken. A firm that might supply itself is in a position to demand from its supplier service good enough to make self-supply unattractive. So far as the price discrimination law permits, it may buy at exceptionally low prices.³³ It may obtain quick delivery, prompt adjustment of claims for defective goods, first right to buy when goods are scarce, and various other preferences that the law is unable to prevent. Similarly, a firm that might distribute its own goods is in a strong position to obtain cooperation by its distributors. If they want any of its products, they have incentives to carry as much of its full line as may be appropriate for their kind of distributive outlet and to give the line preferential sales promotion. Though the law forbids particular ways in which a powerful seller may crack the whip over his distributors—tying arrangements, exclusive dealing arrangements, and full line forcing—so far as these probably will reduce competition, the relationships that are forbidden are those that rest on coercion, contract, or discriminatory inducement. The seller remains free to set up his own distributive outlets and the distributor free to prevent this by voluntarily carrying the full line and perhaps doing so exclusively.³⁴

A diversified firm that uses reciprocity as an aid in selling can do so more effectively than its specialized rival. Reciprocity is a relationship in which a firm buys from a customer because the customer buys from it. Casual and informal reciprocity exists, of course, even between small and specialized firms, but on a scale that is without importance. As applied by a large diversified firm, a policy of reciprocity involves record-keeping by which purchases in all of the firm's diverse activities are added into totals from each source of supply; use of the larger totals by a high-level executive

³³ Though price discrimination that is likely to damage disfavored buyers is forbidden by law, the prohibition can be avoided in various ways, of which the most obvious are purchase of goods that are significantly differentiated or purchase of the entire output of a supplier.

³⁴ Even the scope of the legal prohibitions is uncertain and seems to be becoming more so. Franchise agreements between producers and distributors are not considered inherently unlawful and the limits of their legality are uncertain. *See* 11 ANTITRUST BULL. 417-613 (1966).

(usually called a trade relations director) in negotiations with counterpart executives in the supplying companies as to the total amount of the firm's products that these companies will reciprocally buy; and use of the smaller totals by the firm's salesmen to increase the persuasiveness of their approach to prospective customers who are also suppliers. Since the effectiveness of a request for reciprocity increases with the amount bought from the supplier to whom the request is made, a firm's ability to use such requests increases with its size, and diversified firms can use it better than specialists so far as they are bigger. But they have a further advantage, even against a specialist equally big; for the diversified purchases of a diversified firm increase the chance that the firm's total purchases from a particular source of supply will be large. Moreover, reciprocity can be employed only if the supplier has use for what the customer sells, and whereas the specialist's single product has a limited range of uses, the large diversified firm (unless it produces only consumer goods) not only buys large amounts from a considerable number of suppliers, diversified and specialized alike, but also offers a range of products some part of which is likely to be useful to most of these suppliers.³⁵

2. *Competition with a Firm Similarly Diversified*

When one large diversified firm competes with another that is diversified to a comparable extent and supplies similar products, the types of advantage that have been described above are available to neither. Neither obtains from its diversification a special opportunity to be big. Both are similar in their ability to rechannel funds and spread risks, subsidize one activity from the proceeds of another, enjoy the benefits of joint revenue, spread large lump-sum costs over multiple products, undertake vertical integration, get bargaining advantages from threats to do so, and resort to reciprocity. The competition of each is a check upon the activity of the other. Of course, this competition could be set aside by agreement; but if the law is obeyed, this will not happen. However, such competition is not the same as the competition of specialists. It has peculiar characteristics that affect the way and extent to which it limits the power of the diversified firms.

Two patterns of relationship are possible for firms whose diversification is of substantially the same extent and character. In one of these patterns,

³⁵ Reciprocity has become so important that in 1963 representatives of 118 firms that were engaged in it attended the annual meeting of a "Trade Relations Association." Of the firms represented, 105 were among the thousand largest manufacturing enterprises, as measured by sales; 90 were among the 500 largest; and 52 were among the 200 largest. The association's board of governors consisted of officials from 9 firms, all among the 200 largest, each of which produced products in from 32 to 128 product classes. (Information from a proceeding for preliminary injunction against the acquisition of American Viscose Corporation in June, 1963.)

The effective scope of reciprocity has been enlarged by three-way relationships: Firm *A*, which does not buy from firm *C*, puts pressure upon firm *B*, which does buy from *C*, to induce *C* to buy from *A*. Illustrative examples may be found in Stocking & Mueller, *Business Reciprocity and the Size of Firms*, 30 J. Bus. U. CHI. 73 (1957).

the firms differ considerably as to the relative shares of their total sales and profits that are derived from particular items in their product lines and as to the relative importance that they attribute to individual products. Where this is true, the most sensible policy for each firm is to recognize the other's priority of interest for products important to the other but not to it, in the expectation that similar recognition will be given reciprocally. Without explicit agreement, two firms that adopt such a policy accept reciprocally an allocation of leadership in prices and similar important matters and obtain thereby considerable freedom of action for the part of their business they regard as vital. The competitive pressure that each might exert upon the other and the protection that competition might give consumers of their products are thus substantially reduced. A considerable part of what is often described as oligopolistic forbearance probably can be explained in this way.

In the other pattern, the firms are similar not only in diversification but also in the relative importance that they impute to their various products. Where this is true, informal reciprocal recognition of spheres of influence is not likely. But ad hoc price competition between the firms in selling their various products is likely to be dangerous. Since each can divert funds from other parts of the business to support any of its products, subsidy and counter-subsidy might make such competition very expensive. Since each could injure the other by a competitive raid upon products more important to the other than to itself, but each would be vulnerable to retaliatory raids, each has an incentive to treat competition with the other, not as a series of different moves separately adopted for different products, but as a strategy to be established on a consistent basis at all points of competitive contact. For each, the incentive is to compete in ways that minimize the dangers described above. If there is price competition, each firm is likely to limit it in ways that make price wars unlikely — perhaps by use of a pricing formula applicable to all products or by resort to price reductions only to reflect decreases in recorded costs or decreases in sales or orders that are not considered temporary. Competition in sales effort is likely to be preferred to price competition and is likely to consist largely in activities that do not pin-point the rivalry of the firms as to particular markets. Competition in innovation is likely to be considered still more desirable, partly because it is least susceptible to the raiding type of action and reaction. Where such policies exist, competition may still provide significant incentives and curbs and significant advantages for buyers; but price competition is likely to be considerably less intense than it might be without diversification. The relation between competitors is likely to have aspects of mutual forbearance, akin both in kind and in motivation to that which is attributed by many economists to oligopoly.

In both patterns of relationship between diversified firms, the existence of other large diversified firms in other parts of the economy introduces

another significant competitive check. With divertible funds, diffusion of risk, and capacity to afford heavy initial expenditures, the large diversified firm is a potential entrant into many fields that it does not yet occupy. Whereas a specialized firm, even if large, is handicapped as an invader of a diversified firm's territory, another large diversified firm is not. Potential competition from such firms is likely to set limits to what can be done both by firms that have reciprocally accepted each other's leadership and by those that have mitigated their competition.

V. CONCLUSION

Because of the developments discussed above, the concept of monopoly is inadequate to cover the phenomena of business power, and the concept of oligopoly is inadequate to replace it. Different kinds of power can be derived from (a) control of a preponderant share of a single segregable market; (b) position as one of a few competing firms; (c) possession of a large aggregate of resources in comparison with one's competitors; and (d) diversity of activities across many fields of operation. The first is properly called monopoly (though effects partly due to the third are sometimes attributed to it). The second is properly called oligopoly. The third can be called bigness, and the fourth diversification. Business power structures today contain blends of all of these, and hence are hard to describe, analyze, or appraise on the basis of a single one of these concepts. Discussion of such power structures gives monopoly an emphasis that it no longer deserves; attributes to oligopoly a significance greater than it probably has; and makes little serious effort to cope with bigness and diversification. Yet these are the forms in which business power is growing most rapidly, is subject to least legal curb, and is hardest to appraise as to the elements of good and bad.