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Timothy M. Hurley

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TIMOTHY M. HURLEY*

The Urge To Merge: Contemporary Theories on The Rise of Conglomerate Mergers in the 1960s

I. INTRODUCTION

Merger for the sake of merger, I believe is not justified. Merger for the sake of profit—and profit as a reward for entrepreneurship and risk-taking with its concomitant benefits to society as a whole—is justified. It is a new way of life. Indeed, it may well be the only way of business life.¹

WHEN HERBERT BRINBERG MADE THESE REMARKS at a 1968 Conference on Mergers and Acquisitions at Hofstra University, the American economy was in the midst of its third major merger movement of the century.² During this wave of merger activity—which began quietly in the years following World War II and reached its peak in the 1960s and 1970s—many entities followed the pattern of amalgamating a number of unrelated businesses to form large conglomerate corporations.³ Brinberg's remarks reflect the prevalent belief of this period—that establishing conglomerate corporations can produce a superior business entity in terms of corporate efficiency and risk.

In America during the 1960s and 1970s, conglomerate mergers and conglomerate corporations were the “fashionable” form of corporate acquisition.⁴ The traditional conglomerate firm was an “amalgam of the assets and resources of many independently large enterprises which by themselves frequently represent some of America's biggest and best known corporate names.”⁵ The merger wave was spearheaded by the establishment of multinational conglomerate entities, such as International Telephone & Telegraph, Litton Industries, Gulf & Western, Textron, and Ling Tecmo Vought.⁶ The push toward conglomeration, however, was driven

* B.A., University of Pennsylvania; J.D., University of Maryland School of Law.

1. Speech of Herbert R. Brinberg, *Proceedings of the Conference on Mergers and Acquisitions* 80 (McCutchan Publishing Corp. 1968).

2. See John T. Miller, Jr., *Conglomerates, Conglomerate Mergers and the Federal Antitrust Laws*, 44 ST. JOHN'S L. REV. 613, 615 (1970).

3. See Dero A. Saunders, *Royal Little: The Conglomerator*, FORBES, July 13, 1987, at 264.

4. *Confused Conglomerates*, THE ECONOMIST, January 10, 1987, at 68.

5. Mary Gardiner Jones and Edward J. Heiden, *Conglomerates: The Need for Rational Policy Making*, 44 ST. JOHN'S L. REV. 243, 243 (1970).

6. Joan Harrison, *M&A Timeline*, MERGERS AND ACQUISITIONS JOURNAL, September 1, 2000, at 26.

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by individuals who, "with a mixture of management flair, foresight and sheer energy, had managed to run efficiently and profitably a disparate bunch of companies."⁷ In 1968, at the height of the wave, about eighty-four percent of the large mergers were of the conglomerate type.⁸ Moreover, conglomerate acquisitions accounted for more than \$11 billion of the \$12.6 billion in assets acquired through large acquisitions of manufacturing and mining firms during the same year.⁹

The conglomeration trend that had taken over the world of mergers and acquisitions during the conglomerate movement ebbed in the 1980s as corporate executives turned their focus to other forms of acquisitions. The 1980s saw widespread corporate restructuring that has generally been viewed as an "undoing" of the conglomerate wave of the 1960s and 1970s.¹⁰ At this time, many former conglomerates sold the previous two decades' acquisitions that were unrelated to their core businesses.¹¹ The conglomerate form of business could no longer maintain the investor confidence it held during the wave of merger activity.¹²

Despite the tremendous growth of merger activity during the conglomerate wave, academics have never reached a consensus as to how and why conglomerate mergers achieved their popularity. Although the preceding merger waves had apparent causes,¹³ the conglomerate merger wave departed from the "clearly visible material and technical motivations" of business executives during the earlier movements.¹⁴ Perhaps one of the problems with analyzing the movement toward conglomeration is the apparent lack of relationship among the product lines of conglomerate firms. Still, the study of the conglomerate phenomenon has proved to be important because the issues arising from conglomeration affected academics and professionals in a variety of fields.¹⁵

The focus of this Article will be to examine the motivating factors behind the wave of conglomerate mergers that took place in the 1960s and 1970s. Although much of the recent writing on conglomeration was written from an examination of ex post evidence, this Article will focus on the contemporary theories and motivations that led individuals during the conglomerate movement to believe that con-

7. See *Confused Conglomerates*, *supra* note 4, at 68.

8. Miller, Jr., *supra* note 2, at 615.

9. *Id.*

10. Peter G. Klein, *Were the Acquisitive Conglomerates Inefficient?*, 32 RAND J. OF ECON. 745 (2001).

11. See Martin Sikora, *The M&A Bonanza of the '80s . . . And Its Legacy*, MERGERS & ACQUISITIONS, March / April 1990, at 91.

12. See *Confused Conglomerates*, *supra* note 4, at 68.

13. See Nicholas M. Salgo, *Conglomerates: Another Wave of Business Development or the Beginning of a New Business Era?*, 44 ST. JOHN'S L. REV. 782, 782 (1970) (stating that a student of business history "will soon be aware of one fact transcending all the succeeding waves of business accumulations and mergers: that their motivating factors were relatively easy to recognize, easy to understand, and, consequently, clearly accepted as justified in the period when they occurred or very shortly thereafter").

14. *Id.*

15. See Edwin M. Zimmerman, *Introduction*, 44 ST. JOHN'S L. REV. 3, 3 (1970) (noting that "the debate [the conglomerate wave] provokes is lively and quantitatively substantial among not only antitrust lawyers and economists but also tax policy specialists, accountants, and those concerned with securities regulation").

glomerates were “the only way of business life” in the future.¹⁶ At the same time, this Article will highlight aspects of conglomerate mergers that made many individuals wary of the potential for economic and social harm. The Article will examine the accuracy of these fears and beliefs based on insights from recent studies of the conglomerate wave.

Part I will discuss the various definitions of a “conglomerate merger.” Part II will examine a feature of the conglomerate entity that helped to provide support for its superiority—corporate diversification. During the merger wave, many of the leading executives believed that corporate diversification, through the acquisition of related and unrelated business, would establish a large corporation with increased efficiency and reduced potential risk. Part III will discuss many of the external factors that allowed for the conglomerations to come to the foreground of the corporate world in the 1960s. The factors to be discussed include the strict enforcement of antitrust laws on other types of corporate acquisitions, the reaction of the stock market to conglomerate acquisitions, and the use of accounting techniques to improve the face of the corporation. The rise and fall of the conglomerate merger movement cannot be attributed to any one of these factors. Instead, it was the attractiveness of corporate diversification coupled with external factors that made conglomerate corporations the dominant form of business entity for the greater part of two decades.

II. WHAT IS A CONGLOMERATE MERGER?

Before entering into the discussion of how and why conglomerate mergers came to dominate the economic world of the 1960s and 1970s, it is important to explain briefly how courts and economists have treated the definition of a “conglomerate merger.” Typically there are three types of mergers: horizontal mergers, vertical mergers, and conglomerate mergers.¹⁷ A horizontal merger is a merger “between two or more business corporations that market the same or interchangeable products in the same geographic area.”¹⁸ A vertical merger occurs when a company acquires another company that does business the acquiring company either as a customer or as a supplier of products or materials.¹⁹ A conglomerate merger, the focus of this Article, is often defined generally as a merger where the relationship between the two parties is neither horizontal nor vertical.²⁰

Under the broad umbrella of the term “conglomerate merger,” there are product extension mergers, market extension mergers, and “pure” conglomerate mergers. A

16. See Brinberg, *supra* note 1 and accompanying text.

17. See *infra* notes 84–90 and accompanying text (discussing the differences between these types of mergers and their effect on the enforcement of antitrust statutes).

18. Robert H. Swennes, *Three Theories of Potential Competition under Section 7 of the Clayton Act: Reaching the Conglomerate Merger*, 49 TUL. L. REV. 139, 141 (1974).

19. *Id.*

20. *Mergers and Acquisitions: Understanding the Antitrust Issues* 371 (Robert Schlossberg, ed. 2004).

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product-extension merger is one in which "the products of the acquired company are complementary to those of the acquiring company and may be produced with similar facilities, marketed through the same channels and in the same manner, and advertised by the same media."²¹ A market-extension merger occurs between two noncompeting companies selling similar products in different geographical locations.²²

A "pure" conglomerate merger, typical during the conglomerate wave of the 1960s and 1970s, existed where the relationship or motives between the two entities was less clear. The U.S. Supreme Court has defined a conglomerate merger as "one in which there are no economic relationships between the acquiring and the acquired firm."²³ The Court's definition is similar to the one Congress had in mind when it amended the Clayton Act in 1950.²⁴ The distinction between these forms of conglomerate mergers is often blurred.²⁵ As a result, some commentators concede that *conglomeration* is a less rigid term than those for the other forms of mergers.²⁶

III. THE ATTRACTION OF CORPORATE DIVERSIFICATION

*I would say that it would be worthwhile for people to sit down and study the operating margins of companies that Teledyne, Litton . . . have taken over with their bright young management teams. I would submit that you will find sharp increases in efficiency. I've seen this in many cases[,] and even though these businesses may be in disparate fields, the ingredients of more aggressive, sophisticated management with use of new techniques has made a positive contribution. . . . I submit that many of these conglomerates will be considerably stronger in a period of recession than the individual units would have been left on their own.*²⁷

One of the driving theories behind the conglomerate merger movement was the idea that a conglomerate could be more efficient and progressive in its manage-

21. *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967).

22. See Schlossberg, *supra* note 20 at 373.

23. *Procter & Gamble Co.*, 386 U.S. at 577 n.2.

24. See H.R. REP. No. 81-1191, at 11 (1949) (noting that a conglomerate merger exists when "there is no discernible relationship in the nature of the business between the acquiring and acquired firms").

25. See Peter Asch & Matiyahu Marcus, *Some Economic Aspects of Conglomerate Growth*, 44 ST. JOHN'S L. REV. 81, 81 (1970) (noting that in the *Procter & Gamble* case, the FTC termed the "acquisition of Clorox a 'product extension' merger rather than a conglomerate [merger], reasoning that *some* relationship existed between the companies' activities, albeit non-horizontal and non-vertical").

26. See Salgo, *supra* note 13, at 782-83 (noting that "when we use this word 'conglomeration,' we practically admit that we mean mergers for which the reasons are surely not clear, and in most cases, hardly understandable").

27. Speech of Samuel N. Seidman, *Proceedings of the Conference on Mergers and Acquisitions* 80 (McCutchan Publishing Corp. 1968).

ment of resources and economic growth.²⁸ Supporters of the conglomerate form believed that conglomerate corporations could bring increased corporate efficiency in two ways.²⁹ First, many executives believed that conglomerations were better equipped to make use of the firm's capital.³⁰ Second, the management of conglomerate corporations could more easily and effectively manage a number of unrelated businesses through the use of the resources and administration of a single, large corporation.³¹ The expected result of this increased efficiency in capital and management was twofold: reduction in corporate risk³² and synergistic growth.³³ As a result, the notion that it was simpler and more efficient to grow by diversification prevailed in the conglomerate merger wave.

A. *Efficient Use of Capital*

During the conglomerate merger wave, many of the "conglomerators" were driven primarily by the concept of managing capital efficiently.³⁴ A corporation's movement toward diversification often started when a company—finding that it had more money than necessary to meet the requirements of its existing business—invested the surplus into acquiring new businesses. Based on a number of operating efficiencies, executives believed that the conglomerate firm was the ideal business form to put excess capital to use.³⁵ By combining several separate operations under a collective company, the conglomerate firm could generate a common pool of assets that could be disbursed as desired throughout the company's many divisions.³⁶ As discussed later, the hope was that this increased efficiency would help reduce corporate risk.³⁷

28. For the purpose of this section, the efficiency of a conglomerate will be compared with that of a company that specializes in a single product line or service.

29. Supporters of the conglomerate movement actually believed that conglomerate corporations could increase corporate efficiency in a number of ways. See William J. Kolasky, *Conglomerate Mergers and Range Effects*, 10 GEO. MASON L. REV. 533, 534 (2002) (noting that the potential increases in corporate efficiencies include "providing infusions of capital; improving management efficiency either through replacement of mediocre executives or reinforcement of good ones with superior financial control and management information systems . . . meshing of research and distribution; increasing ability to ride out economic fluctuations through diversification"). For the purpose of this Article, however, these several ideas have been broken down into two discrete sections: efficiency of capital and efficiency of management.

30. See *id.*

31. See *id.*

32. See Harold S. Geneen, *Conglomerates: A Businessman's View*, 44 ST. JOHN'S L. REV. 723, 725 (1970) (noting that "[d]iversification provides a form of security and insurance, as well as a method of adapting to the quickening tempo of change").

33. See Jerome S. Katzin, *The Conglomerate as an Investment Vehicle*, 44 ST. JOHN'S L. REV. 801, 802 (1970) (noting that some conglomerate management teams "seek to acquire companies with some operating relationship which common ownership can make more efficient, the so-called 'synergy'").

34. See *Confused Conglomerates*, *supra* note 4, at 72 (describing the story of Royal Little's reasons for building a conglomerate corporation as "putting capital to its best use").

35. See Joel Dean, *Causes and Consequences of Growth by Conglomerate Merger: An Introduction*, 44 ST. JOHN'S L. REV. 15, 22–23 (1970).

36. See *id.* at 23.

37. See *supra* pp. 14–16.

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If a typical conglomerate firm is a collection of separate companies under a common management scheme, then it is logical that the combination of these companies would allow for the collection of all profits and assets. In a corporation, the main source of internal funds is corporate savings, which are the gross cash earnings generated by the company's operations.³⁸ An individual company is restricted to using the corporate savings it generates itself.³⁹ When several corporations unite through a conglomerate merger, the aggregate of their corporate savings should create a common pool of funds that the conglomerate may use in the future.⁴⁰ If a conglomerate did not make the corporate savings of its several divisions available for companywide capital expenditures, and thus "[t]o restrict each division to the reinvestment of its own cash, . . . [the conglomerate] would destroy a major source of [its] economic superiority."⁴¹ Therefore, the benefit of a conglomerate corporation, when compared to a specialized firm, is that this common pool of funds would be available for use by any division in the conglomerate, as needed.

In addition to creating a common pool of corporate funds, the conglomerate can increase corporate efficiency by distributing corporate funds across company divisions as profit opportunities arise.⁴² Individual companies lack the same ability to shift corporate funds to maximize investment returns.⁴³ Unlike a specialized firm, a conglomeration can allocate funds to those divisions or operations where the funds will be put to the best use and earn the greatest returns.⁴⁴ Likewise, the conglomerate management can make each division compete for the use of these corporate funds, causing divisional management to demonstrate why an allocation to that particular division will provide the conglomerate with a sufficient return on that investment. A conglomeration does not have to look solely among its own existing divisions for investment opportunities with the surplus of corporate funds. As is typical in the experience of a conglomerate, each division would also be competing with the possibility that the conglomerate corporation could use its excess funds to acquire additional companies. Supporters of the conglomerate movement saw this

38. See Dean, *supra* note 35, at 23.

39. *Id.*

40. *Id.*

41. *Id.*

42. See Zsuzsanna Fluck & Anthony W. Lynch, *Why Do Firms Merger and Then Divest? A Theory of Financial Synergy*, 72 J. OF BUS. 319, 324 (1999).

43. See Dean, *supra* note 35, at 23 (noting that "[f]unds can be rationed more knowledgeably and efficiently within the corporate fold than across corporate boundaries by the cumbersome, costly, and relatively ignorant allocation of funds by the impersonal capital markets").

44. See Corwin D. Edwards, *The Changing Dimensions of Business Power*, 44 ST. JOHN'S L. REV. 416, 431 (1970) (noting that if a conglomerate wishes to expand, "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").

ability to allocate corporate funds more effectively as a potential source of economic superiority of the conglomerate firm.⁴⁵

B. Efficient Use of Management and Resources

Parallel to the idea that a conglomerate firm could use capital more effectively than a specialized firm was the idea that a conglomerate firm could make better use of its management than individual companies.⁴⁶ Supporters of the conglomerate form believed that conglomerate management was superior in a number of ways. First, this increased efficiency includes not only hiring more effective management teams, but also providing the ability to shift effective management teams to divisions where they are most needed at a given time.⁴⁷ Second, managers within a conglomerate firm would be subject to greater accountability than those who ran specialized firms.⁴⁸ Third, conglomerate firms could use managerial and operating resources more effectively than specialized firms because techniques and resources could be shared throughout the company.⁴⁹ For these reasons, many believed that a conglomerate could improve the operations of a company simply by acquiring it and adding it to the conglomerate's existing network of managerial techniques and resources.

Just as the ownership of a conglomerate firm could distribute corporate funds in a manner that would produce the greatest return on the investment, conglomerate management could be allocated in a way that would make the greatest use of its human resources.⁵⁰ One of the traits that conglomerate executives looked for when acquiring a target company was the presence of incompetent or ineffective management.⁵¹ Upon acquisition of a new company, the conglomerate was faced with a choice: maintain the existing management or replace it with a management team from within. If the existing management would serve to operate that division of the conglomerate effectively, the conglomerate could maintain the management of the target company. Alternatively, if the target company was saddled with poor and inefficient management, the conglomerate could "move successful executives and employees where they are going to perform their best."⁵² In addition, conglomerate

45. See John C. Narver, *Supply Space and Horizontality in Firms and Mergers*, 44 ST. JOHN'S L. REV. 316, 322 (1970) (noting that at the height of the conglomerate merger era, "resource flexibility is by far the rule rather than the exception for most non-failing, non-trivial firm, and certainly is the case" of the five hundred largest industrial companies).

46. See generally Dean, *supra* note 35, at 24–27.

47. See Dean, *supra* note 35, at 24.

48. *Id.* at 25.

49. *Id.* at 27.

50. See Arthur Wyatt & Leonard Spacek, *Accounting Principles and Conglomerate Growth*, 44 ST. JOHN'S L. REV. 805, 805 (1970) (noting that "[w]hile diversification has many goals, in the conglomerate era a principal goal was to permit successful management to bring its expertise to bear in a broader business arena").

51. See Dean, *supra* note 35, at 20 (noting that "[i]ncompetent management makes a company an easier take-over target because unhappy stockholders are more susceptible").

52. *Id.* at 25.

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firms were able to shift management teams across divisions anytime the need arose, not just upon the acquisition of a new company. Although a specialized firm would have the opportunity both to shift human resources and to raid talent from outside the corporation to resolve management issues, many believed that conglomerates had a greater ability to do so because their management was efficient at supervising the several divisions of the company.⁵³

During the conglomerate merger wave, there was an idea that a conglomerate corporation could increase efficiency by establishing greater accountability for the actions of management.⁵⁴ This theory suggests that the management of specialized firms were in a position to shirk their responsibilities as corporate officers.⁵⁵ Additionally, stockholders in an individual firm can typically sell their shares instead of dealing with poor and inefficient officers. Therefore, the lack of accountability diminishes the efficiency of the firm's management. On the other hand, when a conglomerate corporation acquires a new company as one of its divisions, its management "becomes accountable, not to an invisible stockholder electorate or a benign board, but to a professional 'high command' which is likely to be geared to greed."⁵⁶ The managers within each division of a conglomerate are subject to the watch of a corporate hierarchy.⁵⁷ As a result, this heightened attention to the actions of management in a conglomerate firm increases the overall efficiency of the firm.⁵⁸

The last advantage that conglomerate proponents saw in the business form is the economies of scale that could be achieved through the spread of managerial resources throughout the company.⁵⁹ These economies include many functions at the corporate staff level: research and development, advertising, financial staff services, and computer and information technology.⁶⁰ Of course, these aspects of a corporation are also available for specialized firms. The extent to which a specialist can afford to spend funds on each of these activities is limited by the size of the firm. A conglomerate will likely provide a greater opportunity to invest money into re-

53. See Henri Servaes, *The Value of Diversification During the Conglomerate Merger Wave*, 51 J. FIN. 1201, 1202 (1996) (noting that "[p]roponents of conglomerate diversification implicitly assume that managers of conglomerates are better at monitoring the divisions than the external capital market"); Dean, *supra* note 32, at 25 (stating that there is an implicit belief that "management of a large diversified company will be able to find within its family or raid talent from outside").

54. See Dean, *supra* note 35, at 25-26.

55. *Id.* at 26 (stating that in "a public . . . company, directors tend to be too eminent, too busy, too ignorant and too nice to ride the president hard").

56. *Id.*

57. See Dean, *supra* note 35, at 26.

58. See Wyatt & Spacek, *supra* note 50, at 805 (noting that "[s]ince the evolving professionalism of management would permit better management and increased efficiency in operation of the acquired businesses, it was postulated that higher profits would result").

59. See *id.*

60. See Dean, *supra* note 35, at 27.

search, planning and management.⁶¹ Moreover, the additional benefit of the conglomerate form in this area is that the conglomerate can share and distribute successful techniques and resources among its internal divisions.

C. *Corporate Diversification as a Form of Risk Spreading*

Conglomerates valued corporate diversification not only as a way to increase the efficiency of their companies, but also as a way to reduce the risks associated with operating a business entity. By the height of the merger wave, the notion of a corporation as “an enterprise that produces a product for a market and makes its decisions upon the basis of conditions in that market [was] already obsolete for many large firms.”⁶² By acquiring companies in several unrelated markets, conglomerate firms could provide investors with a diversified portfolio, thought to be more stable and less volatile than that offered by specialized firms.⁶³

Proponents of conglomerates believed that the conglomerate form could reduce corporate risk by eliminating the company’s dependence on a single product line in a single market.⁶⁴ A specialized firm is subject to the movement of the market in which its product is offered and to the actions of its competitors within that market.⁶⁵ If that market is down, the specialized firm will encounter problems.⁶⁶ If one of its competitors increases its control over the market, the firm must react accordingly. In a conglomeration, on the other hand, the operations of the company are spread out into multiple markets. This characteristic provides a conglomerate with flexibility with respect to how to manage each of its many divisions.⁶⁷

Likewise, this diversification lessens the effect of a negative market reaction among one of its divisions. Ideally, the management of a conglomeration would understand the varying strengths of its acquisitions.⁶⁸ If one division is encountering little competition for its offered products in a market, the conglomerate can adjust its prices so that it achieves the highest profits possible.⁶⁹ If a conglomeration suffers a loss in one of its divisions, it can absorb that loss with the gains achieved

61. See Edwards, *supra* note 44, at 433–34 (noting that a conglomerate is likely able to afford more research, top management, equipment and machinery, sales efforts, legal efforts, and political dealings).

62. *Id.* at 425.

63. See Servaes, *supra* note 53, at 1201 (asserting that “[t]hrough diversification, managers create internal capital markets, which are less prone to asymmetric information problems”).

64. See Brinberg, *supra* note 1, at 83.

65. See Edwards, *supra* note 44, at 430–31.

66. See *id.*

67. See *id.* at 425 (stating that “[t]he 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”).

68. See *id.* at 429 (noting that “[w]hen a [large] 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”).

69. See *id.* at 431.

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from the more profitable divisions.⁷⁰ A specialized firm does not have this luxury. Thus, the suggested stability that conglomerates could offer their investors through a diversified company made the conglomerate form a more attractive investment than its specialized company counterpart.⁷¹

D. Synergy

The operating and financial efficiencies that were derived from this corporate diversification gave rise to the idea that conglomerate mergers create synergy.⁷² Synergism has been described as a “stimulation of sales and earnings for the combined operation that would have been impossible for the independent entities alone.”⁷³ This synergy was believed to result from the increased efficiencies provided by the conglomerate form.⁷⁴ Synergy was explained not only by financial synergy, which suggests that conglomerate managers were able to allocate funds more efficiently than external capital markets, but also by managerial synergy, arguing that top managers could monitor the operations of a conglomerate’s many divisions more effectively than individual boards of directors or capital markets.⁷⁵ Therefore, a conglomeration could increase the value and potential of both the acquiring and acquired companies through the repeated acquisition of additional smaller firms.

IV. EXTERNAL FACTORS ALLOWING FOR THE GROWTH OF CONGLOMERATE FIRMS

The rise in conglomerate acquisitions during the 1960s received help from certain external factors that, like corporate diversification, made the conglomerate form attractive for both investors and conglomerate management. As noted earlier, current academics are unable to agree on a single reason that conglomerations dominated merger activity for decades. At the height of the merger wave, businessmen, academics, and politicians were equally puzzled.⁷⁶ This Article focuses on three of

70. See *id.*

71. See Brinberg, *supra* note 1, at 75 (noting that conglomerations “provide an opportunity to introduce counter-cyclical businesses and therefore stabilize the fortunes of the corporation, its employees and its stockholders”).

72. See *id.* at 98 (Seidman stating that “one should note that the rationale for the conglomerate movement is the injection of an element of synergy”); Burton Malkiel, *A Random Walk Down Wall Street* 57 (W.W. Norton & Co. 2003) (1973) (stating that “[b]y the mid-1960s, creative entrepreneurs had discovered that growth meant *synergism*”).

73. Malkiel, *supra* note 72, at 57.

74. See Katzin, *supra* note 33, at 802.

75. See Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 *STAN. L. REV.* 597, 610 (1989) (noting that one of three distinguishable sources of synergy is financial synergy due to more efficient use of capital and management talent).

76. The *Neal Report* in 1969 suggested that there seemed to be an endless number of possible motives for conglomeration:

“The economic forces encouraging conglomerate mergers . . . appear to include the desire of owners of smaller firms to convert their holdings into more readily marketable securities; the desire of management of large firms for growth for its own sake, apart from or in addition to growth in profits; the opportunity to bring

the more commonly recognized influences on conglomerate popularity. First, the strict enforcement of antitrust statutes against other types of mergers allowed conglomerate acquisitions to be a primary option for companies looking to expand through acquisition. Second, the emphasis that investors placed on a corporation's earnings-per-share ratio benefited the conglomerate form, because conglomerates could boost this figure simply through acquisition of a target company. Third, conglomerates could improve their overall financial picture by applying certain accounting practices to their acquisitions of smaller firms. Although each of these factors increased the attractiveness of a conglomeration to both investors and business executives, none of these features alone can explain the emergence of conglomerate mergers as the principal form of acquisition during the 1960s.

A. *Vigorous Antitrust Enforcement*

The most recognized theory for the rise in conglomerate merger activity during the 1960s and 1970s was that the merger wave was a response to the government's rigid antitrust action against a number of large mergers. The direct acquisition of another corporation is one of the most effective ways a company can increase its economic power. The United States has used its antitrust policy, however, to check corporate growth through many types of mergers.⁷⁷ This was the case in the period surrounding the conglomerate merger wave. In particular, in the 1960s and 1970s the government engaged in a strict enforcement of antitrust statutes that checked the majority of large horizontal and vertical mergers.⁷⁸ Free from the heightened

more efficient management personnel or techniques to smaller or less successful firms; the possibility of reducing costs or increasing sales by meshing product lines or processes or methods of distribution; the desire to diversify business activities and reduce risks; the possibility of using one's firm's cash flows or credit in another firm with limited access to capital; the tax advantages of direct reinvestment through the general capital market; and the opportunity for speculative gains through mergers that immediately increase the per-share earnings of the surviving firm."

1968 PRESIDENTIAL TASK FORCE REPORT ON ANTITRUST, 115 Cong. Rec. 5642 (May 27, 1969). This Article does not discuss all of the frequently cited external factors affecting the rise of conglomerate mergers. For instance, some commentators have speculated that conglomerates were favored because there was a tax benefit in "investing profits rather than distributing them to stockholders, since the investment enhances the capital value of the stock, whereas the dividend distribution would be taxed as ordinary income to the stockholders." L. E. Birdzell, *The Conglomerates: A Neighbor's View*, 44 ST. JOHN'S L. REV. 292, 299 (1970). Also, some have suggested that the rise of conglomerations in the United States is directly attributable to conglomerate heads' interests in concentrating power and empire building. See *id.* (noting that "the interest of management in expanding into new fields is explained in terms of the satisfactions—financial and psychological—associated with increases in the size of the organization"); *Confused Conglomerates*, *supra* note 4, at 69 (equating conglomerate CEOs to "junkies [who] need a regular fix of new acquisitions").

77. See Thomas F. Shea, *Antitrust Policy and the Conglomerate Firm: 'A Rose is a Rose is a Rose'*, 44 ST. JOHN'S L. REV. 533, 533 (1970) (noting that "[t]he guiding principle behind antitrust policy in the United States is that competition is the key to a successful economic system and the antitrust laws are the tools by which competition is to be kept viable and effective").

78. See Jerome B. Cohen, *The Economic Aspects of Conglomerates*, 44 ST. JOHN'S L. REV. 49, 49 (1970) (demonstrating the decline in horizontal and vertical merger activity between 1951 and 1968).

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scrutiny of antitrust enforcement, conglomerate mergers were an increasingly safe option for corporate growth through acquisition.

1. *The Enforcement of Section 7 of the Clayton Act*

The government's principal method for striking down anticompetitive mergers is section 7 of the Clayton Act.⁷⁹ "Section 7 . . . does not create a per se prohibition of mergers."⁸⁰ Instead, the statute provides that it is unlawful for a company to acquire the stock or asset of another company where "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."⁸¹ This provision was intended to apply the antitrust laws to all types of corporate acquisitions—horizontal mergers, vertical mergers, and conglomerate mergers.⁸² Still, the government's enforcement of section 7 during the period surrounding the conglomerate merger movement tended to strike down horizontal and vertical mergers, leaving conglomerate mergers as the only remaining form of merger available.⁸³

After the amendment of the Celler-Kefauver Act, horizontal mergers were consistently struck down as anticompetitive.⁸⁴ Horizontal mergers involve the combination of two or more business entities that "market the same or interchangeable products in the same geographic area."⁸⁵ For example, a hypothetical horizontal merger might be the acquisition of Ford Motor Company by General Motors. These types of mergers raise antitrust concerns "because they eliminate a competitor and may thereby enable the merged firm to restrict output and raise price."⁸⁶ In addition, horizontal mergers may enable the acquiring firm to achieve market dominance and prevent increased concentration in the market.⁸⁷

Vertical mergers were similarly attacked through the enforcement of the antitrust statutes. These mergers concern a company's acquisition of another company that

79. See 15 U.S.C. § 18 (2005). The relevant sections of this statute were amended in 1950 by the Celler-Kefauver Act.

80. Joseph P. Bauer, *Government Enforcement Policy of Section 7 of the Clayton Act: Carte Blanche for Conglomerate Mergers?*, 71 CALIF. L. REV. 348, 352 (1983). See *id.* (stating that "section 7 . . . forbids only those acquisitions that have a reasonable probability of causing a substantial lessening of competition").

81. 15 U.S.C. § 18 (2005).

82. Schlossberg, *supra* note 20, at 374 (noting that the legislative history makes clear that section 7 was intended to apply to all mergers, regardless of form). See also Jerrold G. Van Cise, *Aristotle and Congress*, 44 ST. JOHN'S L. REV. 538, 541 (1970) (arguing that at the height of the conglomerate merger wave, it was understood that conglomerate mergers were within the scope of section 7).

83. Kolasky, *supra* note 29, at 533–35.

84. See generally *United States v. Von's Grocery Co.*, 384 U.S. 270, 278 (1966) (finding that the merger of two of the largest retail grocery companies in a single market area would result in the elimination of many smaller grocery firms in the market area); *United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 607 (1957) (holding that a proposed merger between Du Pont and General Motors was in violation of section 7 of the Clayton Act because it was reasonable to foresee that the acquisition of the automotive manufacturer's stock would result in reduced competition in the market).

85. See *supra* note 18 and accompanying text.

86. Kolasky, *supra* note 29, at 535.

87. Betty Bock, *MERGERS AND MARKETS 7: AN ECONOMIC ANALYSIS OF DEVELOPMENTS IN 1967–1968 UNDER THE MERGER ACT OF 1950*, at 102 (1969).

is in either a customer or supplier relationship with the acquiring company.⁸⁸ The government sought to check vertical mergers because the acquisition of a supplier or a customer could “raise significant barriers to entry” or “create serious disadvantages for existing nonintegrated, or partly integrated, firms.”⁸⁹ For instance, suppose that a television manufacturer acquired the only supplier of a rare phosphor needed to manufacture color television sets. The acquiring firm would surely benefit from having an internal connection with the supplying firm; other television manufacturing firms in the market would be conversely harmed by having to seek out business from a competitor to continue to exist in the market. Thus, the government’s enforcement of section 7 made the prospect of growth by vertical merger as equally unpromising as by horizontal merger.

As a result of the heightened enforcement directed against horizontal and vertical mergers, conglomerate mergers became an increasingly attractive option for many executives. After the court’s decision in *FTC v. Procter & Gamble Co.*,⁹⁰ it appeared that the government would challenge any acquisition where the products of the merging companies were somewhat related.⁹¹ Ignoring the fact that section 7 was intended to apply to all merger types alike,⁹² the government did not target conglomerate mergers in the same way it attacked horizontal and vertical mergers.⁹³ The rising number of conglomerate-type mergers during the 1960s reflected this reaction. For instance, during the inception of the merger wave, between 1948 and 1951, conglomerate mergers constituted roughly thirty-eight percent of all merger activity, with horizontal and vertical mergers constituting the majority of acquisitions.⁹⁴ According to the Federal Trade Commission (FTC), in 1968 conglomerate mergers constituted almost eighty-four percent of the number of large mergers and eighty-nine percent of the assets acquired during those mergers.⁹⁵ The number of conglomerate mergers continued to rise through 1968, at which point they made up nearly ninety-one percent of all mergers.⁹⁶ Therefore, many believe that this drastic increase in conglomerate-type acquisitions was driven by the courts’ elimination of horizontal and vertical mergers, making conglomerate “the only feasible avenue of merger.”⁹⁷

88. See *supra* note 18 and accompanying text.

89. Bock, *supra* note 87, at 104.

90. 358 F.2d 74 (6th Cir. 1966).

91. See Dean, *supra* note 35, at 16 (noting that “even acquisitions of products related only by common distribution and by potential entry might be challenged”).

92. See *supra* note 82 and accompanying text.

93. See David R. Kamerschen, *Conglomerate Mergers: The Myth and the Reality*, 44 ST. JOHN’S L. REV. 133, 136 (noting that “while . . . section 7 of the Clayton Act . . . 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’”).

94. Shea, *supra* note 77, at 534.

95. Miller, Jr., *supra* note 2, at 615.

96. See Shea, *supra* note 77, at 534.

97. Dean, *supra* note 35, at 16.

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2. Anticompetitive Arguments Against Conglomerates

Although the government's antitrust enforcement during the 1960s largely tended to overlook conglomerate acquisitions, critics of conglomeration feared that the increasing number of conglomerate acquisitions could have an equally devastating effect on competition in a given market.⁹⁸ Moreover, the Supreme Court maintained that conglomerate mergers were "within the reach" of section 7 of the Clayton Act.⁹⁹ Three anticompetitive effects are typically associated with the existence and growth of large conglomerate mergers: (i) the elimination of potential competition, (ii) the possibility for reciprocal dealings, and (iii) the entrenchment of a firm in a market.¹⁰⁰ Each of these complaints revolved around the size and diversity of the acquiring conglomerate firm. These growing concerns eventually led the Department of Justice to look more closely at conglomerate mergers and their relation to the goals and purposes of the antitrust statutes.¹⁰¹

First, one possible challenge to the conglomerate form is that the combination of two large companies will result in the loss of potential competition in a market.¹⁰² The driving force behind this theory is the idea that the "competition in a market is impaired when a large firm that might have entered the market is eliminated as a potential entrant by merger."¹⁰³ If a firm enters a new market by way of internal expansion, the market is theoretically more competitive because there is an additional seller. Conversely, if the conglomerate enters a market through acquisition of an existing company, the market is damaged because it eliminates the possible increase in sellers. This reasoning assumes, of course, that the conglomerate intended to enter the market whether or not the merger was available.¹⁰⁴

One oft-cited example of the government's attempt to protect potential competition comes in the *Procter & Gamble* case. In *Procter & Gamble*, a large manufac-

98. See Luther C. McKinney, *Section 7 of the Clayton Act as Applied to Conglomerate Mergers, Incipient Antitrust Doctrine*, 44 ST. JOHN'S L. REV., 635, 635-36 (1970) (noting that "[c]ritics of large, diversified corporations fear not only that conglomeration lessens competition in various product lines, but also that it is responsible for the centralization of industrial resources into fewer and fewer hands").

99. *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967).

100. See Richard A. Posner, *Conglomerate Mergers and Antitrust Policy: An Introduction*, 44 ST. JOHN'S L. REV. 529, 530-31 (1970).

101. See Bauer, *supra* note 80, at 349 (stating that "[t]he growing concern about conglomerate mergers was reflected in part in the [Merger] Guidelines promulgated by the Department of Justice in 1968").

102. See *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964) (holding that the merger between the largest out-of-state supplier of natural gas to California and a competitor in a neighboring market would substantially lessen the competition in the market); *Procter & Gamble Co.*, 386 U.S. at 578-79 (holding that the proposed merger would reduce the potential number of competitors in the bleach market).

103. See Posner, *supra* note 100, at 531.

104. See *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158, 176-77 (1964) (finding that the court will look to objective factors indicating that a particular firm is a potential entrant, even if the "subjective evidence that the company intends to enter does not exist"). Additionally, in determining whether a corporation is a likely potential entrant, "the Department will consider the firm's ability to enter the market, in terms of its technological and financial resources, as well as its economic incentives to enter, in terms of the attractiveness of the market." See Bock, *supra* note 88, at 106.

turer of household products acquired the assets of Clorox Chemical Co. (“Clorox”), a major manufacturer of household bleach products.¹⁰⁵ The Court struck down the merger on the grounds that it would have eliminated the competitive structure of the market and could eliminate “the potential competition of the acquiring firm.”¹⁰⁶ In examining the reduction in potential competition, the Court noted that Procter & Gamble had considered entering the bleach market independently, but concluded that entrance by acquisition would be a more economic means of achieving market dominance.¹⁰⁷ Critics of conglomeration asserted that the Court should apply this potential competition charge more frequently to “pure” conglomerate mergers as well.¹⁰⁸

Second, the acquisition of companies, though not directly related, could increase the likelihood of reciprocal dealings. Reciprocity is defined as “the practice of mutual purchasing and selling between pairs of business enterprises, such that each reciprocating firm is both a customer and a supplier of its reciprocity partner, and vice versa.”¹⁰⁹ In its most basic form, this reciprocity takes the form of “I will buy X from you if you buy Y from me.” In the conglomerate context, the danger with reciprocity is that a conglomerate’s management will use the ability to deal within the company to make business deals it would not otherwise make.¹¹⁰ As a result, the remaining companies are weakened by the loss of a potential business partner.

Although reciprocity is not unique to conglomerate corporations, the increase in the number and size of conglomerations during the 1960s highlighted the potential threat of reciprocal buying and selling. One of the benefits of conglomerate corporations is the diversity of products they offer.¹¹¹ Although this diversification may be seen as a benefit to the economic efficiency of a conglomerate, a company that can purchase many of the products and services it needs from within its own divisions could damage the potential business partners in their respective markets. Therefore, diversification may create a greater potential for a conglomerate firm to engage in this anticompetitive practice.¹¹²

105. *Procter & Gamble Co.*, 386 U.S. at 570–72.

106. *Id.* at 578.

107. *Id.* at 580–81.

108. See McKinney, *supra* note 98, at 641 (noting that “the decisions of the Supreme Court clearly demonstrate that when an oligopolistic market structure exists, and the acquiring firm is the most likely entrant, as evidenced by ability, product affinity and past history, the potential competition theory can be utilized to block the acquisition of a significant factor in the market”).

109. Lee E. Preston, *A Problematic Approach to Conglomerate Mergers*, 44 ST. JOHN’S L. REV. 341, 347–48 (1970).

110. See *FTC v. Consolidated Foods Corp.*, 380 U.S. 592, 594 (1965) (noting that the vice of reciprocity is that it injects “an irrelevant and alien factor” into the choice of the supplier). *But see* Posner, *supra* note 101, at 530 (arguing that “[i]f a firm sells in a competitive buying market, it will not purchase on disadvantageous terms in order to retain the patronage of the seller . . . assum[ing] that businessmen are rational”).

111. See *supra* Part II.

112. *But see* Wesley J. Liebeler, *The Emperor’s New Clothes: Why Is Reciprocity Anticompetitive?*, 44 ST. JOHN’S L. REV. 545, 545 (1970) (asserting that reciprocity is not always anticompetitive and may be “beneficial

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Lastly, critics of conglomerate acquisitions suggested that the acquisition of a smaller company by a large diversified conglomerate "entrenches" the position of the smaller company in the market.¹¹³ The notion of "entrenchment" stems primarily from the financial status of the acquiring conglomerate.¹¹⁴ Critics viewed conglomerations as "deep pocket" entities that could use the resources from the entire firm to secure the place of the smaller firm in its existing market.¹¹⁵ "Entrenchment" can result in any of number of anticompetitive effects. For instance, some argued that a conglomerate's "entrenchment" could make "competition by its competitors more difficult, raising barriers to entry, and making it less likely that other companies will enter the target's market."¹¹⁶ Therefore, as a result of the size and diversity of the company, a conglomeration could impair competition in any of the markets it enters by providing the smaller acquired firm with access to its arsenal of marketing, financial, and managerial advantages.

The *Procter & Gamble* case also illustrates the fear of entrenchment. The FTC had determined that the substitution of Procter & Gamble for Clorox, an already dominant firm in the bleach industry, would affect the market in a number of the ways described above.¹¹⁷ In accepting the FTC's position, the Court looked at the enormous advantage in advertising and marketing that Procter, and therefore Clorox, would derive from the merger.¹¹⁸ As one of the nation's largest advertisers, Procter could achieve economies in advertising that smaller, specialized firms in the bleach industry could not.¹¹⁹ In addition, critics noted that "Procter's financial resources . . . could make Clorox virtually impregnable: Smaller bleach producers would not compete too aggressively for fear of retaliation, and prospective new bleach producers, faced with the prospects of huge short-term defensive advertising campaigns by Procter-Clorox, might be far less willing to enter the market."¹²⁰

Critics of conglomerations argued that these anticompetitive effects were commonplace among conglomerate acquisitions and urged for stricter enforcement of antitrust statutes against such mergers. In response, proponents of conglomerations argued that the size and diversification of the companies were positive aspects and that, in fact, conglomerations could increase the competitiveness of a given

to the competitive process, even though, like most aspects of competition, it may discomfort some competitors").

113. See Bauer, *supra* note 80, at 353.

114. See *id.*

115. Schlossberg, *supra* note 20, at 377.

116. Bauer, *supra* note 80, at 353; See also Schlossberg, *supra* note 20, at 377 (noting that "the deep pocket alone would discourage competition and entry because the company could obtain financial or other backing to better withstand narrow profit margins").

117. *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 575 (1967).

118. *Id.* at 573 (stating that in "the marketing of soaps, detergents, and cleansers, . . . advertising and sales promotion are vital").

119. *Id.*

120. John Vanderstar, *Conglomerate Mergers: The Developing Antitrust Guidelines*, 44 ST. JOHN'S L. REV. 596, 604 (1970).

market. Toward the end of the 1960s, the Department of Justice began to challenge conglomerate mergers on a number of these grounds.¹²¹ Still, the courts found that the mere presence of one or more of these three effects was not a per se finding that a conglomerate acquisition should be undone.¹²²

B. The Emphasis on Earnings-Per-Share Ratios

A second explanation as to why conglomerations took over the merger world of the 1960s was that the acquisition itself could be made to create an increase in earnings per share.¹²³ The earnings-per-share figure is “one of [the] key financial ratios that corporations report to their shareholders,” as well as disseminate in the financial press.¹²⁴ Although much has been written in hindsight about the practice of earnings-per-share manipulation, it was understood that this was the way of the conglomerate at the height of the merger movement as well.¹²⁵ Conglomerate executives understood that it was an “algebraic fact that when one firm acquires another with a lower [PE (price/earnings) ratio], its EPS [(earnings per share)] rises.”¹²⁶ As a result of this manipulation, conglomerations have been called “figments of Wall Street’s imagination.”¹²⁷ Still, investor reliance on the earnings-per-share figure helped to support the rise in merger activity in the 1960s.

The typical conglomerate transaction occurred when a conglomerate, usually with a high price/earnings ratio, acquired a company with a much lower price/earnings ratio.¹²⁸ For instance, suppose that the stock of a conglomerate firm (Conglomerate) is selling at \$45 per share and is earning \$1 per share. A second firm (Target), a specialized company with the same number of outstanding shares, has stock selling for \$10 per share and earning \$1 per share as well. In an attempt to acquire Target, Conglomerate offers one of its shares for every three of Target’s shares.¹²⁹ After the merger, Conglomerate can combine the earnings of the two firms and restate them for the diluted equity. Therefore, the result of the acquisi-

121. As of 1968, the Department of Justice had begun to challenge the acquisition of Jones & Laughlin Steel Corporation by Ling-Temco-Vought, Inc., to compel the divestiture of Canteen Corp. by International Telephone and Telegraph Corp., and to attack the proposed takeover of B.F. Goodrich Co. by Northwest Industries, Inc. See Shea, *supra* note 77, at 536.

122. *Id.*

123. Malkiel, *supra* note 72, at 57; John G. Matsusaka, *Takeover Motives During the Conglomerate Merger Wave*, 24 RAND J. OF ECON. 357, 359 (1993) (describing that buyers were driven by earnings-per-share manipulations).

124. Martin Mellman & Norman Prinsand, *That Complex Earnings Per Share Figure (A Product of the Merger Movement)*, 44 ST. JOHN’S L. REV. 894, 894 (1970).

125. See Dean, *supra* note 35, at 17 (stating “[u]nderstandably, rapid and uninterrupted growth in earnings per share is the central objective of the modern conglomerate”).

126. Matsusaka, *supra* note 123, at 359.

127. Cohen, *supra* note 78, at 50.

128. See *id.* at 51 (proposing the hypothetical throughout this paragraph); Matsusaka, *supra* note 123, at 359.

129. This would be an agreeable offer for Company B’s shareholders, because it would result in a 50% premium on the shares. See Cohen, *supra* note 78, at 51.

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tion is that Conglomerate's stock now earns \$6 for every four shares, for a per-share profit of \$1.50.¹³⁰ Although there has been no change in the performance of the companies apart from the actual acquisition, the earnings per share of the resulting conglomeration is higher. To continue to be attractive to its shareholders and its investors, conglomerates were required to continue this pattern of acquisitions. Otherwise, as some predicted, the conglomeration would no longer enjoy the confidence of its investors.¹³¹

The emphasis investors placed on the earnings-per-share figure gave conglomerate corporations the incentive to continue to manipulate their earnings per share through acquisition.¹³² Whenever a company acquired another company whose shares were selling at a lower price/earnings ratio, the result would inevitably be that the earnings per share of the merged company would be predictably higher than it was in the previous year. These acquisitions gave the appearance of corporate growth where there was actually none.¹³³

C. *The Use of Questionable Accounting Practices*

The rise in conglomerate mergers can also be explained by the benefits conglomerations derived from certain controversial accounting practices. Specifically, the pooling-of-interests accounting method and the accountant's treatment of goodwill are two issues that frequently drew criticism toward the height of the conglomerate merger area. The pooling-of-interests method and the goodwill controversy are not unique to conglomerate mergers. Each of these practices was generally available for use by accountants dealing with nonconglomerate companies.¹³⁴ In fact, "the accounting profession [had] not developed any new accounting principles or practices in the 1960's which could be cited as fostering conglomerate growth."¹³⁵ Instead, conglomerates drew criticism for these practices mainly because the frequency of acquisitions by conglomerates highlighted the issues raised by the methods.¹³⁶ Despite the contentions raised by the movement's critics, these accounting

130. Accordingly, Conglomerate's stock based on its price/earnings ratio of 45 rises to \$67.50. *See id.*

131. *See* Cohen, *supra* note 78, at 52 (predicting that "a day of reckoning will come if the conglomerate runs out of acquisitions, or its price-earnings ratio falls. Then, if there is no internal growth in earnings, the market price of the conglomerate's stock will fall as growth expectations collapse").

132. *See* Birdzell, *supra* note 76, at 293 (noting that "[t]he high price-earnings ratios placed on the leading conglomerates by an enthusiastic stock market gave them the appearance of a wave of the future, with a potential without clear limits").

133. Gilbert Burck, *The Merger Movement Rides High*, *FORTUNE*, Feb. 1969, at 81.

134. *See* Wyatt & Spacek, *supra* note 50, at 827 (stating that the "fact is, of course, that accounting principles applicable to conglomerates are no different from those applicable to the wide range of nonconglomerate businesses").

135. *Id.* at 808.

136. *See* Homer Kripke, *Conglomerates and the Moment of Truth in Accounting*, 44 *ST. JOHN'S L. REV.* 791, 795 (1970) (noting that the "pooling and goodwill controversies . . . are not peculiar to conglomerates, but they are highlighted by the frequency of acquisitions by conglomerates").

principles aided the rise of conglomerates by allowing conglomerate firms to take advantage of these beneficial practices.

The pooling-of-interests accounting method can be used to increase the financial appearance of a conglomerate after an acquisition. The method was one of two available accounting methods during the conglomerate merger movement. The first was the purchase accounting method, through which the acquiring company would include the fair market value of all assets of the acquired company, including intangibles, into its balance sheet.¹³⁷ The pooling-of-interests method allows a conglomerate corporation simply to combine the balance sheets of the merging and acquiring companies as they existed before the acquisition. There is no adjustment in the basis of the acquired firms' assets; all assets and liabilities "in the accounts of both or all predecessor companies simply are carried forward to the accounts of the continuing or resulting enterprise."¹³⁸ Upon a comparison of these two accounting methods, conglomerate management concluded that the pooling-of-interests method was a more desirable practice from the point of view of the acquiring firm.

Although the pooling-of-interests accounting method has its benefits for the financial appearance of the conglomerate firm, many critics of the method suggested that the practice lent itself to questionable applications. Similar to the earnings-per-share manipulation described in the previous section, the pooling-of-interests method allowed firms to demonstrate a significant increase in earnings per share on their balance sheets.¹³⁹ Therefore, a conglomerate that failed to achieve its earnings expectations could mask its deficiency by acquiring another firm and adding the entire yearly earnings of the acquired firm to the conglomerate's existing balance sheet.¹⁴⁰ The practical result, as critics argued, was that conglomerate corporations took advantage of these accounting options "to glamorize their profit performance to exploit speculative behavior in a securities market hungry for 'growth' type companies."¹⁴¹

A second accounting practice that allowed conglomerates to demonstrate an improved post-acquisition financial picture was the treatment of goodwill. Goodwill is commonly referred to as the difference between the price paid by the acquiring firm in an acquisition and the current values of the acquired firm's tangible assets. Many executives and accountants disfavored amortization of goodwill "not only

137. See Wyatt & Spacek, *supra* note 50, at 811.

138. *Id.* at 811.

139. *Id.* (noting that when "the book values of tangible assets differ greatly from their fair values . . . a substantial but spurious profit can be reported"). See also Lee J. Seidler, *Mergers: The Accountant as a Creative Artist*, 44 ST. JOHN'S L. REV. 828, 841 ("It is logical to expect that pooling with a profitable company will increase total earnings").

140. See Abraham M. Stanger, *Accounting for Business Combinations: Choice or Dilemma*, 44 ST. JOHN'S L. REV. 864, 868 (1970) (stating that the acquiring company "acquires the benefit of the prior earnings of the acquired corporation by reflecting these on its balance sheet and by restating prior income statements on a combined basis").

141. Henry P. Hill, *Accounting Options for Conglomerate Growth*, 44 ST. JOHN'S L. REV. 855, 855 (1970).

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because of its impact on earnings, but also because it injects a meaningless element into the determination of income."¹⁴² This treatment of goodwill is tied into the discussion of the pooling-of-interests practice. Under the pooling-of-interests method of accounting, the balance sheets of the acquiring firm fail to recognize goodwill. As a result, the acquiring conglomerate does not have to deal with the issue of goodwill amortization.

These two accounting practices primarily allowed conglomerate corporations to improve their financial images through the continuous acquisition of target companies. Because of their highly diversified business activities and their desire to grow through acquisition, conglomerate companies likely encountered these accounting questions more often than specialized firms did.¹⁴³ As noted earlier, the conglomerates did not employ unlawful or fabricated accounting practices in their acquisitions of other companies.¹⁴⁴ Their ability to rely on the pooling-of-interests method, and therefore on the nonrecognition of goodwill, helped maintain investor interest and confidence in the conglomerate form by improving their overall financial picture with their patterns of acquisition.

V. CONCLUSION

Looking back on the 1960s, many academics discredit the theories that served as the impetus for the heightened conglomerate merger activity. Current research proposes that despite their appearance of financial growth and the idea of synergy between two merging companies, many conglomerations were not financially sound in their post-takeover life.¹⁴⁵ Moreover, some research explains that corporate diversification, though idealized by the proponents of the conglomerate era, actually reduced the value of the conglomeration.¹⁴⁶ Perhaps this is one explanation for why the conglomerate merger wave waned in the early 1980s, when conglomerate executives began to divest the divisions they acquired during the 1960s and 1970s.¹⁴⁷

For as long as the wave lasted, however, the conglomerate merger form appeared to be the most attractive type of business entity available for investors and business executives alike. In part, conglomerates gained popularity because they appeared to

142. Wyatt & Spacek, *supra* note 50, at 812; *see also* Kripke, *supra* note 136, at 796 (relating that "[i]n purchase accounting the acquisition puts them on the books of the acquiring company as goodwill, where they again hurt earnings if the goodwill is amortized").

143. *See* Russell A. Taussig, *Combinations, Permutations and Pooling*, 44 ST. JOHN'S L. REV. 846, 846 (1970) (noting that "[o]ne outspoken critic of pooling has expressed the opinion that many acquisitions would be impossible were it not for the cosmetic accounting used by corporate raiders to improve . . . reported earnings").

144. *See* Wyatt & Spacek, *supra* note 50, at 827.

145. *See* Fluck & Lynch, *supra* note 42, at 320 (stating that studies indicate that, "at least for the 1960s, many of these conglomerate mergers involve financially distressed firms").

146. *Id.* at 319 (noting that several studies have shown that diversification tended to be value reducing).

147. *Id.* (noting that studies conducted show that somewhere between 33% and 50% of companies acquired during the conglomerate merger wave of the 1960s and 1970s were subsequently divested).

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be a more stable and efficient type of company than a firm that specialized in only a single product and operated in only one market. Additionally, the earning power of conglomerations appeared to investors to be ever-increasing through the manipulation of the earnings-per-share ratio and certain controversial accounting practices. Lastly, it is possible that conglomerations came to the foreground of the business world because executives seeking expansion through acquisition had no alternative other than the conglomerate merger. Taken alone, each of these explanations for the increase in conglomerate merger activity would not justify such a tremendous surge in the conglomerate form. The combination of these factors, as well as others that lie beyond the scope of this Article,¹⁴⁸ create a framework that could help explain why proponents in the merger-wave era believed that the conglomerate form would be “the only way of business life” in the future.¹⁴⁹

148. See *supra* note 67 and accompanying text.

149. See Brinberg, *supra* note 1 and accompanying text.