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# The Conglomerate: An Agglomeration of Views Reviewed

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# THE CONGLOMERATE: AN AGGLOMERATION OF VIEWS REVIEWED

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The impressive array of papers which makes up this volume touches almost every aspect of the problem raised for antitrust policymakers and implementers by the conglomerate form of business organization. Since I have been cited in one of these papers (Kuhlman and Duke) as one who sees the conglomerate as "a new and dangerous threat . . . ," and on the basis of an earlier article[1] in this journal have been termed a defender of these same conglomerates, I feel ideally situated to attempt to place these valuable, separate contributions in some broader perspective. Who, after all, is better qualified as a synthesizer than one who has himself straddled the issues?

The range of the papers here included is impressive. They reflect the fact that many economists are seriously concerned about any further weakening of the vigor of competition in our economy, vaguely feel that conglomeration poses some such threat, but find, in Richard Miller's words, that "the analytical links between a conglomerate merger and an increase in monopoly power are generally unconvincing . . . ." Professor Kamerschen, in fact, finds that the recent wave of conglomerate mergers "has had little direct impact on market concentration." It is, of course, correct that conglomerate mergers, by definition, do not create a problem of added concentration in some "relevant market." Indeed, the Justice Department has relied on no such argument; rather, it has based its policy position on the fear of "superconcentration." This argument rests on the view that our antitrust laws are rooted in a social philosophy which abhors excessive concentration of economic power. Mr. McLaren, for example, has noted that the antitrust laws seek to preserve competition because "it protects our political system by promoting a broad dispersion of economic power among the many, rather than concentration in the hands of a few."[2] With this interpretation of the social objectives of the antitrust laws it is difficult to quarrel. And there is little question that, when the Congress amended the Clayton Act[3] in 1950, it had similar objectives, fearing what Representative Celler called "the level of concentration in American industry";[4] and what Representative Boggs called "one of the most detrimental movements to a free enterprise economy — . . . the conglomerate acquisition."[5] Indeed, the House Report accompanying the bill sought "to make it clear that the bill

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1 Stelzer, *Antitrust Policy and the Conglomerates*, 44 ST. JOHN'S L. REV. 196 (1969).

2 *Current Antitrust Division Policy on Mergers, Acquisitions and Joint Ventures*, address by Richard W. McLaren, Town Hall of California, Los Angeles, California, May 27, 1969, at 3 (mimeo).

3 15 U.S.C. § 12 *et seq.* (1964).

4 95 CONG. REC. 11,489 (1949).

5 *Id.* at 11,496.

applies to all types of mergers and acquisitions, vertical and conglomerate as well as horizontal . . . ."[6] But, it adds, "which have the specified effects of substantially lessening competition . . . or tending to create a monopoly."[7]

So, we come full circle. Conglomerate mergers are to be prevented when they lessen competition. But do they?

The views expressed in these papers cover a wide range. Stanley Hollander finds conglomerates to have a beneficial effect on competition and consumer welfare in the retail trades; William Smith favors a "sympathetic" attitude toward financial congenerics; and John Kuhlman and Richard Duke find it "impossible . . . to assert that conglomerate acquisitions reduce competition within the traditional interpretation of that phrase." Werner Sichel more or less concurs: "Conglomerateness *per se* does not impede competition," and is joined by Richard Miller, "Analysis . . . indicates that conglomerate mergers and corporate diversity may improve competition or be neutral, contrary to the analysis contained in current merger policy."

On the other hand, Joel Dirlam has a less sanguine view concerning the structural impact of conglomerates. "As the diversity and size of the conglomerates grow, the possibility that further mergers will eliminate potential competition is easier and easier to envisage." In this view he is joined by Charles Berry, who sees conglomerate mergers as "a way, if not of creating market power, certainly of augmenting such power."

As I read these papers, certain generalizations suggest themselves.

First, as indicated above, the dominant view concerning the relation of conglomerates to market structure is that they do not increase concentration, but do increase business size. Those who focus on the former aspect of market structure tend to be relatively undisturbed by the now-ebbing conglomerate merger wave; those who fear business "size" (Dirlam) or "power" (Corwin Edwards), or "corporate scale" (Berry) are more troubled by the conglomerate phenomenon. My own view is that while conglomerates do indeed increase the size and scope of business units, they provide the important offsetting advantage of enabling newcomers to rise to positions of economic power, introduce new ways of financing and managing businesses, and unseat entrenched managements. This, rather than some concept of optimum corporate size, may be just the fluidity the antitrust laws seek to preserve. Mr. Mitchell has admonished that conglomerate mergers may "indeed be a threat to our . . . social structure."[8] But they may be a "threat" in a very different sense from that understood by the Attorney General's auditors. When the respected London *Economist* reported on the move against the LTV-Jones & Laughlin merger, it noted:

> Outside Washington a discreet cheer for the suit against Ling was raised in the boardrooms of the big steel companies; the steel trade unions liked it too. A raider like Ling-Temco-Vought is an instant and

6 H.R. REP. No. 1191, 81st Cong., 1st Sess. 11 (1949).

7 *Id.*

8 Address by John N. Mitchell, Georgia Bar Association, Savannah, Georgia, June 6, 1969, at 4 (mimeo).

> unwelcome competitor to the established giants, and with its higher earnings multiples can even threaten to buy them out. As for the unions, they find it harder to bring a multi-product company like Ling to its knees in a dispute than a mammoth but almost single-product company.[9]

And Senator Philip A. Hart, Chairman of the Senate Antitrust and Monopoly Subcommittee, wondered about the sudden spurt in interest in attacking new, but not "established," diversified firms in an attempt "to maintain the status quo."[10] There are, after all, "close to a dozen apparently traditional U.S. corporations . . . which possess a breadth of unrelated diversification at least as great as that of the so-called conglomerates."[11] Indeed, as L. E. Birdzell notes in his paper, diversification is a traditional and accepted practice in American industry, although he suggests that, to some extent, "the older multi-product firms in fact diversify more from necessity than from choice . . . ."

The direction in which policy is pushed by a desire to preserve competition is, then, not clear. Conglomerate mergers would appear to provide, in many instances, the only realistic possibility of entry by a newcomer — management with, perhaps, a different view of such things as the efficacy of price competition — into concentrated industries. They often provide, in their take-over bids and threats, an opportunity for stockholders to unseat otherwise all-but-impregnable, self-perpetuating managements. *Fortune* notes, "The recent merger wave, especially the take-over bid, has powerfully revived the influence of stockholders."[12]

That the entry of a newcomer via merger, rather than through the construction of new productive capacity, can be unsettling there is little doubt. Take the case of Wheeling Steel during the period of Norton Simon's reign. In contrast to the other steel producers, Wheeling adopted a policy of protecting its customers against price increases instituted after their orders were taken. This, in the words of the trade press "broke the solid steel front of 'price in effect at time of shipment.' "[13] Whether or not Wheeling could handle the resultant flood of business is irrelevant for our purposes; the fact remains that a *new* manager of *existing* assets tried a new method of pricing, to the consternation of the steel establishment. Would the cause of competition have been served by keeping the Hunt Foods conglomerate out of the steel business? Jules Backman is undoubtedly correct when he points out, in his article, "By 'shaking things up' the conglomerate can add a new dimension to competition in many markets."

When we turn from structure to problems of business practice, the difficulties increase. The most widely discussed problem is that of reciprocity.

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9 *Biting the Hand of Business*, THE ECONOMIST, Apr. 5, 1969, at 35.

10 Address before the Lawyers Club of the University of Michigan, Ann Arbor, Michigan, Apr. 8, 1969, at 2 (mimeo).

11 *The Multicompanies: Conglomerate, Agglomerate and In-Between*, FORBES, Jan. 1, 1969, at 77.

12 *Got a Light, McLaren?* FORTUNE, May 1, 1969, at 62.

13 IRON AGE, Sept. 1, 1966, at 142.

And here, two questions are raised: (1) Is reciprocity "bad"? (2) Does conglomeration enhance the possibility of its occurrence?

Mr. Birdzell feels that reciprocity is neither "unambiguously evil" in effect or so likely of occurrence "that otherwise reasonable forms of business organization must be suppressed in order to avoid reciprocity." Backman, in an extensive discussion of reciprocity, attempts to distinguish "the opportunity for reciprocity" from "the actual practice of reciprocity." Indeed, he goes further, and argues that where price and other factors are identical, "it is illogical to hold that a company is guilty of an anticompetitive act when purchases are made from its friends," *i.e.*, "a supplier who also is a good customer." Why, then, do so many place such emphasis on the reciprocity problem? I suspect it stems from two basic sources. First, as Dirlam points out, "Expansion through conglomerate merger increases the number of markets in which there may be a danger of reciprocity." Second, the public sense of equity is offended by the notion that a corporate interrelationship, rather than efficiency, determines who becomes a major corporation's supplier.

In my own view, diversification (not only conglomeration) does enhance the possibility of reciprocity. A business firm engaged in many areas of activity can demand from suppliers of one division reciprocal business for another. Indeed, in some instances it need make no explicit demand; the matter can be left to its suppliers' imaginations, and what Judge Timbers has called the "reciprocity effect" may occur.[14] And there is little doubt that reciprocity is a widespread practice, although one which is probably declining (at least on a formalized basis).[15] But the potential for reciprocity which conglomeration produces is as likely to be the result of diversification by internal expansion as it is of conglomeration by mergers. Consequently, if we were to forge a public policy aimed at preventing the creation of any potential for reciprocal business dealing, we would have to develop some program aimed at preventing diversification via internal growth as well as via merger. And this none of the authors represented here states a clear willingness to do. Perhaps we shall have to learn to live with the *potential threat* while sharpening our attack on the *actual practice* of reciprocity. This can be done by careful analysis of the extent to which a company's purchasing policy is guided by a desire to reward customers. In this connection it has been my own experience that the more usual quantitative methods are of little value. The simple statement, "I'll buy from you if you buy from me," would imply the usefulness of measures of interrelationship (correlation) to detect reciprocity. But we have found that such techniques yield spurious results in some instances. Another technique and its associated statistical tests may, however, be used to detect and measure reciprocal practices.

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[14] United States v. International Tel. & Tel. Corp., 306 F. Supp. 766, 781 (D. Conn. 1969).

[15] Mr. McLaren has noted that as a result of the Department's enforcement efforts, "[f]irms that engaged in systematic reciprocity more or less in self-defense have tended to abandon it. . . ." Address by Richard W. McLaren, in BNA ANTITRUST & TRADE REG. REP. A-5 (Feb. 3, 1970).

This technique employs the use of purchase and sales data of potential reciprocity and nonreciprocity candidates. Detailed comparisons of sales and purchase increases and decreases can be developed. These then can be compared with the kinds of increases and decreases which one would expect in the presence or absence of reciprocity. These relationships can be analyzed statistically and tested through probability analysis. The final output from this analysis is then twofold: the qualitative acceptance or rejection of the hypothesis that "reciprocity has existed," and a quantitative determination of its extent, if any.

These should provide supplements to the studies of the factors suggested as relevant by Judge Timbers: whether the product characteristics lend themselves to reciprocal dealing (Backman notes that some products "are not susceptible to reciprocity"); the size and diversification of other competitors; and so on.

By thus focusing on the *practice,* as the Justice Department did in the case of U.S. Steel, it can eliminate the dichotomous policy of moving against conglomerate mergers which create only the potential for reciprocity, while supporting a bill which would be likely to permit banks to enter the insurance, travel agency and other businesses — this in a period of tight money and where many states have interest rate ceilings. For banks are, as Fitzgerald said of the very rich, different from the rest of us. Not only do they, as Hemingway reportedly pointed out in response, have more money, but their substantial power over credit creates such a probability that their customers will feel obliged to use their other divisions, that bank diversification should be separately and more closely restricted. (But note carefully William Smith's contrary argument that the analysis on which this conclusion rests "failed to acknowledge the essential dynamics of market structure where resale price maintenance with free entry prevails.")

The other widely treated problem is that of subsidization, with Dirlam perhaps raising the issue most squarely. There can be little question that conglomeration creates a danger of subsidization. Conglomerates can, if they so choose, finance operating losses of one subsidiary or division with profits from another — and for protracted periods. This results in resource misallocation as well as in possible competitive injury to the efficient, nondiversified competitor. The latter finds himself faced with the competition of a division immune from the market test of its efficiency, and from the penalty for inefficiency.

Again, however, we are faced with a problem which is implicit in all conglomeration, not only conglomeration via merger. The question, which it seems to me can only be answered on a case-by-case basis, is whether this potential for subsidization actually materializes and what policies can be developed to minimize the extent of subsidization.

That there is a substantial amount of short-run subsidization in any diversified enterprise I do not doubt. Whether there is long-term subsidization of uneconomic ventures I do not know — this is one of several areas in which our lack of knowledge of the behavior of diversified enterprises is monumental. Consequently, as Dirlam notes, in this as in other areas "public or private conclusions must be tentative." But we do know that conglomerate managements are under particularly severe pressure to maintain rapid growth in earnings (see Kuhlman and Duke's paper). We also can safely guess that what Henry Einhorn in his article terms "improved disclosure rules," perhaps including divisional profit reporting, are just around the corner. Perhaps for these reasons, there seems to be a growing pressure on big firms to spin off their losing and marginal operations. The trade journal of the merger movement, *Mergers and Acquisitions,* looks to the sale of divisional subsidiaries or branch operations as a source of "much activity in the coming decade."[16] *M & A* notes, "There is far more status to lose in the management community by keeping a loser going than in trying, failing and getting out quickly."[17] As a consequence, over 20 percent of the consummated mergers now represent the sell-off of a division, subsidiary or product line — and these sell-offs are occurring at twice the average of earlier years.[18] Examples abound: Walter Kidde & Company is reportedly considering selling divisions which might, as independent companies, command higher market multiples; Computing & Software, Inc. sold its Gencom Agency to E.M.I. Electronics Ltd. (Gencom distributed E.M.I.'s electro-optical products) to permit "further management concentration on the company's primary business endeavors";[19] Bendix sold its semiconductor business to Solitron Devices, Inc., and so on. (These sales may, of course, represent something other than disposal of a loser: an acquirer may possess some scarce resource which will accelerate the growth rate of another company's division, and hence be in a position to offer an irresistibly attractive price.)

To the extent, then, that we now have sell-offs of divisions, and that this will be accelerated by the advent of divisional profit reporting, the danger of subsidization is reduced. And, of course, any systematic subsidization aimed at driving out a competitor always has been subject to antitrust action. Consequently, in view of the fact that subsidization is a potential danger inherent in all diversification, not only conglomeration via merger, and in light of the considerations discussed above concerning the need to maintain fluidity, the potential for subsidization does not seem to provide a clear and sufficient basis for an overall anti-conglomerate twist to antitrust merger policy.

But these tentative conclusions are my own. The wide range of information and the sharp insights provided by the authors represented in this volume certainly permit quite contrary judgments to be reached. In either case, however, the judgments will be more informed, and the level of the debate elevated, by the existence of this volume.

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16 *The Merger Boom — How Long Can It Last?*, MERGERS & ACQUISITIONS, Spring 1967, at 8.

17 *Id.* at 9.

18 Corporate Sell-Off, MERGERS & ACQUISITIONS, May-June 1969, at 78.

19 *Id.* at 79.