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Martin L. Lindahl

CONGLOMERATE MERGERS AND ACQUISITIONS: AN INTRODUCTION

MARTIN L. LINDAHL*

Gathered here are approximately 30 articles dealing with conglomerates and conglomerate mergers.[1] They are of very high quality on the whole and present a great variety of materials and points of view. An interesting feature of the papers is the inclusion of materials going beyond the diversified firm operating largely in the manufacturing sector of the American economy. Financial conglomerates and congenerics, the latter being diversified companies engaged in banking and markets closely related to banking, are subjected to careful analysis in papers by Peter Gutmann[2] and William Smith.[3] Professor Gutmann outlines the factors accounting for the phenomenal growth in recent times of the one-bank holding company. He reviews the numerous possible abuses in such institutions, which range from the creation of bank dominated economic power centers, to unfair competition in the form of tied loans and unequal access to credit. These abuses prompted the enactment of regulatory legislation by the House in late 1969, which if concurred in by the Senate, spells the doom of the financial conglomerate and greatly restricts the congeneric. Mr. Smith's essay supplements the Gutmann piece by focusing on the prospective contributions to competitive rivalry and consumer welfare by the financial congenerics. The appropriate antitrust stance, in Mr. Smith's view, should be sympathetic toward diversification mergers, especially where entry into promising new markets is facilitated by the acquisition of "core" or "fringe" firms rather than those already dominant in the related market.

Another type conglomerate, namely, the huge, complex, diversified firm in the retail trades, is treated by Professor Hollander.[4] He finds an unprecedented diversification at the enterprise rather than the establishment level, and efficiencies in the large trading conglomerate that augur for the promotion of competition and consumer welfare rather than an undesirable concentration of economic power. Professor Hollander notes briefly the reaction of foreign observers to the growth of trading conglomerates. Finally, Hans Mueller[5] in his essay pays brief attention to some international aspects of and attitudes toward the development of conglomerate enterprise in manufacturing and related fields.

An economic reappraisal of the manufacturing conglomerate at this

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* Emeritus Professor of Economics, Dartmouth College.

1 Within the time constraints, the *St. John's Law Review* was able to supply approximately 20 articles to the present writer to read in preparing this note.

2 *See* p. 471 *infra.*

3 *See* p. 483 *infra.*

4 *See* p. 235 *infra.*

5 *See* p. 460 *infra.*

point in time is most appropriate. The stock markets have been making such a reassessment, and as of mid-January, the average market prices of a group of leading conglomerate common shares stood at 52 percent of their annual highs. Some stocks had declined as much as 60 to 75 percent from their highs recorded within the year. The materials in the individual essays that may serve as the basis for an evaluation may be classified in two broad categories. Some of the papers treat virtually all aspects of the conglomerate merger movement, whereas the others relate to some specific bit of evidence of significance in evaluating conglomerate enterprise. Prominent in the latter category is John Boyle's[6] painstaking and impressive analysis of pre-merger growth and profit characteristics of acquired firms in conglomerate mergers. He concludes that over 90 percent of the large corporations acquired in recent years were strong and financially viable companies. They were not "potentially" failing companies, as has been asserted, but were instead firms fully capable of challenging the entrenched positions of larger companies had they not been swallowed up in conglomerate mergers. Professor Thomas Hogarty,[7] without distinguishing the type of merger, also deals with the profits of mergers. He reviews data for the period 1953-1964 and finds that the "average merger produces zero functional gains and some mergers produce extraordinary profits." He makes the observation that mergers would be an attractive form of investment for "risk-takers," an apt characterization, perhaps, of the managers of conglomerates.

Raymond Piccini[8] finds that mergers have been a minor source of growth for most of the hundred largest companies in the post-war period. His group of one hundred companies contained few conglomerates, but those large companies most actively engaged in mergers did diversify through merger to a greater extent than the others while the firms acquired were larger than other acquired companies. Professor John Kuhlman and Richard Duke,[9] in a well-reasoned and perceptive essay, venture the findings that the highly-leveraged conglomerates are sensitive to adverse business conditions, that there are no apparent real economies in the purchase and sale of companies, and that eventually conglomerates will be forced to adopt traditional strategies, make capital allocation decisions, and become truly concerned with the operations of acquired companies. They see the major problem as financial in nature, and not a reduction in competition in the conventional sense. A restructuring of the private sector has occurred which may or may not be a more rational economic organization. Finally, Professor John Ferguson[10] examines the competitive effects of the product-extension merger as illustrated by *FTC v. Procter & Gamble Co.*,[11] and

6 *See* p. 152 *infra.*
7 *See* p. 378 *infra.*
8 *See* p. 171 *infra.*
9 *See* p. 61 *infra.*
10 *See* p. 392 *infra.*
11 386 U.S. 568 (1967).

General Foods Corp. v. FTC.[12] He is severely critical of the Federal Trade Commission's analysis and finds that economies of scale in advertising derive from sales in several markets, and to allow such mergers is to permit a larger number of firms to exist in a consumer product market, thus lowering concentration. Both product-extension mergers and advertising are found to benefit consumers.

Several of the essayists, notably Jules Backman,[13] L. E. Birdzell,[14] Richard A. Miller,[15] and J. Fred Weston,[16] present comprehensive treatments embracing the historical, theoretical, and empirical aspects of diversified firms. They consider at length the objections to conglomerate mergers voiced by Corwin Edwards[17] and others, some of which have afforded the basis for antitrust actions as well as actual court decisions. The encouragement of cross-subsidization and predatory pricing, the increased use of reciprocity and reciprocal arrangements to promote sales, the removal of a potential entrant into a market penetrated by merger, the increase in "deep pocket" advantages to acquired firms, a raising of entry barriers, enhanced forebearance in competitive activity among firms in the relevant market, and the extension of monopoly power are all discussed ingeniously and exhaustively. For the most part, the objections are found not to stand up in the light of economic theory, business practice, and empirical evidence, or are found to be greatly exaggerated in their anticompetitive implications. The positive economic contributions of conglomerates in diversifying risk, invigorating lethargic and inefficient firms, attaining a specialization in management as between headquarters and operations executives, and instituting systems approaches and more objective resource allocative decisions are, as Mr. Birdzell puts it, good reasons for continuing the experiment of testing new forms of organization in the laboratory of a free economy.

A multitude of views respecting public policy toward conglomerate mergers will be found in the papers. Practically every author finds an opportunity to express a view regarding policy. Those writers who find that conglomerate mergers have uncertain, neutral, or procompetitive effects, of course, deplore the attempt to forestall them, often characterizing it as an attack on "bigness" as such, and would favor a permissive policy for the time-being at least. Professor Werner Sichel[18] and others see no need for adding new legislation against conglomerates since the antitrust laws already are directed at any substantial monopoly control that conglomerate growth may engender in any line of commerce.

Several of the papers contain new ideas, concepts, and instruments of

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12 386 F.2d 936 (3d Cir. 1967), *cert. denied*, 391 U.S. 919 (1968).

13 *See* p. 90 *infra*.

14 *See* p. 292 *infra*.

15 *See* p. 211 *infra*.

16 *See* p. 66 *infra*.

17 *See* p. 416 *infra*.

18 *See* p. 356 *infra*.

analysis for antitrust purposes. Professor John Narver,[19] for example, develops new and potentially useful concepts in viewing firms as pools of mobile or adaptable resources capable of responding readily to a range of demand for products called a "supply space." Merging firms actually occupying the same supply space or line of commerce would be viewed as possessing the same ability to supply, hence the merger could be identified as horizontal even though in a static context it would be described as conglomerate. Supply-space analysis presented in terms of objective data would reveal fully the competitive implications of any merger and would, it is asserted, make it difficult for large firms seeking growth by merger in a particular supply space, yet permit mergers among small firms which will not increase concentration but promote competition. Professor Lee Preston,[20] in a similar vein, argues that beyond the tracing of structural and behavioral changes stemming from conglomerate mergers, the emphasis on documentation and analysis should be shifted toward a survey of the number of different situations in which anticompetitive effects may arise. Such a survey, using input-output tables, might reveal potential reciprocity possibilities, instances of potential foreclosure, and situations in which sources of potential competition have been eliminated. These competitive impacts plus their individual probabilities and the overall probability of one or more significant effects should be taken into account in individual cases and in determining more general judicial standards. Such analytical approaches and judicial criteria that go beyond the traditional, it is argued, are essential to the effective application of section 7 to conglomerate mergers.

Other proposals worthy of note are those of Professor David Kamerschen,[21] Professor Henry Einhorn,[22] and Professor Charles Berry.[23] Professor Kamerschen believes that Adams' proposal, to apply the notion of the physically integrated public utility holding company complex to reorganizations of conglomerate companies having unwarranted concentrations of economic power, is worthy of consideration. Such integration, geographic or otherwise, would apply only to large firms and hopefully would enhance corporate efficiency and technological progressiveness. Professor Einhorn also borrows from the sector of regulated industries for a proposal to deal with the inflexibility of the current evaluation and control of pure conglomerates. He advocates a procedure whereby each conglomerate merger would be evaluated on its own merits and both the beneficial and the harmful features weighed to determine its "net" economic impact. In determining whether or not mergers are in the "public interest," regulatory agencies must probe for and recognize anticompetitive effects, but may find economies or other benefits to the public of such significance as to override

19 *See* p. 316 *infra.*
20 *See* p. 341 *infra.*
21 *See* p. 133 *infra.*
22 *See* p. 451 *infra.*
23 *See* p. 266 *infra.*

the anticompetitive impact. While much can be said for considering each merger on its merits under the regulated industry procedure, there may be some question as to the capability of courts to evaluate and weigh the disparate economic factors involved. There is a real danger also that the performance of the merged company will not yield the alleged benefits, and yet result in irretrievable social losses in terms of anticompetitive consequences.

Much more acceptable in the view of this commentator are the basic argument and the proposals supported by Professor Berry in his paper on the conglomerate merger and economic policy. He takes issue with the general proposition that conglomerate mergers as now defined are not capable of creating, or at least augmenting, market power and therefore, attempts to prevent them impose needless social costs in terms of efficiency. Professor Berry urges that many conglomerate mergers embrace firms having market power in industries that are not totally independent, and, where close or even distant substitutes are involved, the degree of market power may be enhanced in both markets. But more important is the influence of such mergers in the "dynamics of industry structure" in eliminating the threat of entry by large industrial corporations that are uniquely suited to surmount entry barriers stemming from corporate scale requirements for successful operation in the protected industries. While barring the merger of large firms, there would be no objection to the actual entry of a large firm by the acquisition of a minor firm that could strengthen its competitive position by taking advantage of the retained earnings, the nationally known corporate name, or the technological know-how of the acquiring company. Berry supports, with some reservation, the proposal in the *White House Task Force Report on Antitrust Policy*,[24] which would limit the acquisition by a large firm (assets of $250 million or annual sales of $500 million) of a leading firm (one having a market share of 10 percent or more and one of the four largest) in a concentrated market. The thrust of the merger restriction would be to guide the activity of large firms in a competitive direction that would lessen market concentration in the future and retain the salutary impact of the threat of entry upon performance in concentrated markets.

It is quite apparent that economists have engaged in extensive investigation and hard thinking about a significant current problem in the antitrust field. There are still wide gaps in our knowledge of conglomerate mergers, as the writers have been quick to point out, but notable progress has been made. The nonprofessional reader may be disappointed to find a lack of consensus among scholars in a venerable and mature discipline like economics. But despite the lack of agreement, the ideas presented in the papers in this *Symposium* will be extremely helpful in fashioning a policy toward conglomerate mergers which will be for the public good.

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24 1968 PRESIDENTIAL TASK FORCE REPORT ON ANTITRUST, 115 CONG. REC. 5642 (daily ed. May 27, 1969).