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THE CONGLOMERATE MERGER WAVE: AN INTRODUCTION

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It will take time to place "the conglomerate merger wave" in perspective and evaluate its consequences. Few industrial events have excited quite the hyperbole, on many sides, evoked by the recent fast growth of a number of new firms, even though they are still a minor and untested factor compared to established firms (including older conglomerates).

The cross-currents of opposing interests, some of them very deep and powerful, have surfaced both in commentary and in policy. Where the pressures and complexities of the issues so greatly transcend the stock of empirical knowledge, there is bound to be confusion.

This brief introductory note will try to specify the economic questions which will endure beyond the present phase of the debate and to comment on one aspect of policy. The papers which follow do address, or at least touch on, most of these issues, in some cases creatively.[1] The papers are remarkably fresh and thoughtful for a collection arranged at short notice and dealing with a phenomenon which has gained prominence so recently. Much of the facts and competitive issues have changed recently, since for example the Hart Committee's hearings in 1965.[2] Judging by the present *Symposium* and other sources, the following four research issues appear likely to persist.

First, what are the extent and direction of the conglomerate trend so far? Data from the Federal Trade Commission's Bureau of Economics have suggested a large and growing shift,[3] but there are grounds for skepticism. Raymond Piccini's paper suggests a rather smaller conglomerate content in 1951-1961 mergers than the FTC data convey.[4] Charles H. Berry has shown that the "true" degree of diversification by large firms increased only by 3 to 5 percent during 1960-1965, far less than the 40 percent rise in the numbers of industries in which these firms operated.[5] The *net* permanent addition via conglomerate mergers to meta-concentration is in doubt, partly because the durability of many of the newer conglomerates is unknown. The more recent large mergers include some heterogeneity in assets, ranging from manufacturing to financial categories. J. Fred Weston notes (as have others) that the

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1 Within the time constraints, the *St. John's Law Review* was able to supply 16 articles to the present writer to read in preparing this note.

2 *Hearings on Economic Concentration Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 89th Cong., 1st Sess., pt. 2 (1965).

3 BUREAU OF ECONOMICS, FTC, ECONOMIC REPORT ON CORPORATE MERGERS (1969).

4 *See* p. 171 *infra*.

5 C. BERRY, CORPORATE GROWTH AND INDUSTRIAL DIVERSIFICATION 1-18 (1969).

rise in meta-concentration may have been overstated in the FTC, Census and *Fortune* tabulations.[6] The scope and incidence of "new" conglomerate formation has not been adequately compared with that of "old" diversification by established firms. Nor has the evolution of old diversification been analyzed fully.

There is evidently room for much skepticism and further study of the volume and incidence of true conglomerate growth — both gross and net — in the past. These questions contain difficult problems of definition and conjecture, and so they are likely to persist.

Second, will the past trends continue? What economic determinants are at work? In both the United States and Great Britain, 1969 may have burst the conglomerate bubble for good, or it may be only a pause. It is too early to say, though the recent drastic drop does lend this *Symposium* an ironic, perhaps retrospective, status. Whether they are a financial phenomenon (as John M. Kuhlman and Richard Duke suggest[7]) or reflect genuine economies (as Weston and others believe), they may be expected to revive after the present financial conditions change. But a Kuhlman-Duke conglomerate has economic importance primarily when it may switch from growth to long-run profit maximizing objectives. More research on the determinants and incentives of diversification (via merger and otherwise) is needed in order to predict the future trends, both in volume and character, and thereby place the past changes and policy issues in correct perspective.

Third, what real effects on competitive conditions and economic performance does diversification (including conglomerate mergers) have? The size and incidence of diversification within individual markets may be the main factors, together with the internal strength and centralization of control of the conglomerate firms.[8] There may also be other factors. In any case, the size and incidence of past diversification and the recent mergers are only beginning to be known.[9] The inner character of diversified firms is in doubt; *vide* Weston's and Kuhlman and Duke's contrasting papers. And no causality (as distinct from correlation) between diversification and enterprise behavior has yet been established.[10]

Therefore *fourth*, the net costs and benefits of diversification, old and new, are still obscure. If the newer conglomerates are *not* a trivial economic matter, then their economic effects may usually include: (1) widening the acquired firm's competitive options via improved access to capital, and (2) realization of economies in management and coordination, *etc.*, as is frequently claimed. Even if the conglomerates *are* trivial (and also if they are

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6 *See* pp. 77, 78 *infra*.

7 *See* p. 61 *infra*.

8 W. SHEPHERD, MARKET POWER AND ECONOMIC WELFARE: AN INTRODUCTION chs. 2, 9 (1970).

9 *Id.* at ch. 9.

10 This is true even of Michael Gort's extensive study of earlier periods. M. GORT, DIVERSIFICATION AND INTEGRATION IN AMERICAN INDUSTRY (1962).

not), (3) their take-over threats may discipline firms prone to *X*-inefficiency.[11] This third effect (discussed especially by Berry and L. E. Birdzell) may be large, though all three effects (and other possible ones) are still largely unknown. A framework for analysis of such costs and benefits clearly needs to be developed, even if most of the variables in it would be nearly empty boxes for the time being. One may expect, at this point, that the *net* economic effects of conglomerate mergers either way will usually turn out to be small, compared to those both of established diversification and of other elements of market structure. Until the analytical framework is made explicit and the research done — which may take many more years — one can do little more than conjecture.

Such imprecision of economic guidelines need not paralyze antitrust action toward conclomerates, though it does counsel moderation. As a matter of general antitrust strategy, no potentially important variable in the evaluation should be ignored outright. The apparent shift of policy in 1969 against large-firm mergers, especially those by newer conglomerates, seems to ignore entirely the take-over discipline on inefficiency.[12] It would shield precisely those firms which it purports to constrain, and the resulting loss in efficiency could outweigh the other gains in competition and performance (as Berry and Birdzell note). The Campbell-Shepherd proposal runs some of this risk, too, but it can be easily adapted to retain much of the take-over probabilities.[13] Under it, all firms ranking below the leading firms in individual industries are exempt. The original proposal illustrated a possible eventual scope of such a treatment, but a lesser quantitative reach could be adopted within the basic framework. The threshold for market size and "leading-firm" shares could be raised. Firms could be exempted if their leading positions are only in their secondary products (*e.g.*, which comprise less than one-third of their sales, or some such fraction); in such cases, the entrenching effects, if any, may already be present and a further merger will add little to them.

Such quantitative adjustments trade off the pro-competitive effects for the take-over effects, at the margin. The optimum quantitative balance is presently a matter for conjecture, but one can illustrate how far alternative adjustments would reach. As a first approximation, moderate adjustments as suggested above would in 1968 have left exempt about 9 of the largest 50

11 However, the threatened firms may divert their efforts toward purely tactical maneuvers to prevent a take-over rather than toward reducing internal inefficiency as the best long-run defense. Such a diversion may subtract from efficiency, not add to it. Generally, a Weston type conglomerate will be more likely to drive target firms toward true efficiency improvements, while a Kuhlman-Duke type conglomerate may evoke only the more superficial short-run stratagems, because they may suffice to ward off such threats.

12 *See* 1968 PRESIDENTIAL TASK FORCE REPORT ON ANTITRUST, 115 CONG. REC. 5642 (daily ed. May 27, 1969); Address by Att'y Gen. John N. Mitchell, Georgia Bar Association, May 26, 1969, in 5 TRADE REG. REP. ¶ 50,247 (1969).

13 Campbell & Shepherd, *Leading-Firm Conglomerate Mergers*, 12 ANTITRUST BULL. 1361-82 (1968).

manufacturing firms, about 19 of the 51-100 group, about 25 of the 101-150 group, and about 12 of the 151-175 group, as ranked by sales. In contrast to the *Neal Report* and Attorney General Mitchell,[14] who reach beyond this entire group of 175 firms, our proposal would preserve the take-over threat of perhaps 60 to 70 of the largest 175 firms.[15] It would also retain the deterrence against the main probable anticompetitive effects of leading-firm conglomerate mergers.

The whole question begs for more precision of definition and empirical knowledge. But this seems to be at least the right basis for framing the policy choices. One hopes that this *Symposium* will evoke more research on those main questions and more exactitude in framing antitrust strategy.

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[14] *See* note 12 *supra.*

[15] The strength and direction of take-over possibilities depends partly on the character of the potential acquiring firms. Many of the 60 to 70 firms noted here are oil and steel companies, but the majority are spread over a wide variety of industries.