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# THE ECONOMIC ASPECTS OF CONGLOMERATES

JEROME B. COHEN\*

## THE DEVELOPMENT OF THE CONGLOMERATE TREND

A conglomerate has been defined as "a kind of business that services industry the way Bonnie and Clyde serviced banks."

Relatively few *large* mergers — involving concerns with assets of \$10 million or more — occurring since World War II involved direct competitors, and the relative importance of such mergers has declined sharply. Whereas horizontal mergers comprised 38.8 percent of the assets of all large mergers in 1948-1951, this percentage had fallen to 4.2 percent in 1968.

Vertical mergers have also declined in relative importance, falling from 23.8 percent of the assets in 1948-1951 to 7.2 percent in 1968. Conglomerates, on the other hand, rose from 37.5 percent in 1948-1951 to 88.5 percent of assets in 1968.

The highest gain has come in the pure conglomerate category, which in 1968 accounted for 43.6 percent of the assets of all large mergers, as compared to 39 percent for product extension mergers and 5.9 percent for market extension mergers.<sup>1</sup>

Companies turned to conglomerate acquisitions primarily for two reasons. First, vigorous antitrust enforcement effectively checked large horizontal and vertical mergers. Horizontal and vertical mergers represented 47.3 percent of all mergers from 1951 to 1955, 37.6 percent of all mergers from 1956 to 1960, and then, 25.3 percent from 1961 to 1968. The numbers of these two merger types have, in fact, dropped below 10 percent in the last several years.<sup>2</sup>

Since the current merger movement has been so largely conglomerate, and since the conglomerate, especially the pure conglomerate, has little direct impact on market concentration, it became increasingly clear that a large horizontal or vertical acquisition was likely to be challenged successfully, whereas the conglomerate, until recently, did not appear to violate the amended section 7,<sup>3</sup> and might therefore escape antitrust prosecution.

In fact, it is argued that conglomerates often revive competition in settled industries by picking up marginal or moribund or staid producers and energizing them with new capital, fresh management, and imaginative

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<sup>1</sup> BUREAU OF ECONOMICS, FTC, ECONOMIC REPORT ON CORPORATE MERGERS 60-62, App. Table 1-9 (1969).

<sup>2</sup> *Id.* at 62-63, App. Table 1-1.

<sup>3</sup> Act of Oct. 15, 1914, ch. 323, § 7, 38 Stat. 731, as amended, Act of Dec. 29, 1950, ch. 1184, 64 Stat. 1125, presently codified as 15 U.S.C. § 18 (1964).

ideas. Complacent managers of sleepy companies may be taken over and replaced by shrewd and energetic entrepreneurs who may tend to enhance and stimulate competition. With horizontal and vertical acquisitions largely blocked and the conglomerate road seemingly open, the conglomerators moved in on the established companies.

The president of Gulf & Western has argued that the conglomerate form provides advantages in three areas: management, markets and money. The conglomerates, he claimed, use newer management techniques and have more effective entrepreneurial spirit. Additionally, they can pay more for high-level managerial skills and spread them over a variety of enterprises.

Under the conglomerate structure, it should be possible for one subsidiary to profit from the experiences of another, and for all subsidiaries to draw on the general overall financial, management, and marketing expertise of the corporate headquarters. One heard similar arguments for the public utility holding companies of the 1920's.

As to markets, the conglomerate, he argued, is not in one market, but in many. When the outlook for one market is unpromising, the resources can be withdrawn from that market and transferred to another. Should one market go completely bad, the subsidiary operating in that market can be transformed in character or product without significant damage to overall performance.

As to money, the argument is that the conglomerate can raise or mobilize funds to finance growth more effectively than the single product firm.

I know, however, of no economic or other studies which show that Gulf & Western and other conglomerates such as IT&T have management, marketing or financial advantages over such companies as General Electric, General Motors, IBM, or Standard Oil Company of New Jersey. As large companies, they may have advantages over small companies, but so may large companies generally over smaller companies.

*Forbes*, in its *21st Annual Report on American Industry*, declared:

Yardsticks make abundantly clear, the multi-company—conventional or conglomerate—is anything but a resounding success. There are, it is true, managerial triumphs like Textron. But they are the exceptions rather than the rule. The bulk of U.S. multi-companies score well below the median for U.S. industry at large in profitability, while their growth records are more modest than their aspirations would suggest. This is true of the older multi-companies as well as the newer conglomerate types.<sup>4</sup>

A second and perhaps more important motivation for conglomerate acquisitions has been financial. As *Business Week* noted, conglomerates have been called "figments of Wall Street's imagination,"<sup>5</sup> because their foremost tool is the price-earnings multiple. The higher a conglomerate's stock price

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<sup>4</sup> *21st Annual Report on American Industry*, FORBES, Jan. 1, 1969, at 78.

<sup>5</sup> *Conglomerates*, BUS. WEEK, Nov. 30, 1968, at 74.

relative to its earnings per share, the less it spends to buy another company.

Consider this example in which everybody makes money when a conglomerate uses a high p/e to acquire a company having a low p/e. A conglomerate whose stock sells at \$45 a share and is earning \$1 a share makes a deal to acquire a company that has the same number of shares outstanding, and a stock selling at \$10 and also earning \$1.

The conglomerate offers one of its shares for every three of the other company's — an irresistible 50 percent premium to the other's shareholders. When the merger is complete, the conglomerate (which has issued a third as many new shares as it already had outstanding) can combine the earnings and restate them for the diluted equity.

Now, where three shares of the parent's stock used to earn \$3, four shares earn \$6 for a per share profit of \$1.50. Simply as a result of the acquisition, earnings per share have risen from \$1 to \$1.50. And the conglomerate's stock based on the p/e ratio of 45 now rises to \$67.50 per share. The magic of it is that the conglomerate has converted a low growth expectation into a high growth expectation, and thereby multiplied the market value of the acquired company's profits.

*Fortune* has termed this "the chain letter effect":<sup>6</sup>

This can give the appearance of growth where none exists, and often produces a chain-letter effect whose terminal stages may be painful. And like a strange new virus, it can and does infect even the most conservative of multi-market companies.<sup>7</sup>

Any time a company buys another whose shares are selling at a lower price-earnings ratio, earnings per share of the merged company will inevitably be higher than those of the acquiring company in the previous year. Contrariwise, any time a company buys another with a higher price-earnings ratio, the combination will turn up with lower earnings per share. This seems incredible, for it means that a conglomerator is better off — or seems better off — merging with an inferior organization than merging with a superior one. Yet it is so, and the synergism of arithmetic will prove it.

To cite another example: Assume Company *A* has 1 million shares earning \$1 each; they are selling at \$30 a share because the market judges *A*'s growth favorably. Now assume Company *B* also has 1 million shares earning \$1 each; they are selling at \$10 a share because *B* has shown little growth if any. *A* generously offers *B*'s stockholders \$15 a share in *A*'s own stock, which has the advantage of exempting *B*'s stockholders from an immediate capital-gains tax. In other words, *A* trades 500,000 of its own shares for all of *B*'s million shares. The new company is capitalized at 1,500,000 shares earning \$2 million. This works out not to \$1 a share, as before the merger, but to \$1.33.

Although nothing has really changed in the companies, and the econ-

<sup>6</sup> Burck, *The Merger Movement Rides High*, *FORTUNE*, Feb. 1969, at 81.

<sup>7</sup> *Id.*

omy is certainly no richer, earnings per share are a third higher. On the strength of this showing, the market may bid the new stock to an even higher p/e multiple. But 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.

A striking example is "Automatic" Sprinkler. In *Forbes' 21st Annual Report on American Industry*, it ranked number one in profitability because it had the highest average (four-year) return on stockholders' equity of any company in United States industry — a striking 65.2 percent.<sup>8</sup> The reason was that Automatic had leveraged itself to the hilt. Its common equity was a mere \$36 million versus more than \$72 million in long-term debt and preferred. It ran into massive problems in 1968, and with its earnings off sharply, its stock fell from a 1968 high of 74 to about 16 in 1969. Its ability to make further acquisitions went up in smoke. Thus, Automatic became one of the first of the conglomerates to stumble badly and it was clearly not the last.

A more recent example is Gulf & Western. Through more than 80 acquisitions in 11 years — starting with a tiny near-bankrupt auto bumper maker — Charles Bluhdorn assembled a company with \$1.5 billion in sales, with operations ranging from cigars and zinc mines to sugar and motion pictures. Over the past five years, its per share earnings appeared to increase an average of more than 50 percent annually, its sales more than 60 percent a year, and its stock more than six times. It made extensive use of pooling of interests accounting and of leverage. Its short-term debt rose from \$11.5 million in January 1964, to \$931 million in January 1969, an increase of 7,800 percent.<sup>9</sup>

But in the nine months ending April 30, 1969, Gulf & Western's operating earnings were down nearly 19 percent, while on a fully diluted per share basis the decline was 25 percent. From a 1968 high of 66 the stock plunged more than 45 points to a 1970 low of about 17, costing stockholders well over \$600 million.

I would not imply that there are but two prime motives for conglomeration. As the *Neal Report*<sup>10</sup> declared:

The economic forces encouraging conglomerate mergers are numerous and complex, and are not easy to identify in particular cases. These appear to include desire of owners of smaller firms to convert their holdings into more readily marketable securities; the desire of manage-

<sup>8</sup> *21st Annual Report*, *supra* note 4, at 80.

<sup>9</sup> *Big G & W Profits Traced to Dealings*, N.Y. Times, August 7, 1969, at 47, col. 2. For a discussion of pooling of interest accounting, see Briloff, *Dirty Pooling*, BARRON'S, July 15, 1968, at 1; Fisch & Mellman, *Pooling of Interest: The Status of the Criteria*, J. ACCOUNTANCY, Aug. 1968, at 42; Seidman, *Pooling Must Go*, BARRON'S, July 1, 1968, at 9; Snavely, *Pooling Is Good Accounting*, FINANCIAL ANALYSTS J., Nov.-Dec. 1968, at 85.

<sup>10</sup> 1968 PRESIDENTIAL TASK FORCE REPORT ON ANITRUST, 115 CONG. REC. 5642 (daily ed. May 27, 1969).

ment of large firms for growth for its own sake, apart from or in addition to growth in profits; the opportunity to bring 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 firm's cash flows or credit in another firm with limited access to capital; the tax advantages of direct reinvestment of earnings by corporations instead of distribution to stockholders for 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.

Whatever the causes, it is clear that many conglomerate mergers are not explainable in terms of obvious efficiencies in integrating the production or marketing facilities of the firms involved.<sup>11</sup>

#### THE ECONOMIC IMPACT OF CONGLOMERATION

What is the impact of conglomerates on overall concentration? Have conglomerates increased or diminished competition? What are the effects of conglomerates on market performance and on market structure?

Contrary to popular opinion, economists have been arguing about these questions for quite a while, just as the attack on conglomerates has been building up for a long time. As on many other matters, the economists do not agree.

One of the earliest references to what was later to be labeled "conglomerate power" is found in a book written by Professor Arthur R. Burns in 1936. It was called *The Decline of Competition* and described at some length the opportunities open to firms distributing products over a wide area, or requiring a similar selling organization. As Burns viewed it, integration might permit division of "monopoly profits" to subsidize sales in other markets or blur the unit costs of production, and hence the normal competitive forces that are supposed to lead to optimum behavior in a market — criticisms later voiced by critics of conglomerates.

On March 7, 1947, the Federal Trade Commission (FTC) submitted to Congress a report entitled *The Present Trend of Corporate Mergers and Acquisitions*. The following two paragraphs of the report suggested the nature and possible effects of conglomerate mergers, and revealed the FTC's hostile attitude:

The traditional rationalizations for mergers are less applicable to this type of acquisition . . . than to horizontal and vertical types because of the greater difficulty in obtaining thereby any important efficiencies of production and distribution.

Perhaps the most important danger . . . inherent in these conglomerate organizations is the economic power which they can wield over a large number of different industries. Threatened with competition in any one of its fields of enterprise, the conglomerate corporation may sell

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<sup>11</sup> *Id.* at 5645.

below cost or may use other unfair methods in that field, absorbing its losses through excessive profits made in other lines of activity, all rationalized in the name of "meeting competition." The conglomerate corporation is thus in a position to strike out with great force against small business in a variety of . . . industries. There are few greater challenges to small business today than the continued growth of the conglomerate corporations.<sup>12</sup>

The Commission's 1948 report to Congress, entitled *The Merger Movement: A Summary Report*, contained four pages on conglomerate mergers in which the FTC observed that there was less economic justification for this form than for other patterns of growth. It was argued, for example, that conglomerate acquisitions do not engender augmentation of production skills or know-how, as horizontal acquisitions often do.

The Report declared that it was not disallowing any possibilities of economies in conglomerate acquisitions, but that with dissimilar economic activities and no technological relationship, economies could be achieved only with great difficulty, and were minimal at best.<sup>13</sup> In addition, this Report declared:

[T]he motives underlying conglomerate acquisitions appear to include such diverse incentives as desires to spread risks, to invest large sums of idle liquid capital, to add products which can be handled with existing sales and distribution personnel, to increase the number of products which can be grouped together in the company's advertisements, etc.

But in addition to these factors, there is present in most conglomerate acquisitions a simple drive to obtain greater economic power.<sup>14</sup> With the economic power which it secures through its operations in many diverse fields, the giant conglomerate corporation may attain an almost impregnable economic position.<sup>15</sup>

Helping to pave the way for the 1950 Celler-Kefauver amendment, Dr. John M. Blair, then Chief of the Division of Economics of the Federal Trade Commission, testified in July 1949, before a House subcommittee: "There is another type, the conglomerate acquisition . . . [in which the] type of business of the acquiring firm is only distantly, if at all, related to the business of the acquired firm." Noting that the Commission believed "that this conglomerate type of acquisition is one which is peculiarly dangerous to small business," he stated that a diversified company "is in a position to strike out with great force against any smaller company which may seek to compete with it in any one of the variety of fields in which it is engaged. . . ."<sup>16</sup> The conglomerate could, of course, recover any losses

<sup>12</sup> FTC, *THE PRESENT TREND OF CORPORATE MERGERS AND ACQUISITIONS* 12-13 (1947).

<sup>13</sup> FTC, *REPORT OF THE FEDERAL TRADE COMMISSION ON THE MERGER MOVEMENT* 59-60 (1948).

<sup>14</sup> This has repeatedly been the Commission's assertion, though no real evidence has been adduced to support or prove the contention.

<sup>15</sup> *MERGER MOVEMENT*, *supra* note 13, at 59.

<sup>16</sup> *Hearings on the Study of Monopoly Power Before the Subcomm. on Antitrust and*

it did incur in the competitive war with the profits realized in its other fields of endeavor.

John Narver, summing up the legislative history of the Celler-Kefauver Act, has stated:

Concern about conglomerate mergers generally emphasized two issues: (1) the concentration of assets ownership, and (2) the competitive superiority of conglomerate firms over single-market firms. The lawmakers appeared to be concerned primarily with the first threat, the sociopolitical implications; economists' testimony indicated a greater concern with the competitive economic effects.

The amended Section 7 is interested, all in all, in merger consequences. For the Act to be effective regarding conglomerate mergers, it would seem necessary to know those consequences. But conglomerate merger consequences are considerably more difficult to explicate than those of horizontal or vertical mergers.<sup>17</sup>

Professor Corwin Edwards coined the term "conglomerate bigness" and tried to show its potential threat to competition in a paper published in 1955.<sup>18</sup> He stated:

This aspect of the power of large concerns becomes more conspicuous as the diversity of operations becomes greater, that is, as the likelihood that the large concern has monopoly power in any particular market becomes less. When the large company spreads across many products throughout a wide geographical area and covers a series of stages in production and distribution, its opportunities for multiple contacts with other large concerns are at their greatest, and the advantage to be derived from an effort to get the best of another large company at a particular point is least evident. Similarly, such a company has the maximum chance to discipline or destroy any particular small company by a localized attack without serious inconvenience to itself, and has the minimum vulnerability to attack from a single small company.<sup>19</sup>

In 1964, while testifying before a congressional committee, he continued to attack conglomerate bigness, but conceded:

Conglomerate enterprise does not have a well-defined place either in public policy or in economic theory. . . . Until recently, neither lawmakers nor economists were concerned with conditions in which the size and power of a business enterprise depends, not on possession of a large share of a single market, but on operation across a considerable number of markets.<sup>20</sup>

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*Monopoly of the House Comm. on the Judiciary*, 81st Cong., 1st Sess., ser. 14, pt. 1, at 219-20 (1949) (testimony of Dr. J. M. Blair).

<sup>17</sup> J. NARVER, *CONGLOMERATE MERGERS AND MARKET CONCENTRATION* 58-59 (1967).

<sup>18</sup> Edwards, *Conglomerate Bigness as a Source of Power*, in *BUSINESS CONCENTRATION AND PRICE POLICY* 336 (Nat'l Bureau of Economic Research ed. 1955).

<sup>19</sup> *Id.*

<sup>20</sup> *Hearings on Economic Concentration Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 88th Cong., 2d Sess., pt. 1, at 37 (1964) (testimony of C. Edwards).



And:

I would like to interject here that I do not want what I have been saying or what I shall say to be understood as a condemnation of large conglomerate enterprises as such. The problems we are concerned with here are matters of degree. As yet we know relatively little about them. What we need very badly is case-by-case examination, case-by-case study, and in the absence of such study, generalizations have to be extremely tentative.<sup>21</sup>

Of conglomerate mergers, Professor George Stigler, who recently headed an antitrust task force for President Nixon, had only the following to say in 1955:

Conglomerate mergers owe much of their current interest, and perhaps their intellectual parentage, to Corwin Edwards, who has portrayed them as a menacing but elusive form of organization. The essence of this type of firm, as I understand it, is that although the firm need not have an appreciable degree of market control in any one market, yet because of the many markets in which it operates and the large resources it possesses, a power is acquired to sell and buy at preferential terms. I must confess that the exact mechanics by which the total power possessed by the firm gets to be larger than the sum of the parts (in individual markets) escapes me, and I am not sure that there are any companies that meet the specifications of the conglomerate firm. There is a certain resemblance between Edwards' concept and the structure of, e.g., duPont, but duPont has monopoly power in many markets, and therefore one does not have to resort to conglomerateness to explain its power and prosperity.

If there are conglomerate firms, I suspect that their chief sins are associated with their amassing of wealth. But the antitrust laws are not the weapons with which to deal with non-monopolistic concentrations of wealth.<sup>22</sup>

More recently, in the report of the task force which Professor Stigler headed for President Nixon, it is stated: "We seriously doubt that the Antitrust Division should embark upon an active program of challenging conglomerate enterprises on the basis of nebulous fears about size and economic power."<sup>23</sup>

<sup>21</sup> *Id.* at 42.

<sup>22</sup> G. STIGLER, *THE ORGANIZATION OF INDUSTRY* 304 (1968) (footnote omitted). Chapter 22, *Mergers and Preventive Antitrust Policy*, is reprinted from 104 U. PA. L. REV. 176 (1955).

<sup>23</sup> 1969 PRESIDENTIAL TASK FORCE REPORT ON PRODUCTIVITY AND COMPETITION, 115 CONG. REC. 6472, 6476 (daily ed. June 16, 1969) [hereinafter cited as STIGLER TASK FORCE REPORT]. Kaysen and Turner displayed a similar uncertainty in 1959, when they wrote:

No light whatever can be shed on the probable status of "conglomerate mergers," which the committee reports on the 1950 amendment indicated were to be covered by the revised section 7. We are inclined to believe that few if any true conglomerate merger cases — entirely devoid of both vertical and horizontal aspects — will be brought, if for no other reason than that standards of illegality seem wholly elusive. Most mergers that crudely appear to be conglomerate will

The supplementary report of the Attorney General's National Committee to Study the Antitrust Laws, after noting that the most unique characteristic of the merger movement in the 1960's is its essentially conglomerate character, went on to say:

Since most conglomerate acquisitions do not have any direct or immediate effect on concentration, the economic and legal questions presented are generally more complex and elusive than those presented by a horizontal or vertical acquisition. Each case must be analyzed on the basis of its economic facts, including such factors as the structure and competitiveness of the market involved, the size and strength of the acquiring company relative to other firms in the industry, the merger's probable effect on potential competition, the effect on barriers to entry, and the probability of reciprocal dealing created by the merger.<sup>24</sup>

Similarly, in its *Merger Guidelines*, issued in 1968, the Department of Justice stated:

Generally speaking, the conglomerate merger area involves novel problems that have not yet been subjected to as extensive or sustained analysis as those presented by horizontal and vertical mergers. It is for this reason that the Department's enforcement policy regarding the foregoing category of conglomerate mergers cannot be set forth with greater specificity.<sup>25</sup>

And, as ardent an antitrusteer as Paul Rand Dixon has declared:

[I]n the conglomerate merger field, the fact that the acquiring and acquired firms occupy different markets automatically means that the traditional tools of analysis . . . are wholly inadequate; one firm has simply replaced another and hence there has been, by definition, no change in either of those dimensions.<sup>26</sup>

In 1965, Donald F. Turner stated:

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prove to have vertical or horizontal elements or both if the markets involved are carefully analyzed and defined.

C. KAYSEN & D. TURNER, ANTITRUST POLICY 131 (1959). Similarly, they declared:

We have made no recommendations covering "conglomerate" mergers, and we are inclined to make none. The only leverage in a merger of this kind is the leverage of money. Many firms without significant market power have plenty of money. There is no apparent reason for letting them make conglomerate acquisitions, and at the same time rule that a firm with market power cannot. We are not prepared to say that it is reasonable to cut the latter off from any acquisitions. In view of the comparatively stringent ban on vertical or horizontal acquisitions by firms with market power, it would seem a reasonable concession to the advantages of mergers as entry-facilitating devices, and to the importance of a strong market for assets, to permit conglomerate acquisitions for everyone, perhaps barring some extreme cases where adverse effects are obvious or the concentration of wealth is huge, e.g., A.T.&T. and U.S. Steel.

*Id.* at 134.

<sup>24</sup> ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS, SUPPLEMENTARY REPORT 83 (1968).

<sup>25</sup> *Merger Guidelines*, in 1 TRADE REG. REP. ¶ 4430, at 6689 (1968).

<sup>26</sup> Dixon, *Antitrust Policy: Some "Legal" and "Economic" Considerations*, 14 U.C.L.A. L. REV. 979, 991 (1967) (footnote omitted).

Tentative as our analysis has been it indicates quite strongly that one cannot support an attack of much greater breadth on conglomerates without trenching on significant economic and other values, and therefore without an unprecedented reliance on judgments of an essentially political nature. There are indeed many who will rousingly make those judgments. There are many who firmly believe that "superconcentration" — further concentration of assets in the hands of large, conglomerate firms — is a very bad thing even if devoid of any anticompetitive consequences. There are others who find that point of view almost sickening.

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I do not believe Congress has given the courts and the FTC a mandate to campaign against superconcentration in the absence of any evidence of harm to competition.<sup>27</sup>

Professor Leonard Weiss of the University of Wisconsin has testified that the conglomerate merger "has always been an important means of entering a new industry . . . [I]t may also be the best, the most effective way of entering some of these highly concentrated industries that require great amounts of capital."<sup>28</sup> Later, in connection with an empirical investigation of profits, he said that the formation of merger giants might be the most feasible way to create lumps of capital which would then be capable of threatening industries which were shielded by capital cost barriers. In addition, he said that conglomerate mergers might be the best way to reduce capital costs between large and moderate scale enterprise, at least outside of the highly differentiated goods fields.

Following acquisition of an "established bridgehead," a large firm may widen it by expanding capacity and output. If the firm were not permitted to lower the "risk barriers to entry" by merging, entry might not occur at all. Conglomerate mergers may thus enhance competition by facilitating entry into a different line. Diversification may thus produce new competitive forces in a market.

Professor Michael Gort in one of the few factual investigations in a field where speculations abound, found that in a substantial majority of cases very large firms entering an industry new to them did *not* become one of the eight top firms even after the lapse of 20 years.<sup>29</sup> His study of market shares of identical leading firms in 205 manufacturing industries did not confirm Edwards' theory that absolute size of a firm is a source of market power. Instead, size turned out *not* to be an important variable in explaining stability in shares of the market held.

Yale Brozen, Professor of Business Economics at the University of Chicago, at a recent National Industrial Conference Board Forum, expressed the thought that the current conglomerate furor might lead to legislation limiting movement by multi-industry companies into new fields.

<sup>27</sup> Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313, 1394, 1395 (1965).

<sup>28</sup> Hearings, *supra* note 20, 89th Cong., 1st Sess., pt. 2, at 743 (1965).

<sup>29</sup> M. GORT, *DIVERSIFICATION AND INTEGRATION IN AMERICAN INDUSTRY* (1962).

Were that to occur, competition would undoubtedly suffer from a lack of potential entrants, as openness of entry is a requirement for competition.

Despite the disagreements and uncertainties among economists as to the economic impact of conglomerates, and in the face of few facts or conclusive studies of the economic effects of conglomerates on competition, the Justice Department is now vigorously in pursuit of the conglomerate on a variety of grounds. First, it is charged, conglomerates may eliminate potential competition. Potential competition is said to exist where a market is concentrated, where the acquiring firm has the ability to enter profitably on its own, and where there are few other potential competitors. Second, conglomerates create opportunities for "reciprocal dealing" or potential reciprocity. Third, conglomerates pose substantial dangers to competition by the expansion of nationwide marketing structures, capital resources, advertising budgets, etc., on behalf of the acquired companies. This is the "deep pocket concept," or "entrenchment." Fourth is what is known as a "community of interest." This seems to be a "recognition of common goals by large diversified companies." The "community of interest" assumes that, within concentrated markets, large diversified companies probably have little interest in competing with each other. Fifth, conglomerates are said to increase overall concentration. Overall concentration allegedly decreases competition. Therefore, conglomerates are held to decrease competition.

All this is in the face of disagreement among economists about the impact of overall concentration on competition. There is disagreement about whether the merger movement has or has not led to a diminution in the number and vigor of small and medium sized firms. There is disagreement as to whether conglomerate expansion has enhanced or diminished competition, and raised or lowered barriers to entry. There is also disagreement as to whether high concentration is associated with high efficiency or high profitability. Economic studies have been fragmentary and inconclusive and economists are found on both sides of many fences.

The *Stigler Task Force Report* said:

We strongly recommend that the Department [of Justice] *decline* to undertake a program of action against conglomerate mergers and conglomerate enterprises, pending a conference to gather information and opinion on the economic effects of the conglomerate phenomenon.<sup>30</sup>

This view seems to stem from the notion of some economists that a conglomerate merger does not increase the market share of the acquiring firm in a given market, and that it has not yet been demonstrated that competition in a line of commerce or in a relevant market has been injured by a conglomerate merger.<sup>31</sup>

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<sup>30</sup> STIGLER TASK FORCE REPORT at 6473 (emphasis added).

<sup>31</sup> See, e.g., Stelzer, *Antitrust Policy and the Conglomerates*, 44 ST. JOHN'S L. REV. 196 (1969).

I tend to be partial to the conclusion of a bright young attorney, Joel Davidow, who in November 1968 wrote:

From this analysis, it is a short step to the contention that the trend to conglomerates may be pro-competitive. At the very least it can be argued that the experiment should be allowed to continue, since the economy is sufficiently dynamic and competitive to ensure that the laggards will fall by the wayside, the charlatans will be unmasked, and the dinosaurs with pea-sized brains will become extinct.<sup>32</sup>

To borrow from one of Mr. McLaren's recent speeches, current Justice Department antitrust policy with respect to conglomerates reminds one of the foreign airliner on its way from New York to Europe. When the plane had been out over the ocean for a time, the pilot came on the public address system and said:

I have two pieces of news to report to you: one good and the other bad.

First the bad news: We are lost.

Now the good news: We are ahead of schedule.

The Justice Department seems ahead of schedule on a course that has new, different and perhaps dubious economic bearings.

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<sup>32</sup> Davidow, *Conglomerate Concentration and Section Seven: The Limitations of the Anti-Merger Act*, 68 COLUM. L. REV. 1231, 1285 (1968).