Observations on Public Policy Toward Conglomerate Mergers

Joel B. Dirlam
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Conglomerate mergers have exploded in the past three years, vastly expanding what was already the most pronounced merger movement in our economic history. The mergers have been stimulated by a kind of speculative fever duplicating in many respects the market for public utility holding company securities in the late 1920's. There has been a belated reaction by the antitrust enforcement agencies, which, in its turn, has drawn counterfire from the conglomerates and their supporters. It is the purpose of this paper to arrive at an evaluation of antitrust policy toward conglomerate mergers, against the background of structural change resulting from mergers.

It will be recalled that in 1968 the number and dollar value of large acquisitions reached the spectacular total of 201 and $12,800,000,000 respectively.¹ Total acquisitions in 1968 were $15 billion, and in 1969, according to the Federal Trade Commission (FTC) Staff Report, the annual rate was $20 billion for the first nine months;² Over the period 1948-1968, almost 21 percent of the asset growth of the 200 largest corporations was accounted for by acquisitions. Conglomerate mergers played an increasingly important role in acquisitions. According to Federal Trade Commission estimates, they made up 37.5 percent of the large acquisitions in the period 1948-1951; but in 1968 they accounted for 88.5 percent of acquired assets in large mergers.³ In the earlier years, so-called "product extensions" dominated; later on the "other," or pure conglomerate acquisitions predominated. The deduction might be drawn that the more recent mergers involve firms with no functional relationship, whereas the earlier mergers were generated by a desire to use management or organizational capabilities in allied areas. However, examination of the series upon which these classifications are based raises a serious question about the distinction between the "product extension" and the "other" conglomerates. Information was not always available that would permit classifying firms on a 4-digit basis (indeed it would often have been impossible to do so) and reliance was placed almost exclusively on a 3-digit classification. As a consequence, the union of rather diverse organizations was often regarded as a "product extension." To take two instances out of many, American Standard's acquisition of Westinghouse Air Brake was

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¹ Hearings on Economic Concentration Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 91st Cong., 1st Sess., pt. 8A, at 43 (1969) (Staff Report) [hereinafter cited as Concentration Hearings Part 8A].

² Id. at 4.

³ Id. at 673, App. Table 1-9.
called a "product extension," the acquiring company being classified as 343 (plumbing and heating) and the acquired company 374 (railroad equipment), while Teledyne's merger with Ryan Aeronautical likewise was called a "product extension," although in the Staff Report the acquisition was referred to as a "major leap into defense-space activities." Because Occidental's acquisition of Hooker Chemical, and coal company mergers with Continental Oil, Occidental, and Standard of Ohio were classified as "product extensions," the FTC Staff Report did not group these oil companies with the conglomerates in its case studies. Parenthetically, it is curious that an antitrust suit should have been filed against Kennecott Copper for its purchase of Peabody Coal Company — classed as a pure conglomerate acquisition — while the "product extensions" of petroleum companies were not challenged.

The Staff Report showed conclusively that, in part as a result of the 1948-1968 merger movement, there has been a significant increase in the over-all concentration of manufacturing assets. Corporations with $1 billion and over of assets have increased their share of total assets from 26 percent to 46 percent. And the share of assets held by the 200 largest rose from 46.3 percent in 1948 to 60.4 percent in 1968. Beginning in 1963, the largest manufacturing corporations began to acquire firms in activities other than manufacturing more rapidly, so that in 1968 the value of such acquisitions equaled that of the manufacturing assets acquired.

The rise in concentration in manufacturing cannot be primarily attributed to conglomerate mergers, or even to mergers. They have had, however, a very important contributory influence. Moreover, conglomerates formed and expanded during the recent merger movement have moved into the ranks of the largest industrial corporations, although none have penetrated the top 10. In 1968, ITT ranked 11th among the Fortune 500 largest (in terms of sales), General Telephone and Electric 21st, and LTV, 25th. The 20 largest of these new conglomerates, ranked by assets, are shown below in Table I. It is significant that, among the hundred largest industrials in Fortune's 1968 list, ranked by assets, there were 21 of the new conglomerates. (Except for Signal Companies and Tenneco, petroleum companies have not been included, following the designation used by the FTC Staff Report.) If we take account of the fact that either through earlier mergers or internal expansion, most of the 200 largest industrials have increasingly diversified over the years, there is no doubt that we are witnessing a restructuring not only of manufacturing industry, but when the financial acquisitions are included, of the private economy itself. Within a single

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5 Concentration Hearings Part 8A at 553.
6 Id. at 164.
7 Id. at 173, Table 3-3.
8 Id. at 187, Table 3-9.
### TABLE I
25 LARGEST RECENTLY MERGING CONGLOMERATES Ranked by Assets, 1968 Among 500 LARGEST INDUSTRIALS

<table>
<thead>
<tr>
<th>Rank</th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>General Telephone and Electric</td>
</tr>
<tr>
<td>15</td>
<td>ITT</td>
</tr>
<tr>
<td>16</td>
<td>Tenneco</td>
</tr>
<tr>
<td>22</td>
<td>LTV</td>
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<tr>
<td>34</td>
<td>Gulf and Western</td>
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<tr>
<td>36</td>
<td>Monsanto</td>
</tr>
<tr>
<td>40</td>
<td>AVCO</td>
</tr>
<tr>
<td>45</td>
<td>W.R. Grace</td>
</tr>
<tr>
<td>55</td>
<td>Singer</td>
</tr>
<tr>
<td>58</td>
<td>North American-Rockwell</td>
</tr>
<tr>
<td>63</td>
<td>Northwest Industries</td>
</tr>
<tr>
<td>65</td>
<td>Glen Alden</td>
</tr>
<tr>
<td>66</td>
<td>Signal Cos.</td>
</tr>
<tr>
<td>67</td>
<td>Litton</td>
</tr>
<tr>
<td>68</td>
<td>R. J. Reynolds</td>
</tr>
<tr>
<td>77</td>
<td>Sperry Rand</td>
</tr>
<tr>
<td>83</td>
<td>Boise Cascade</td>
</tr>
<tr>
<td>86</td>
<td>Olin Mathieson</td>
</tr>
<tr>
<td>89</td>
<td>FMC</td>
</tr>
<tr>
<td>95</td>
<td>Xerox</td>
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<tr>
<td>99</td>
<td>TRW</td>
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<tr>
<td>101</td>
<td>General Dynamics</td>
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<tr>
<td>119</td>
<td>Norton Simon</td>
</tr>
<tr>
<td>133</td>
<td>White Consolidated</td>
</tr>
<tr>
<td>136</td>
<td>Teledyne</td>
</tr>
</tbody>
</table>

* Since 1950.

**Source:** The Fortune Directory, May 15, 1969.

decision-making unit, policies will be adopted affecting a wide spectrum of customers and an equally diverse number of their activities, ranging from TV programs to insurance, and from rolling mills to meat. This is a new phenomenon in American economic development.

The restructuring of industry has proceeded in complementary fashion not only to create, within the large diversified corporations, control over decisions in many industries, but to obliterate, because of their disappearance within the conglomerates, the firms that once could be identified as members of independent industries. Of the large meat packers, only Swift and Cudahy remain; Morell is part of AMK, Wilson was acquired (and its associated activities reconstituted) by LTV, and Armour, after liaisons with Gulf and Western, and General Host, has come to rest with Greyhound. For unfathomable reasons the steel industry has also become attractive to the new conglomerates. Jones & Laughlin moved into LTV; Youngstown Sheet and Tube was acquired by Lykes; Northwest Industries owns Lone Star Steel; Crucide, after merging with Pittsburgh, was purchased by Colt, and Crane took over CF & I; Bethlehem attempted a large-scale merger with Cerro. The non-captive coal industry is now largely a branch of the
petroleum industry. Book publishing is part of communications and dominated by RCA, CBS, Xerox, Time, Inc., National General and Litton. This is not to say that competition in these absorbed industries has evaporated; but its character, reflecting the policies of conglomerate management, must inevitably be altered. Many of the TV stations, including the three major networks of this most influential communications medium, are under the control of firms with outside interests. The power the conglomerate might exercise in the strategic area of communications was startlingly revealed in the course of ITT's unsuccessful battle to take over ABC.

The consequences of conglomerate alliances with financial intermediaries cannot be precisely determined. These firms provide a ready source of cash; and they also provide stability. How the latter advantage contributes to the rapid growth that the conglomerates have striven for is not clear. It is to be hoped that as the Federal Trade Commission carries its study of conglomerates into the next phase it will report on the question. Gulf and Western has acquired Associated Investment; Avco and Paul Revere happily merged; City Investment has acquired Home Insurance; Xerox lost Commercial Credit Corporation to Control Data; Leasco has taken over Reliance Insurance; Teledyne has acquired insurance and finance companies; and National General has benefited by a large dividend from Great American Insurance.

There are very few in-depth studies of the policies of large, influential conglomerates, either of established firms, or the process of formation of the new ones. Industry studies have focused on the primary activity of the large corporations in steel, petroleum, aluminum and automobiles. Relatively little attention has been paid to the influence on behavior of conglomerate or diversified investment. There have been no empirical studies to show whether, in making decisions, the large conglomerate firms that dominate the market economy behave as though they were aggregations of single-product firms. Unfortunately, economists seem to have assumed that the theory applicable to single-product firms should suffice to explain the concentrated conglomerate economy. With a few exceptions, they have neglected the conglomerate problem. When Professor Edwards suggested that large conglomerate firms might behave differently from single-product firms, he was told that markets might be influenced by concentration and relative size, but not by diversified assets and income. This point of view dominated the report of the White House Task Force headed by Professor Stigler, prepared as late as 1968, which could not see that the conglomerate problem lay within their terms of reference, since the existence of pure conglomerates could not influence policy within particular markets. The possibility that

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10 1969 WHITE HOUSE TASK FORCE REPORT ON PRODUCTIVITY AND COMPETITION, 115
conglomerate or diversified firms might subsidize low prices in one area or for one product from profitable operations elsewhere was denied; such action would be irrational.

Business historians have written almost without exception about the experience of firms dominated by single-product, or at most, single-industry problems. Alfred Sloan's *My Years with General Motors* concentrates on the automobile business.\(^{11}\) The "old" conglomerates, like Union Carbide, du Pont, or General Electric—conglomerate in the sense that they are active in a number of fields, some of which are only distantly related—have been subjected to only limited scholarly analysis.\(^{12}\) The Federal Trade Commission's *Staff Report* marshals instances that fully document the practice of reciprocity and the use of cross subsidization by conglomerates, reinforcing the classic examples of Standard of New Jersey and the Great Atlantic & Pacific Tea Co.\(^{13}\) The *Staff Report* also touches on instances where large conglomerates have accommodated each other on several fronts. It does not show whether they have affected the rate of innovation, or whether they slowed down the rate of new entry or in other ways affected the tone of completion. A full-scale study of these and other economics of conglomerates would call "for a commitment of resources comparable to those expended in the Commission's Meat-Packing, Public Utility, and Chain Store Investigations."\(^{14}\) In the absence of such a study, public or private conclusions must be tentative. We must make-shift, then, with such analyses as are available of the behavior of conglomerates that have been charged with violation of the antitrust laws, pieced out with materials from the business press.

One aspect of the recent conglomerate merger movement seems clear enough. Most of the mergers have been touched off by some motive other than an intention of exercising leverage to improve market position. The shift to conglomerate acquisitions appears to have been a response to the successful campaign by the enforcement agencies to check horizontal and vertical mergers, indicating that the merging firms were spurred on by a deep-seated drive toward expansion. Their willingness to shift partners in mid-stream, with a sublime indifference to the type of industry with which they were to become affiliated, confirms this conclusion. Balked of its acquisition of Westinghouse Air Brake Co., Crane found happiness with C F & I, and investment in Alcoa and Southern Pacific Railroad. When Control Data snatched away Commercial Credit Corporation, Xerox simply purchased a computer manufacturer. Textron lost its bid for United Fruit to AMK, but seems unperturbed. In many instances, unconsummated acquisitions have

\(^{11}\) Non-automobile activities are discussed in A. Sloan, *My Years with General Motors* ch. 19 (1963).


\(^{13}\) *Concentration Hearings Part 8A* at 403 & n.2.

\(^{14}\) *Id.* at xii (separate statement of Commissioner Elman).
paid off in substantial capital gains when the stock was sold to the ultimately successful partner.

It is easy to see why firms want to grow, particularly when growth can be arranged rapidly, painlessly, and profitably. Management benefits from the higher salaries and perquisites, including options on more readily marketable stock, that come with size. Both management and stockholders gain during a bull market from the creation of stock price increases deriving from the combination of high and low price-earnings ratio companies. And both management and stockholders feel safer as participants in larger firms, with readier access to funds, better protection against surprise take-overs, and, after a certain minimum size is reached, almost automatic protection against failure. None of these motives is rooted in anticipated changes in competitive tactics in any specific market, but the altered perspective of the firm cannot help but affect its behavior.

Once a critical size is reached, the firm no longer has to concern itself with short-run problems. It "dwells in many markets," and its "planning is more concerned with secular shifts in demand curves than with their elasticity." The large single-product firm can outlast the small single-product firm, but the large conglomerate is in an even better position. Many motives play a part other than the hunger for reaching a size where the firm will be insulated from dangerous consequences of short-run adversity. These other motives — creation of financial gains from manipulation of securities and securities prices — are too well known to need elaboration.

The willingness of Singer to continue to carry Friden over the years that it failed to earn a reasonable return, Ford's unsuccessful attempt to renovate Philco as a full-line appliance manufacturer, and Litton's assuming the burdensome Royal typewriter operation testify to the type and size of operation that a diversified, large conglomerate can undertake. It is generally supposed that General Electric's computer business has been subsidized. The ability of conglomerates to finance losses in one segment for what sometimes seems to be an indefinite period may, of course, increase the number of competitors in the long run. On the other hand, it may divert resources from their most economical use.

In any event, the assurance of income from more or less protected sources must influence management in making decisions on maintenance or expansion of currently unprofitable lines. If conglomerates were operated like pure investment companies, sunk costs would not influence such decisions, but when the management commits itself to making a subsidiary's program successful, it may be reluctant to admit failure and dispose of the losing operation.

Public policy toward conglomerates has taken two forms that may be conveniently distinguished for purposes of review and analysis. First, and most important, are the complaints filed against conglomerate mergers (and

warnings that complaints will be filed). Second, the issuance of guidelines or rules serves notice of when mergers will be challenged.

Complaints filed against Northwest Industries' attempted take-over of Goodrich and ITT's acquisition of Hartford Insurance, Grinnell and Canteen have roused interest and stimulated criticism. It is well to remember, however, that these are not the first conglomerate mergers to be challenged; although there have been extensions to antitrust policy, the gaps are not as wide as they might seem at first glance. The government's successful (and somewhat unexpected) victory under section 7 in United States v. E. I. duPont de Nemours & Co.\(^{16}\) rested, in part, on the incompatibility of antitrust goals and the persistence of a huge conglomerate. There is reason to believe that the Department of Justice was anxious to diminish the absolute size of the duPont complex; the suit initially included U.S. Rubber Co. The pre-emption by duPont of a substantial part of the GM market for fabrics and finishes was a partial basis for the decision, but also important was the social purpose of antitrust, "which is clearly not served by permitting the 'colossus of the giant automobile industry' to come, even to some small extent, under the control of the 'Greatest Chemical Aggregation in the World.'"\(^{17}\) Although trivial in comparison, suits against Ingersoll-Rand's acquisition of the three coal-mining machinery companies, United States v. Ingersoll-Rand,\(^{18}\) and Reynolds Metals' purchase of a florist foil converter, Reynolds Metals Co. v. FTC,\(^{19}\) were based, in part at least, on disparities in power rather than vertical foreclosure or elimination of horizontal competition through merger. In all three cases there was a specific market in which the conglomerate merger changed, or would change, the structural relationships; the influence on behavior was inferred, although in the GM-duPont case there was evidence of attempts to misuse power.

With the FTC v. Consolidated Foods Corp.\(^{20}\) and FTC v. Procter & Gamble Co.\(^{21}\) decisions, the application of section 7 to conglomerates (in spite of the Supreme Court's rejection of the term in Procter & Gamble) developed additional dimensions. These dimensions, however, still focused on particular defined markets. Structural elements, including degree of concentration, elimination of potential competitors, and aggravation or creation of disparities in size, were the basis for the Procter & Gamble decision. The probability of a change in behavior was discussed; but "there is certainly no requirement that the anticompetitive power manifest itself in anticompetitive action before § 7 can be called into play."\(^{22}\) In the Consolidated Foods

\(^{16}\) 353 U.S. 586 (1957).
\(^{17}\) Dirlam & Stelzer, The duPont-General Motors Decision: In the Antitrust Grain, 58 COLUM. L. REV. 24, 41 (1958) (footnotes omitted).
\(^{18}\) 320 F.2d 509 (3d Cir. 1963).
\(^{19}\) 309 F.2d 223 (D.C. Cir. 1962).
\(^{21}\) 386 U.S. 568 (1967).
\(^{22}\) Id. at 577.
case, reciprocity was a consciously employed tactic, a misuse of market power to strengthen a concentrated market. The Department of Justice opposition to ITT's purchase of ABC and its stations was grounded in part on the possibility that ITT might become a potential competitor of ABC through a fourth network, or through CATV. But the Department also argued that, if it absorbed ABC, ITT would no longer attempt to promote technological change that might threaten the position of the networks.

In 1968, the Government challenged the proposed Caterpillar Tractor-Chicago Pneumatic Tool merger because it might choke off potential entry by Caterpillar into the manufacture of air compressors for rock drills; Caterpillar would also have secured control of a strategic diesel engine patent. Since no complaints were filed, it is impossible to be certain of the reasons for Department of Justice hostility to the Bethlehem-Cerro, Gulf and Western-Armour, and International Minerals and Chemical-Morton Salt mergers. However, it is likely that eliminating potential competition was hypothesized in all three. Bethlehem might have used its geological expertise and technology to search for and mine copper; International Mineral might have refined or produced salt; and Universal American and E. W. Bliss were potential competitors of Armour's Baldwin-Lima-Hamilton. Although Bethlehem, like most steel companies, is now attempting to diversify, we have no way of knowing whether it would enter copper mining through internal expansion. The Justice Department may, however, have objected to further expansion of the 19th largest industrial by merger.

By 1969, the complaints were including, as a kind of "boiler plate," allegations that the proposed merger would lead to further concentration in manufacturing in general. This charge appears in the complaints in United States v. Ling-Temco-Vought, Inc., United States v. Northwest Industries, Inc., and United States v. International Telephone and Telegraph Corp. In addition, the complaints alleged the competitive dangers first spelled out in Procter & Gamble and Consolidated Foods. Nevertheless, it is clear that the Department of Justice is inviting the courts to strike down conglomerate mergers because they add to "super-concentration," apart from their potential effect on competition in distinct and defined markets.

These complaints reflect the views of the chief of the Antitrust Division and the Attorney General. Both have explicitly stated (in sharp contrast to the views of Professor Turner) that they intend to push beyond the boundaries set by the 1968 Merger Guidelines, which were anchored, even in the

conglomerate sections, to probable impact on specific markets. Mr. McLaren, in testimony before the House Ways and Means Committee in March 1969, gave notice that the Antitrust Division intended to fight the "radical restructuring" of the economy resulting from the new wave of conglomerate mergers. In June 1969, the Attorney General, in effect, extended the Guidelines when he announced that the Department might "very well" oppose any merger among the top manufacturing firms, or firms of comparable size in other industries, or between one of the top 200 and any leading producer in any concentrated industry.

Criticisms of the advanced position of the Department of Justice come from a variety of sources. There are economists who deny that conglomerates pose a problem for antitrust. The Stigler Report, and its working papers, shrug off both the narrower market effects of conglomerate mergers and the possibility that competition in an economy dominated by a few conglomerates may be wholly different from the competition we are familiar with. Reciprocity is no threat to competition. It can lead either to inefficiency, which would reduce profits, thus leading rational management to abandon it, or, by reducing selling costs, would improve profits and should be encouraged. According to the Stigler view, "monopoly power in one commodity is not effectively exploited by manipulating the price of an unrelated commodity." If employed by members of an oligopoly, it is merely a way of secretly cutting prices. The practice can have no net anticompetitive effect.

It is difficult to accept this view of reciprocity. In spite of the "demonstration" that firms with market power will not, in all likelihood, use it to enforce reciprocity, there is much evidence that they do so. In a classic instance, ACCO, the produce buying subsidiary of A & P, consistently and successfully pressured growers, shippers and jobbers to use its facilities. In some cases, "brokerage" was paid to ACCO by jobbers on produce they

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[M]y predecessors at the Antitrust Division took the position that purer forms of conglomerate mergers could not be reached under section 7 because, in their views, where merging firms are commercially unrelated, proof cannot generally be made of a reasonable likelihood of a substantial lessening of competition . . . [B]usinessmen and their lawyers . . . cannot rely on the merger guidelines issued by my predecessors in this regard . . . [W]e are willing to risk losing some cases to find out how far Section 7 will take us in halting the current accelerated trend toward concentration by merger . . .

Id. (testimony of R. McLaren).


31 1969 Presidential Task Force Report on Productivity and Competition, 115 Cong. Rec. 6472 (daily ed. June 16, 1969). The Working Paper on the Conglomerate Merger by Professor R. H. Coase took the position that such a merger would leave the competition situation unchanged, and that competition would sort out the inefficient. There was no reason to fear size when most of the conglomerate mergers "are outranked in size by a hundred or more firms in the United States." Id. at 6479.

32 Id. (Stigler, Working Paper on Reciprocity).

33 Concentration Hearings Part 8A at 323-97.
obtained from another broker. In the Consolidated Foods case, perhaps the company could have used what monopsonistic power it possessed to extract higher margins on the processed foods it wholesaled, but it preferred to employ that power in another market to entrench the position of Gentry. The view that the use of reciprocity is irrational overlooks the fact that businessmen may prefer to reduce the intensity of competition in their selling markets at the expense of sacrificing competition in their buying markets, perhaps because risks of loss of revenue are weighted more heavily than risks of paying higher prices for available supplies. The outcome is to reduce opportunities for smaller or newer competitors.

It is also urged that the mere possibility of reciprocity should not be a factor in determining the legality of conglomerate mergers. If the practice is used, the enforcement agencies could move successfully against it. Some what the same position has been taken by courts in the ITT and Northwest Industries decisions denying the Government preliminary injunctions against mergers. In the Northwest Industries decision, Judge Will found that the reciprocity potential would increase because of the merger, and that a subsidiary of Northwest had practiced reciprocity before it was acquired by Northwest. On the other hand, Mr. Heineman, President and Chief Executive Officer of Northwest, strongly opposed the use of reciprocity, and had made a study of Goodrich’s shipments by rail only in order to determine how serious an issue might be raised by the Department of Justice. In the ITT case, Judge Timbers concluded that ITT would probably not be able to influence its suppliers to use either Grinnell’s sprinklers or pipehangers, or Hartford’s insurance. It was architects and builders who were responsible for the installation of the former, while the selection of insurance was a complicated business transaction, which would not lend itself to alteration because of pressure from a customer. ITT had not employed reciprocity to advance Avis; Mr. Geneen, President of ITT, opposed the practice, and the use of “profit centers” would deter ITT’s divisional management from distortions of purchasing decisions.

In Allis-Chalmers Manufacturing Co. v. White Consolidated Industries, on the other hand, the court gave considerable weight to reciprocity potential in issuing a preliminary injunction against White’s efforts to take over the company. Both White and Allis purchased about $42 million of steel products annually, and a large part of the output of the combined

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36 Dirlam & Stelzer, supra note 17.
38 Id. at 1078-83.
company (particularly rolling mills) was purchased by steel makers. The LTV-Jones & Laughlin and ITT-Canteen mergers have not yet gone to trial. In the first the Government called attention to the pervasive use of reciprocity by steel companies and charged that J & L's sales would be helped by LTV's purchases of automobiles and use of railroad transportation.\textsuperscript{41} Similarly, because ITT makes annual purchases exceeding $550 million from about 725 companies, reciprocity could be used to install Canteen Corporation's food services or machines in these suppliers' plants.\textsuperscript{42}

Expansion through conglomerate merger increases the number of markets in which there may be a danger of reciprocity. Those complaints that have alleged the probability of reciprocity's reducing competition have, without exception, involved the acquisition of important firms. Although Judge Timbers would not hold that Grinnell was a "dominant" firm in the manufacture of sprinklers, there is no doubt that it is one of the leading producers; it did over 50 percent of the power pipehanger business. Canteen is "one of the few nationwide vending organizations"; with its largest competitor, it handles over 10 percent of in-plant food supplying. Jones & Laughlin is the sixth largest basic steel producer. Even if conglomerate chief executives insist that they oppose reciprocity, their suppliers may make purchases to create an atmosphere of good will. On the other hand, the more diverse the conglomerate, the more costly the record-keeping necessary to make reciprocity function. If it is the potential for reciprocity that is to be prevented, proving its absence will be very difficult when a large, diverse firm is involved in a merger.\textsuperscript{43}

To the extent that a conglomerate merger removes a potential competitor, or, by expanding its size, entrenches an important firm in a concentrated market, there would be general agreement that it should be prevented, following the doctrine expounded in \textit{Procter & Gamble} by Mr. Justice Douglas. Competitors might be deterred from entering, or smaller firms might become more cautious in competing due to their fear of retaliation. Yet, the existence of potential competition, entrenchment, or probable changes in attitudes by smaller firms are difficult to demonstrate conclusively. The \textit{Neal Report}’s merger amendment proposal attempts to eliminate speculation and uncertainty and when possible distortion of market to bring conglomerate acquisitions into the "product-extension" category. The antimerger law would be amended to prohibit unions of "leading" firms and "large" firms. Leaders have 10 percent of a market where the four largest have 50 percent or more of the sales; large firms have assets

\textsuperscript{42} Complaint at para. 9(a), United States v. International Tel. & Tel. Corp., Civil No. 69 C 924 (N.D. Ill., filed April 28, 1969).
\textsuperscript{43} Proposals to develop techniques to determine whether reciprocity exists cannot very easily determine whether a customer is purchasing in order to be considered as a supplier. \textit{Cf.} Stelzer, \textit{Remarks Before the A.B.A. National Institute on Conglomerates and Other Modern Merger Movements}, at 5, Oct. 23, 1969 (mimeo).
of more than $250 million or $500 million in sales.\textsuperscript{44} This rule is similar to the one proposed by Campbell and Shephard,\textsuperscript{45} except that the prohibition is absolute.

As the diversity and size of the conglomerates grow, the possibility that further mergers will eliminate potential competition is easier and easier to envisage. Where large firms are seeking to diversify, a combination will almost inevitably affect their plans. Jones & Laughlin, for instance, prior to its acquisition by LTV, had been contemplating diversification into a number of industries, at least nine of which had also been under study by LTV's subsidiaries.\textsuperscript{46} As the Allis-Chalmers decision shows, the mere statement of interest in a field by a large diversified firm may be accepted by the courts as evidence of the existence of potential competition. Although the court issued only a preliminary stay, it gave substantial credence to statements by Allis' management to the effect that Allis seriously considered entering the household appliance field, where White's Kelvinator maintains a shaky foothold, and intended to produce rolling mills, for which it supplies electric drives, in competition with White's Blaw-Knox.\textsuperscript{47} In order to defeat a takeover, it seems sufficient to show that entry has been considered, no matter how impractical that entry may be. On the other hand, in denying the government's request for a temporary injunction in the ITT case, the court refused to find that ITT might enter the property insurance business, although there has been substantial cross entry by life and casualty companies.\textsuperscript{48} In the Northwest case, after detailing the circumstances that indicated there was potential competition between Goodrich and Northwest in various chemical products and footwear, Judge Will could reach no firm conclusion.\textsuperscript{49} Whether at a trial anything more conclusive could be introduced is debatable. If the standards of the district court in United States v. Penn-Olin Chemical Co.\textsuperscript{50} are followed, there will be very few instances in which elimination of potential competition can be shown.

Entrenchment of leading firms was strongly charged in the complaint against ITT's acquisition of Grinnell and Hartford Insurance. Moreover, the Government viewed the combination of Hartford, as an insurer, and Grinnell, as a manufacturer of fire protection equipment, as lending itself to exclusion of competitors, even without the availability of the financial

\textsuperscript{44} 1968 Presidential Task Force Report on Antitrust, 115 Cong. Rec. 5642, 5651-52 (daily ed. May 27, 1969). Markets must be bigger than $100 million for two years or more before the section would apply. Id. at 5651.

\textsuperscript{45} Campbell & Shepherd, Leading Firm Conglomerate Mergers, 13 Antitrust Bull. 1361-82 (1968).


\textsuperscript{49} 301 F. Supp. at 1094-97.

\textsuperscript{50} 246 F. Supp. 917 (D. Del. 1965), aff'd by an equally divided Court, 389 U.S. 308 (1967).
power of ITT. In dismissing the request for a stay, Judge Timbers simply gave more weight to the company witnesses than to the government's. There was little possibility that Hartford could influence the insurees to give precedence to Grinnell products.\(^5\) Judge Timbers was similarly unwilling to conclude that Hartford would be favored in obtaining the insurance business of ITT in spite of the fears of an executive officer of a competitive insurance company.\(^6\) In a contrasting case, Wilson was enjoined from acquiring Niessen, a leading firm in the gymnastic equipment business, because, in view of the tremendous disparity in size between the merged firm and its competitors, it would surely be entrenched in its 28 percent share of the market.\(^7\) There was no evidence tending to show that Wilson intended to enter the business, although it complemented its sporting goods line.

There is a temptation to conclude that where there are large disparities in size, entrenchment can be assumed automatically. Instances where acquisition by a much larger firm has failed to support the position of a leading firm are hard to come by. Ford's failure with Philco may show the power of its opposition in the kitchen appliance line. Independents may cast about for similar support if faced by a competitor owned by a giant conglomerate.

There are other defenses of conglomerate mergers, apparently to be applied to cases recently brought by the Government. First, it is argued that small owners should be given an opportunity to sell out to larger firms; this provides an incentive for new entry. There can be no quarrel with this proposition, but it seems to have no relevance to any of the conglomerate purchases challenged or likely to be challenged by the Government. More persuasive is the argument that firms in sick industries should be allowed to cure themselves, or offset their troubles by joining forces with a company in a healthy industry. Acquisitions by textile, railroad, movie, and tobacco companies are justified on these grounds. Singer, buffeted by Japanese competition, reduced its dependence on sewing machines. Defense firms, like Litton, attempt to move into other areas. More broadly, the stockholders of the conglomerates are said to benefit from the diversification that reduces the variability of earnings.

While one can sympathize with the efforts of managements of tobacco companies to enter the production of some less damaging product, there appears to be no benefit to the economy at large from the use of escape by merger. Stockholders in tobacco companies benefit, but to the extent that

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\(^6\) Id. at 794.

\(^7\) United States v. Wilson Sporting Goods Co., 288 F. Supp. 543 (N.D. Ill. 1968). Judge Timbers distinguished between the Wilson case and ITT's acquisition of Grinnell; the disparity in size was not quite so great between acquired and acquiring firm. Otherwise, the situations seem to be parallel. Reciprocity was not involved in the Wilson case; elimination of potential competition was not a factor; there was evidence of unimpeded entry. Nevertheless, the merger was enjoined. See United States v. International Tel. & Tel. Corp., 306 F. Supp. at 780.
they do, the shareholders in the acquired companies must lose. Through a liquidating dividend, the tobacco company stockholders could be given the opportunity to switch their investments to other fields. (Tax considerations are neglected; they may distort decisions, and if they do, amendment of the tax law is required.) The maintenance of the organizational structure of a firm in a declining industry can not convey economic advantage. The transfer of the organizational structure of a declining firm via merger cannot involve any appreciable economic advantage over the shift in resources accompanying liquidation.

A somewhat more intriguing defense of the “new” conglomerates views them as the means for entry of outsiders into the Business Establishment. This argument does not attempt to enlist our support for Mr. Ling, Mr. Geneen, Mr. Miller, Mr. Asch, Mr. Steinberg, Mr. Bludhorn and Mr. Black, solely on the ground that forbidden the opportunity to merge, they might have been unable to occupy such important positions. More importantly, the threat of merger, it is argued, galvanizes somnolent management into action, and actual take-over speeds up the innovative process. Threat of a take-over seems as likely to drive companies to seek a haven in a more agreeable conglomerate, if threatened with acquisition by one, which, like White Consolidated, has the reputation for giving incumbent management the axe. Goodrich appears to have devoted much of its management’s time to staving off its acquisition by Northwest; its earnings record remains undistinguished. Allis-Chalmers, besides fighting potential partners, has been retrenching; there is little to show that its position will improve over the long run.

Take-overs have been more closely related to disparities in price-earnings ratios, or the ability to utilize financial self-levitation, than to improvements in management efficiency. Some of the best-managed firms have disappeared voluntarily into conglomerates because their stockholders have been attracted by what appeared to be substantial stock gains. The Grinnell, Talon, Abex and Blaw-Knox merger agreements can largely be explained in these terms.

The problem is the stock market, not the basic business of many of these companies. They are not the glamor stocks in today’s market. They make the go-go types yawn. They sell, the best of them, for ten times earnings and even less. And so they are very vulnerable.54

The most successful conglomerates do not make a practice of picking up poorly-run companies in order to improve management. Textron, for instance, considers only companies whose management it hopes to retain. Again, the Ford-Philco merger is instructive. The new management found itself unable in the end to cope with the problems of the appliance industry. There are many instances of the loss of good management on the occasion of acquisition by a conglomerate (or in other types of mergers). The prob-

lem of integrating existing management, or training new, is a cost of merger that has often been overlooked. \(^{55}\) Since so much of the time of the top executives of the rapidly growing conglomerates has been devoted to reviewing opportunities for new acquisitions, and piecing together attractive deals, there would seem to be relatively little that could be contributed to carrying on the conventional management activities.

As an example of innovation, Wheeling Steel's introduction of a different method of price quotation has been cited. \(^{56}\) It is unfortunate that after this short-lived deviation from the norm, Norbert Simon relinquished his interest in steel; how characteristic it was of conglomerate behavior cannot be determined. Wheeling's position was desperate. Jones & Laughlin has been a moderately innovative firm, and Ling may have had in mind not technological but organizational change. The time may have come for disintegration of some of the steel giants, in their own interest. Whether such an approach — similar to that which Ling followed with Wilson — is intended, we do not know. Much if not most of the innovation of the conglomerates appears in their financial methods and their advertising. No evidence has yet appeared to show that conglomerate divisions and subsidiaries innovate a more than proportional share of cost-reductions or important new products.

A few subsidiary points remain to be considered. With the debacle that has overtaken the prices of most of the fast-growing conglomerates, it may seem unnecessary to devote much attention to the hypothesis that management science has advanced to the point where there are no diseconomies of scale, and where expertise in problem-solving can be applied to any type of problem. Litton's willingness to undertake an economic development program in Greece epitomizes this form of hubris. Nevertheless, the improvements in communications and information-processing, combined with the increasingly sophisticated technology of most industries must have led to changes in the role of management — but not necessarily to the advantage of the conglomerates. The Dean of the Syracuse University Business School sees little more than a ritual role for top management. In the first place, it is prevented from reviewing the most difficult problems, which are usually worked out at a lower level. In most cases, management is programmed by subordinates to reach "correct" solutions by the nature of the corporate communications system, which insures that senior executives are convinced that a problem is not a real one since everyone else agrees on the solution. Opposing arguments have all but disappeared by the time the problem gets to the top. Moreover, executives are influenced by the professionalism of the "presentation." Finally, senior executives do not have the time or training to go into problems in detail, which forces decisions to be made at a lower

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\(^{55}\) *Hearings Pursuant to S. Res. 262, supra* note 9, at 188-89 (testimony of I. Stelzer).

level in the organization. And there is little reason to believe that the decisions that cannot be made lower down would be any worse if made by flipping a coin.\textsuperscript{57} This theory, while entertaining, fails to explain why some conglomerates like Textron have been continuously successful.

If the economic justification for conglomerate mergers is to lie in their superior earnings, this defense too must be given up. In the first place, the measure of their success is itself suspect. As everyone knows, per share earnings will inevitably rise when a company with a high price/earnings ratio merges with one with a low price/earnings ratio, and comparison of before and after shows "improvement." Other comparisons of "published financial statements of highly acquisitive multicompanies are rendered all but meaningless. . . . [They] cannot be compared meaningfully with the financial statements of other companies or even with their own historical record."\textsuperscript{58} Growth rates, often used as the basis for evaluating company performance, are unreliable; \textit{Forbes}, in introducing its comparison of almost 600 companies, felt required to scout the validity of its own index. "[B]e suspicious," the magazine told its readers, "of any company that shows a five-year earnings growth rate of more than 20% a year."\textsuperscript{59}

A review of the earnings record of 16 of the most active acquiring companies,\textsuperscript{60} and recognizing the limitations of the basic data are not biased downwards, shows the merging conglomerates have not outperformed their more conservative colleagues.

One is entitled, therefore, to some scepticism about the claim that these companies have been better stewards for their stockholders than have other firms.

Although it is impossible to generalize from isolated examples, the motives governing some of the recent acquisitions suggest that something other than careful investment appraisals have determined purchases. The management of Lykes, for instance, seems to have been attracted to Youngstown Sheet and Tube because the company owned "natural resources," was selling at a low price/earning ratio, and had a substantial cash flow. Perhaps the cash flow can offset the fact that Youngstown is a "company that is clearly no beauty" in "an industry that is one of the least profitable in the country."\textsuperscript{61} Jones \& Laughlin, after it was purchased by Ling, has produced a series of disasters. SCM bought Glidden, which was only a modestly profit-


\textsuperscript{58} \textit{Forbes}, Jan. 1, 1970, at 104. There are a few exceptions to this generalization; Textron, for instance, has gone so far as to call attention to the fact that in its published statements it uses accelerated depreciation, amortizes the investment tax credit, amortizes purchased good will, and computes earnings per common share after allowing for conversion of preferred stocks and exercise of all warrants and options.

\textsuperscript{59} \textit{Id.} at 53.

\textsuperscript{60} The list of the \textit{Staff Report} has been used, omitting Union Oil, Occidental Petroleum, Sun Oil, Phillips, Georgia-Pacific and U.S. Plywood-Champion Papers, because their acquisitions were closer to horizontal or vertical than those of the others.

\textsuperscript{61} \textit{Forbes}, April 1, 1969, at 30.
### PUBLIC POLICY

#### TABLE II

**Profitability of 16 Leading Merging Conglomerates by Rank**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Latest 12-month return on equity</th>
<th>Rank</th>
<th>5-year return on capital</th>
<th>5-year return on capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Textron</td>
<td>16.9</td>
<td>45</td>
<td>17.8</td>
<td>45</td>
</tr>
<tr>
<td>2. Teledyne</td>
<td>14.9</td>
<td>87</td>
<td>14.8</td>
<td>87</td>
</tr>
<tr>
<td>3. LTV</td>
<td>8.7</td>
<td>106</td>
<td>14.1</td>
<td>106</td>
</tr>
<tr>
<td>4. RCA</td>
<td>17.0</td>
<td>123</td>
<td>13.3</td>
<td>123</td>
</tr>
<tr>
<td>5. Studebaker-Worthington</td>
<td>10.3</td>
<td>159</td>
<td>12.8</td>
<td>159</td>
</tr>
<tr>
<td>6. Litton Indus.</td>
<td>13.3</td>
<td>169</td>
<td>12.1</td>
<td>169</td>
</tr>
<tr>
<td>7. FMC</td>
<td>13.3</td>
<td>180</td>
<td>11.9</td>
<td>180</td>
</tr>
<tr>
<td>8. White Consol.</td>
<td>25.3</td>
<td>183</td>
<td>11.8</td>
<td>183</td>
</tr>
<tr>
<td>9. North American-Rockwell</td>
<td>8.4</td>
<td>186</td>
<td>11.8</td>
<td>186</td>
</tr>
<tr>
<td>10. McDonnell-Douglas</td>
<td>28.1</td>
<td>209</td>
<td>11.3</td>
<td>209</td>
</tr>
<tr>
<td>11. Gulf &amp; Western</td>
<td>10.1</td>
<td>239</td>
<td>10.6</td>
<td>239</td>
</tr>
<tr>
<td>12. ITT</td>
<td>11.9</td>
<td>269</td>
<td>10.1</td>
<td>269</td>
</tr>
<tr>
<td>13. Signal Cos.</td>
<td>9.1</td>
<td>340</td>
<td>8.5</td>
<td>340</td>
</tr>
<tr>
<td>14. Gen. Tel. &amp; Electric</td>
<td>12.5</td>
<td>415</td>
<td>7.0</td>
<td>415</td>
</tr>
<tr>
<td>15. Tenneco</td>
<td>13.5</td>
<td>457</td>
<td>6.2</td>
<td>457</td>
</tr>
<tr>
<td>16. Gen. Am. Trans.</td>
<td>11.0</td>
<td>444</td>
<td>6.1</td>
<td>444</td>
</tr>
</tbody>
</table>

**Source:** Forbes, Jan. 1, 1970, at 44.

able company, largely to insulate itself against acquisition by larger conglomerates. The premia over the market value offered in recent take-over bids—mostly made when the market was far above its current levels—bears witness to the "discounting the hereafter" spirit that has generated many of the mergers.

### Conclusions

Following the procedures adopted in the horizontal and vertical merger enforcement policy, the rules to be applied to conglomerate mergers have given pre-eminence to structural features. In fact, the Attorney General has based policy squarely on a criterion that some economists believe to be irrelevant—absolute size. Should this policy be abandoned, pending the holding of a "conference," as Professor Stigler proposes, or should an entirely different approach be adopted? If structural tests are not to govern policy, then perhaps the British approach should be considered as an alternative. In two recent cases the Monopolies Commission had occasion to review conglomerate acquisitions. In both, the effect on management was the key element in deciding whether the merger should be approved or disapproved. This is in conformance with the policy, as spelled out by the

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63 Hearings on H.R. 13270, supra note 29, at 2489-90 (statement of L. Swinehart, Director of Research, W.T. Grimm & Co.).
64 Speech of Att'y Gen. Mitchell, supra note 30.
65 Cf. Hearings Pursuant to S. Res. 262, supra note 9, at 228 (testimony of M. Adelman).
66 British Monopolies Comm., The Rank Organization Limited and The De La
Board of Trade, that examines mergers on a case-by-case basis, taking account of both the internal and external effects of mergers. Not only does the Board of Trade ask for structural and behavioral information, but it also endeavors to check on the probable effect on performance. The Board of Trade attempts to determine "what have been the consequences for efficiency of earlier mergers in which either of the firms has been involved," and inquires into the quality of management and the likely effect of the merger on technological advance. The motives for the merger are examined, along with its effect on internal management procedures and functioning, and on personnel. If the merger is to be consummated largely to achieve tax or financing gains, and no efficiency gains result, it will be disapproved.

There are certain attractive qualities to the British program. It seems not at all unlikely that, forced to respond to as probing a series of questions as those suggested by the Board of Trade, many of the conglomerate mergers might have been dropped in mid-stream because management would have been unable to justify them. On the other hand, the procedures of both court and Federal Trade Commission antitrust proceedings seem ill-suited to reach reliable conclusions about the effect of mergers on efficiency. The informal and flexible character of the Board of Trade and Monopolies Commission activity lends itself to relatively quick decision-making, in which the administrative body and, one assumes, the business community, can have a high degree of confidence. Hence, even though the Board of Trade admits that if conglomerates with "their power centres outside any particular industry and... partly withdrawn from the traditional modes of competition," came to be the typical industrial firm, the competitive environment would be transformed, it will not adopt a general rule applicable to large conglomerates.

We seem to have no alternative to the adoption of structural rules. They can do little harm; no one has shown that there have been efficiency losses resulting from them. They are inequitable, favoring the established as against the new conglomerates. But the new conglomerates can, of course, expand by reinvesting earnings or attracting outside funds. If, to be "fair" to the new conglomerates, we must allow them to tip the balance definitively toward super-concentration, we may have to be unfair. Equity can also be done by setting a size limit for all corporations, and bringing under direct control those whose decisions directly affect the incomes, status, and environment of large sections of the community.

67 BRITISH BOARD OF TRADE, MERGERS—A GUIDE TO BOARD OF TRADE PRACTICE 12 (Her Majesty's Stationary Office, 1969).
68 Id. at 17.