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CONGLOMERATES: THE NEED FOR RATIONAL POLICY MAKING

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To me, however, the real danger — and the danger in any large corporation whose top management is remote and must impose consistent business practices on the local resources it controls — is not economic. It's the danger of becoming faceless and compassionless: Of being too removed to react and too isolated to understand.

C. Peter McColough, President, Xerox Corporation.

INTRODUCTION

The typical conglomerate firm of the 1970's is an amalgam of the assets and resources of many independently large enterprises which by themselves frequently represent some of America's biggest and best known corporate names. In common with many newly emerging economic institutions and phenomena, they bring in their wake problems which are both economic and social. Thus, citizen groups and government regulators are concerned with the political and social implications of the combination under one corporate management of large industrially oriented companies together with companies specializing in the distribution of information.[1] Others raise concerns about the impact on individual freedom and privacy of the combination of hitherto independently operated businesses, such as, for example, businesses involved in the production of both hardware and software under one roof, or in both the furnishing of credit reports and the collection of debts.[2] Congressmen have questioned whether the trend towards conglomerates and the rise of the professional conglomerate managers will loosen even further the community ties of the local corporate management. They are concerned with the effects which the takeover of such local companies will have on their headquarters community, particularly their local suppliers and customers, on their trade union ties, on the local banks, and even law firms which had previously serviced many of their needs.[3]

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1 *See, e.g.*, ABC-ITT Merger, 7 F.C.C.2d 245, 331, 332 (1967); *Computer Assisted Education: A New Challenge in Social Responsibility*, Address by Mary Gardiner Jones, Computer Seminar, Shoreham Hotel, Washington, D.C., June 13, 1968, at 9-34 (mimeo).

2 Celler, *Conglomerate Merger Investigations*, 38 ANTITRUST L.J. 139 (1969); Hruska, *Bigness and Diversification: The Conglomerate*, 38 ANTITRUST L.J. 184 (1969); Miller, *Personal Privacy in the Computer Age: The Challenge of a New Technology in an Information Oriented Society*, 67 MICH. L. REV. 1091 (1969).

3 *See supra* note 2. *See also* BUREAU OF ECONOMICS, FTC, ECONOMIC REPORT ON COR-

These are some of the questions being raised about the wider ramifications of the conglomerate merger trend which seems to be proceeding at such a rapid rate in the United States. They are questions to which policy makers must find answers if they are to frame a rational policy towards the conglomerate phenomenon.

This paper, however, has a narrower focus. It seeks to concentrate essentially on the competitive and general economic performance characteristics of conglomerates. Thus, Part I will consider the two types of behavior viewed by students of the conglomerate merger movement as having the greatest competitive significance: cross-subsidization or the ability to use revenue and profits from one profit or product "center" in order to "subsidize" operations in an unrelated one; and reciprocal dealing and forbearance, either actual or potential, said also to be a hallmark of conglomerates. It also deals with the structural market condition which conglomerate mergers directly influence and which it is generally agreed is one of the most competitively significant aspects of this merger movement: the loss of acquired and/or acquiring firms as potential competitors into each other's markets.

Part II will touch briefly on the broader policy questions of whether conglomerate performance, so far as we know it, is consistent with the achievement of such socially desirable goals as efficient use of resources to obtain maximum amount of productive output and consumer welfare, and the progressive development of new products and processes characteristic of a dynamic, on-going economy. While antitrust, concerned as it is with competitive structure and conduct, has not usually emphasized overall socio-economic performance as relevant to its proceedings, the policy-maker, whose actions inevitably affect society on a broad basis, must be in touch with all elements, manifestations and aspects of the conglomerate movement which bear upon their socio-economic role. The second part of the paper will, therefore, separately analyze the efficiency and progressiveness of conglomerates.[4]

For purposes of this analysis, acquisitions will be considered conglomerate where both the acquiring and acquired firms produce different and basically unrelated product lines and share few if any common resource inputs with each other. Thus eliminated are: (1) product extension mergers where both acquiring and acquired firms, though producing different products, may have common or similar distributional, promotional, or advertising facilities and resources which are capable of combination or inter-

PORATE MERGERS [hereinafter cited as FTC REPORT] 453-57, 473-97 (1969). For a statistical "anatomy" of the extent of the conglomerate merger movement, see *id.* at chs. 1-4, especially ch. 2 at 95-106.

[4] Limitations of space have dictated that other, sometimes broader performance dimensions of conglomerates besides efficiency and progressiveness simply not be treated. Therefore, we do not discuss, for instance, the extent to which conglomerates affect the social and economic stability of the communities wherein they operate.

change to each other's mutual benefit; (2) market extension mergers, where both acquiring and acquired firms produce the same products but in different markets, and thus may share through combination all production, distribution and promotional resources which geographic distance does not render impracticable; and (3) horizontal and vertical mergers, where product or resource inputs are either identical or functionally related. What we are left with then as the focus of our study are relatively "true" conglomerates, *i.e.*, those which do not share common resources or similar or related product lines.[5]

I. POTENTIAL ANTICOMPETITIVE BEHAVIORAL AND STRUCTURAL EFFECTS OF CONGLOMERATES

A. *Cross-subsidization of Internal Corporate Resources*

Among the possible anticompetitive tactics regarded as particularly significant in the behavior of conglomerates is that which has been broadly defined as cross-subsidization. This is the assumed ability of a large diversified firm to use its overall size and market power, or its strong position in various individual markets as a means of maintaining or enhancing its position in other specific markets to the detriment of actual and potential competitors in those markets.

The anticompetitive incidence of this type of behavior can be deliberate and overt, or wholly unintentional. A conglomerate may set about deliberately to engage in predatory pricing (such as geographic or product price discrimination designed to thwart and eliminate competition), "excessive" promotional expenditures, the setting of unduly low prices, the use of its products as loss leaders, the adoption of disciplinary price cuts in order to keep overly aggressive competitors in line, and the launching of other consciously excessive, or possible retaliatory action. Or, a conglomerate firm, without any explicit or conscious anticompetitive tactics, may simply draw on its overall market strength in the ordinary course of business in order to give itself superior advantage in various specific markets in which its units are operating, thereby intimidating actual and potential competitors.[6]

This ability to use overall strength, profits, and power, drawn from some markets in the subsidization of operations in others, is not a phenomenon peculiar to conglomerates. Rather, it can apply to any large multi-

[5] Of course, it must be recognized that there is probably no such entity as a "true" conglomerate. Almost all diversified firms have at least some product lines which use at least some of the same inputs as others. The largest conglomerates even have some minor horizontal or vertical product overlap or relationship. *See* J. NARVER, CONGLOMERATE MERGERS AND MARKET COMPETITION 3-6 (1967).

[6] *See* FTC REPORT at 398-405; Hines, *Effectiveness of Entry by Already Established Firms*, 71 Q.J. ECON. 132 (1957); Stocking, *Comment on Corwin Edwards — Conglomerate Bigness as a Source of Power*, in BUSINESS CONCENTRATION AND PRICE POLICY 352 (Nat'l Bureau Econ. Research ed. 1955); Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1339 (1965).

diversified firm whether it obtained its position through merger or internal expansion. However, merger-built conglomerates have been considered peculiarly vulnerable to the charge of cross-subsidization. The diverse organizational structure and complexion of a conglomerate, composed as it is of a series of separate corporate operations, organized for a variety of financial and/or economic motives (increased liquidity, tax loss write-offs, managerial know-how, superior technology or distribution), under a single top management hierarchy, may lend itself to the creation of "cross-subsidization" situations in which the pressure for short-range increases in sales volume or superior management performance in some other dimension will become of greater importance than the concern with profit maximization said to characterize more traditional firms.

For instance, possible pressure from top conglomerate management for here-and-now performance, sales, and earnings, as well as the partial ability to disguise or hide, through lack of meaningful divisional reporting or joint cost allocation, the profit and loss results of an accounting balance sheet, may sorely tempt a division manager to ignore the fact that cross-subsidization does not maximize profits. Thus, he may use non-profit-maximizing pricing and promotional expenditures anyway if they will gain for him a temporarily increased market share or increased sales.[7] He may be oblivious to the possibility that the consequences of his cross-subsidization behavior — in driving out or intimidating competitors and thus aggrandizing his market and profit position — may, in the long run, induce new entry and thus be in vain.[8]

Similarly, a division manager may, if he is in charge of a less profitable part of the conglomerate, be interested in his own self-perpetuation rather than economically rational profit maximization or loss minimization. Thus, he may use cross-subsidization from a more profitable part of the enterprise as a technique for market survival in his own profit "center" when the signals of economic loss in the marketplace tell him that he should exit from the business.

The exercise, or threat to exercise, the range of "cross-subsidization" competitive options which the overall multi-industry strength, lack of separate divisional reporting responsibility, and special motivations of conglomerate management give to the conglomerate, can thus result in other

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7 *See, e.g.*, W. BAUMOL, BUSINESS BEHAVIOR, VALUE, AND GROWTH (1967).

8 Under such circumstances, a cross-subsidization policy might be especially feasible if one of a conglomerate's divisions enjoyed a solidly entrenched market position in a relatively competitively stable high-profit industry. The profits thereby engendered could be used to promote the market position of another unit operating within a much more competitively dynamic framework, or could enable the more competitively challenged unit to adopt an aggressive market strategy embodying low prices or high promotional expenses or a combination of both without the pressure to show the type of precisely reported separate profit results which a less conglomerate rival would have to show in order to enjoy the confidence of the investment community on which its access to capital is dependent.

firms being competitively intimidated or driven out of business, potential entrants being discouraged, or defensive mergers being promoted. Any one of these consequences contains the potentiality for increasing concentration, and thus leading to worsened economic performance.[9]

Many economic theorists — both those who see some potential anticompetitive dangers in conglomerates from behavioral areas other than cross-subsidization and those who for the most part do not — tend to minimize the importance of cross-subsidization as a source of anticompetitive potential.[10] These economists argue either that such policies are not apt to be adopted by conglomerates or that if adopted they will not necessarily engender anticompetitive consequences. To some, it is simply inconceivable, or at least unlikely, that conglomerates would pursue cross-subsidization policies. They see conglomerate managers as conforming to the traditional economic mold of maximizing profits in each individual profit center, and thus deem it unlikely that conglomerates would pursue the pricing or marketing strategies of cross-subsidization which depart from profit-maximizing behavior.[11] Nor is there any reason to believe, according to those who question the competitive effect of cross-subsidization, that conglomerate entry into a market will automatically engender timidity on the part of competitors and a consequent lower level of competition. It is just as likely to generate vigorous counter measures as a result of the new competitive pressures exercised by the conglomerate entrant. To these economists, therefore, cross-subsidization policies can be an important tool by which to shake lethargic markets out of their noncompetitive stupor and break oligopolistic price levels; or, perhaps, they can be a lever which a new entrant can use to penetrate a market successfully.[12]

Both the Federal Trade Commission (FTC) and the courts have recognized the anticompetitive potential of cross-subsidization tactics and have

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9 FTC REPORT at 399-457.

10 *See id.* at 401-03; 1969 PRESIDENTIAL TASK FORCE REPORT ON PRODUCTIVITY AND COMPETITION, 115 CONG. REC. 6472 (daily ed. June 12, 1969) [hereinafter cited as STIGLER TASK FORCE REPORT]; Turner, *supra* note 6, at 1339-62.

11 Economists stress two ways in which cross-subsidization can depart from profit-maximizing behavior. First, the excessive promotion or lower prices in the cross-subsidized market may not be consistent with short-run profit maximization, since they involve deliberately incurred losses, presumably for the purpose of obtaining longer-run profits through increased market share and attendant economic power in the cross-subsidized market. Second, they may not result in long-run profits either, since such profits, if gained through enhanced market share and attendant enhanced market power, may well be dissipated by the entry of new firms who see such higher profits as an incentive themselves to enter the market.

12 These economists point out that the readily apparent nature of cross-subsidization practices and their obvious illegality mean that corporations fearing antitrust law enforcement will simply not adopt such strategies. Or they argue that such policies will not be adopted either because they are economically undesirable or because they do not fit the corporate strategy underlying the acquisition in the first place (*i.e.*, those undertaken in order to obtain large cash reserves or a tax loss, or for some other non-industrial purpose).

in specific cases either referred to this potential or have in fact expressly relied upon it as one of the factors leading to the conclusion that a particular acquisition was likely to lessen competition or create a monopoly.[13] Most recently in *FTC v. Procter & Gamble Co.*,[14] the Supreme Court, holding Procter's acquisition of Clorox illegal, relied in part on the potential which Procter & Gamble's more powerful and diversified resources provided for the use of aggressive market tactics, heavy sales promotions and advertising advantages in order to further entrench Clorox in the bleach industry to the disadvantage of its existing, less powerful competitors as well as new entrants.

While none of these cases involved the unrelated corporate units which our definition of conglomerates has posited, there would seem to be nothing unique or substantially different about the conglomerate's power to engage in cross-subsidization that would immunize from the same criticism of anticompetitive vulnerability. However, since every conglomerate almost

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13 The FTC, in its opinion in *In re National Tea Company*, specifically rested its conclusion as to the illegality of National Tea's market extension acquisitions in part on its use of the profits from operations in some of its markets in order to subsidize operations (and possible anticompetitive tactics) elsewhere. *In re* National Tea Co., No. 7453 (FTC, March 16, 1966).

The FTC also relied in that case on the strong aggregate concentration trends in the food industry. The FTC took a similar position in its *Foremost Dairies* decision, in which it concluded that "the resultant disparity in size and type of operations permits the large conglomerate to strike down its smaller rivals with relatively little effort or loss in overall profit." This potential market advantage is similarly realized by a firm selling a single product in many separate markets, for its operations in any one market are not governed solely by that market's conditions. For these reasons, market-extension mergers may be viewed and judged on the same grounds as conglomerate mergers. Foremost Dairies, Inc., [1962 Transfer Binder] TRADE REG. REP. ¶ 15,877 at 20,686 (FTC 1962).

The court decisions seemingly embracing theories of cross-subsidization as grounds for holding mergers illegal did not for the most part involve conglomerate acquisitions and in some instances have been interpreted by hindsight as involving essentially predatory pricing tactics or keen competition rather than cross-subsidization potential. FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 542-46 (1960) (and cases cited therein); Moore v. Mead's Fine Bread Co., 348 U.S. 115 (1954); Standard Oil Co. v. United States, 221 U.S. 1, 43, 76 (1911); Forster Mfg. Co. v. FTC, 335 F.2d 47 (1st Cir. 1964); United States v. New York Great Atlantic & Pacific Tea Co., 173 F.2d 79, 88 (7th Cir. 1949); Porto Rican Am. Tobacco Co. v. American Tobacco Co., 30 F.2d 234 (2d Cir. 1929); Adelman, *The A & P Case: A Study in Applied Economic Theory*, 63 Q.J. ECON. 238 (1949); McGee, *Predatory Price Cutting: The Standard Oil (New Jersey) Case*, 1 J. LAW & ECON. 137 (1958).

14 386 U.S. 568 (1967). Again, in 1968 the Supreme Court affirmed per curiam a Court of Appeals ruling that General Foods, a major manufacturer of a diversified line of food products sold at grocery stores and supermarkets, violated section 7 of the Clayton Act when it acquired S.O.S., the leading U.S. manufacturer of household steel wool pads, a line in which General Foods had not been engaged prior to the merger. Like Procter and Gamble, General Foods had large scale resources and a substantial advertising and promotional program into which the promotional activity of S.O.S.'s products could fit. *In re* General Foods Corp., 386 F.2d 936 (3d Cir. 1967), *cert. denied*, 391 U.S. 919 (1968).

The FTC's outstanding complaints involving acquisitions by "true" conglomerates do not focus on the cross-subsidization issue. Likewise, the outstanding complaints of the Justice Department against particular conglomerate mergers focus only secondarily, if at all, on the cross-subsidization aspect of their conduct.

by definition will have this potential, the question arises whether its mere existence would be enough to damn a conglomerate merger. Here again case law would seem to indicate that such automatic disqualification will not be applied to the conglomerate acquisition. The same automatic potential presumably exists for any diversified firm and yet neither the antitrust authorities nor the courts have ever challenged these acquisitions on this potential alone.

The contrasting arguments of the economists on the competitive importance of cross-subsidization, together with the limited applicability of existing case law, underscore the unreality of positing automatic anticompetitive consequences to the cross-subsidization potential of conglomerates. Moreover, they also point up the basic problems now confronting policy makers in their efforts to devise effective internal policies or guidelines by which to approach these mergers.

What is clearly needed, but not presently available, is additional evidence as to whether cross-subsidization is extensively engaged in by conglomerates, and if so, whether it makes a difference for the short-run and longer-run competitive structure of the affected industries. It is probably not possible to obtain *direct* evidence as to the prevalence of cross-subsidization among conglomerates without devoting more legal, economic, and financial resources to the effort than would be deemed realistic.[15] It is more realistic and feasible, however, to find out whether conglomerate mergers, presumably through cross-subsidization as well as other types of behavior, have affected market structure and competitive performance in acquired-into lines; for example, were the corporate resources of the acquired firm augmented or depreciated; what happened to the product or marketing facilities of the acquired companies; have post-acquisition industries affected by entry of conglomerates become more concentrated; has the pace of entry slowed or exit accelerated in the acquired-into industry; have product differentiation or scale barriers to entry increased; has investment in industry or product lines acquired by conglomerate firms become more

[15] This is because the lack of separate divisional reporting of the individual profit centers of a conglomerate firm, the difficulty of allocating joint overhead costs of a multi-product conglomerate, as well as the variety of relatively procompetitive motivations and intent which could prompt the kind of low price behavior which under its anticompetitive aspects is called cross-subsidization would all get in the way of a straightforward investigation of cross-subsidizing conglomerate conduct. Thus, the chances to obtain evidence of cross-subsidization such as was found for the ITT-ABC conglomerate merger would appear to be few and far between. In that particular case, ITT anticipated that after capital expenditures and debt repayment, and assuming ABC continued in third place, it would yield a cash flow approaching $100 million between 1966 and 1970, almost all of which was thought by ITT to be available for reinvestment outside the television business. ABC-ITT Merger, 7 F.C.C.2d 245, 331, 332 (1967).

Because it is a more objective measure, one can probably more easily test (and hopefully it will be done) the question of whether conglomerates increase promotional expenditures on relevant acquired products to levels above those prevailing before acquisition. Relatively objective and systematically kept data would be involved in such a test, and thus it does appear possible.

stable or unstable; has rate of return on acquired assets increased post-acquisition (which might be indicative of enhanced market power);[16] were the employment or pricing strategies altered in such a way by the merger that greater wage and price inflexibility or contribution to inflation has resulted?[17]

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[16] For the use of profit rates as a method of evaluating alternative measures of market power, *see* J. BAIN, BARRIERS TO NEW COMPETITION (1956); Collins & Preston, *Price-Cost Margins and Industry Structure*, 51 REV. ECON. & STATS. 271 (1969); Comanor & Wilson, *Advertising, Market Structure, and Performance*, 49 REV. ECON. & STATS. 423 (1967); Miller, *Marginal Concentration and Industrial Profit Rates*, 24 SO. ECON. J. 259 (1967); Weiss, *Average Concentration Ratios and Industry Performance*, 11 J. INDUS. ECON. 247 (1963).

[17] There is some additional direct empirical case study evidence on cross-subsidization beyond that brought out in the litigated examples described above, but it too applies to product or market extension mergers and thus does not really suggest precisely how significant anticompetitive cross-subsidization is likely to be for "true" conglomerates. *See* ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 165-66 (1955); J. DIRLAM & A. KAHN, FAIR COMPETITION 212-16, 234-41 (1954); E. ROBINSON, MONOPOLY 73-74, 195-205 (1941); G. STOCKING, WORKABLE COMPETITION AND ANTITRUST POLICY 320-21 (1961); Hirsch & Votaw, *Giant Grocery Retailing and the Antitrust Laws*, 25 U. CHI. J. BUS. 1 (1952); Lanzillotti, *Pricing Objectives in Large Companies*, 48 AM. ECON. REV. 921, 935 (1958); Stevens, *The Powder Trust, 1872-1912*, 26 Q.J. ECON. 444 (1912); Wallace & Douglas, *Antitrust Policies and the New Attack on the Federal Trade Commission*, 19 U. CHI. L. REV. 1, 26 (1952).

Unfortunately, there is no *convincing* market evidence that, once into an industry, conglomerates have used cross-subsidization conduct anticompetitively in order to increase their market share, obtain further concentration increases, raise entry barriers, or hasten exit through intimidation of actual and potential competitors. Further there is no evidence that conglomerates, either through cross-subsidization or some other behavioral tactic, have brought with them in their acquired-into markets such undesirable types of economic performance as increased rates of return on acquired assets which might be indicative of enhanced market power, short term wage and price inflexibility, inflation, and investment instability. Concentration, increased size, and heightened entry barriers have long been linked to these undesirable dimensions of economic performance. *See Econometric Studies of Industrial Organizations*, paper by Leonard Weiss at Annual Meeting of Econometric Society in New York, Dec. 1969. However, the evidence indicating how conglomerate mergers affect the level of concentration, barriers to entry, and economic performance in the industries into which they acquire is contradictory and inconclusive. On the one hand is evidence which seems to indicate that mergers are not associated with higher rates of return for the acquiring firm. *See* J. BOSSONS, K. COHEN & S. REID, *Mergers For Whom—Managers or Stockholders?* in CARNEGIE INSTITUTE WORKSHOPS ON CAPITAL MARKET EQUILIBRATING PROCESSES (1966). These findings were extended in a book by S. REID, MERGERS, MANAGERS AND THE ECONOMY (1968). *See also* E. KELLY, THE PROFITABILITY OF GROWTH THROUGH MERGERS (1967); Cohen & Reid, *Effects of Regulation, Branching, and Mergers on Banking Structure and Performance*, 34 SO. ECON. J. 134 (1967); E. Heiden, Mergers and Profitability (unpublished paper); T. Hogarty, The Success of Industrial Mergers, June 1969 (unpublished thesis, State University of New York at Buffalo); W. Kelly, The Influence of Market Structure on the Profit Performance of Food Manufacturing Firms, 1969 (unpublished Ph.D. dissertation, Department of Economics, University of Maryland); J. Stone, Conglomerate Mergers: Their Implications for the Efficiency of Capital and the Theory of the Firm, Mar. 27, 1969 (unpublished thesis, Harvard University).

On the other hand is evidence showing that the conglomerate merger movement may well be linked with increased concentration and thus with increased market power. *See* FTC REPORT at 225-26, 248-50.

None of the studies, however, separate the effect of conglomerate merger on concentration and rate of return from the effect of other types of merger (product extension, At the level of basic research, there is a need for inquiry into the motivation of conglomerate management, *i.e.*, whether top management and division managers respond to the call of profit maximization according to models of perfect competition which maintain that cross-subsidization is unlikely, or whether they answer to some other motivational impetus, such as the desire to gain or keep a place in a management hierarchy which emphasizes such goals as short-run sales performance, a context where cross-subsidization would make a great deal of sense as a competitive technique. Such basic research into management motivation is one of the really unexplored areas of conglomerate merger inquiry.

Given the pressing need for more clear-cut empirical evidence to resolve the theoretical and policy dilemma of whether conglomerates really do change structure by engaging in the sort of anticompetitive conduct embodied under a cross-subsidization rubric, it must be concluded in the meantime that cross-subsidization does remain a potential competitive problem for "true" conglomerates as well as for other large size diversified firms who have achieved their diversified position through some other non-conglomerate means (product extension, horizontal or vertical merger, or internal expansion). Public policy requires an expeditious investigation of conglomerate merger-induced changes in competitive structure of acquired-into markets as a means of testing whether the potentiality for cross-subsidization has any real competitive importance. Otherwise, a policy based on generalized statements about cross-subsidization would have no solid basis.

B. *Reciprocal Interdependence of Conglomerates*

One of the most serious anticompetitive dangers pointed to regarding conglomerate mergers is that they increase the number of contact points in input and output markets both among conglomerate firms, and between conglomerate and non-conglomerate firms. This creates a mutual awareness of common interest among such firms which can then lead to the possibility of reciprocal dealing. This is the practice whereby a given conglomerate which enjoys both a customer and a supplier relationship (one or both obtained through merger) with another firm or which discovers that because of merger it competes with another multi-product firm across more than one product market can agree with that other firm to engage in mutual dealing in goods or favors. The conglomerate with the merger induced customer-supplier relation could exact an agreement to buy from or sell to the other firm only on condition that that firm also deal with it (reciprocal dealing);[18] or both parties who have become potential or direct competitors

horizontal, vertical) or from diversification through internal expansion. In addition, the *FTC Report* is statistically inconclusive. *Id.* at 248-50.

18 The potential for reciprocal purchasing among conglomerates is seen to most clearly exist when the conglomerate enterprise is a *leading* purchaser of a given product line from Company *A* and also a *leading* supplier of another product line to Company *A*

across multiple product lines through merger can mutually agree to forbear vigorous competition with each other in one or more of the separate markets in which they both do, or can compete.[19]

Case law, presently outstanding merger complaints of the Justice Department, and economic theory all agree that reciprocity practices can be anticompetitive.[20] The Supreme Court has carefully noted that not every acquisition which might permit reciprocal sales practices violates section 7 of the Clayton Act.[21] Rather, the test of illegality depends upon such factors as whether the acquiring company commands a substantial share of the market and whether there is a clear probability of reciprocal buying.[22]

Economic theory posits the anticompetitiveness of reciprocity on the fact that it tends to distort business processes away from competition based upon price, product quality and service, and channels the purchase and sale of goods and services toward the essentially noncompetitive bases of economic power and corporate interrelationships. Reciprocal arrangements

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and the conglomerate's reciprocating product line is also part of a highly oligopolistically structured industry so that *A*'s alternative choice of sale — and hence its ability to resist the conglomerate pressure — is considerably lessened. For a more elaborate explication of the structural industry conditions favoring reciprocity agreements, see FTC REPORT at 324-28; Turner, *supra* note 6, at 1387-88.

19 *See* FTC REPORT at 458-71. An example will illustrate this latter type of reciprocity. Let us assume that a conglomerate previously engaged in car rental acquires through merger a position in another industry, motion picture production. As a result the likelihood is increased that it now shares a contact point with another conglomerate or diversified firm who already happens to be in both car rentals and motion picture production. If the relative competitive advantage of each conglomerate lies in a different product, one in car rentals and the other in motion picture production, the newly acquiring conglomerate may decide not to compete vigorously in that in which he has an advantage for fear of being retaliated against in that in which he is relatively disadvantaged. The result of this new conglomerate contact point is forbearance of competition by at least one and possibly two important competitors in each of two industries.

20 Case law on the subject is perhaps best expressed in: FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965); United States v. General Dynamics Corp., 258 F. Supp. 36 (S.D.N.Y. 1966); United States v. General Dynamics Corp., 246 F. Supp. 156 (S.D.N.Y. 1965).

Complaints of the Justice Department all list potential reciprocity as an allegation. *See, e.g.*, Northwest Industries-Goodrich, Civil No. 69-C-1102 (N.D. Ill., filed May 21, 1969); LTV-Jones & Laughlin, Civil No. 69-438 (W.D. Pa., filed April 14, 1969).

Under existing case law, it is not essential to a finding of anticompetitive reciprocal dealing that one or the other of the parties engage in overt bludgeoning or coercion. Reciprocity can ensue from more subtle arrangements such as a threatened withdrawal of orders if products of an affiliate are not bought. Certainly no express agreement need be shown, nor is it necessary to demonstrate the fact of reciprocal buying. A clear showing of the potentiality, coupled, as the Supreme Court stressed, with a large share of the market can be enough. Consolidated Foods Corp. v. FTC, 380 U.S. 592 (1965). In that case the evidence showed that Gentry's sales manager had sought to increase sales by notifying prospective buyers that Consolidated's purchases from them would depend on their purchases from Gentry.

21 15 U.S.C. § 18 (1964).

22 Consolidated Foods Corp. v. FTC, 380 U.S. 592 (1965), *rev'g* 329 F.2d 623 (7th Cir. 1964). The FTC, in being upheld by the Court, had based its findings of anticompetitive effect on the fact that the merger conferred upon a large diversified corporation "a crushing weapon against small, single line competitors."

foreclose market entry on the basis of poorer leverage and less fortunate product mix, and not because of an inability to compete effectively on price or quality. Thus, the possibility of reciprocal dealing can increase concentration, raise entry barriers and rigidify and stabilize prices as whole categories of business transactions are removed from the discipline of price competition, and firms injured by the foreclosure are maneuvered into defensive conglomeration.[23]

There are some economists, however, who reject this notion that the potential of reciprocity can be a competitive threat since they doubt that companies will in fact resort to such a tactic absent assurance of more favorable terms than those otherwise available in the market. Moreover, they do not believe that the practice offers a company sufficient advantages in general to warrant its adopting such a practice.[24]

It would seem that these conflicting theoretical viewpoints could easily be reconciled on the basis of empirical data evidencing the true pattern of anticompetitive reciprocity in American business, *i.e.*, to what extent and under what circumstances does the potential for reciprocity become activated, and, once activated, what are its specific anticompetitive effects in various markets. Certainly, the record demonstrates that up to the time that the antitrust agencies mounted their challenge against reciprocal practices, companies in industry after industry had trade relations departments on such an extensive basis that a special trade association of these companies was established.[25] While this establishes that such firms had the *opportunity* to engage in reciprocal dealing, there has been no in depth collation of empirical data as to the extent to which firms actually have engaged in reciprocity behavior and what its competitive effect has been. No systematic studies have been conducted, for instance, relating the frequency of *actual* reciprocity behavior to the structural conditions of the market which some economists believe foster it. What evidence there is on

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23 This point of view regarding reciprocity is most completely and articulately expressed in FTC REPORT at 328-32.

24 Stigler argues that reciprocity "restores flexibility of prices" in oligopolistic markets, and concludes that, "[i]n short, reciprocity is probably much more talked about than practiced, and is important chiefly where prices are fixed by the state or a cartel." G. Stigler, Reciprocity 3, Feb. 18, 1969 (working paper for STIGLER TASK FORCE REPORT). Coase comes to a similar conclusion. In dismissing reciprocity as a problem in conglomerate mergers, he concludes:

> This practice might, of course, lead to greater efficiency (for example, by reducing marketing costs) or it might lead to inefficiency (by substituting a subsidiary's higher cost supplies for an outsider's lower cost supplies). If this practice leads to efficiency, there is no reason to stop it; if it leads to inefficiency, there is no reason why the conglomerate should adopt it (since it would reduce its overall profits).

R. Coase, The Conglomerate Merger, Feb. 18, 1969 (working paper for STIGLER TASK FORCE REPORT).

25 Ammer, *Realistic Reciprocity*, 40 HARV. BUS. REV., Jan-Feb 1962, at 116 (1962); Mc-Creary & Guzzardi, *Reciprocity: A Customer Is A Company's Best Friend*, FORTUNE, June 1965, at 180.

actual reciprocal behavior consists largely of individual case studies.[26] Likewise, there has been little or no evidence on the question of precisely what the anticompetitive effect of reciprocity has been even in those cases where it was found to actually exist, *i.e.*, to what extent the affected markets were foreclosed through the reciprocal dealings, and whether concentration and entry barriers were increased and/or prices rigidified and stabilized.

Identifying the conditions which transform the threat of reciprocity into actual practice, requires an analysis of such issues as whether there is a critical market share which a firm must have in order to *practice* reciprocal leverage rather than simply pose the threat; how nearly equal must the value of reciprocated products be in relation to each other for reciprocity to be actuated; how concentrated and conglomerated are the industries in which actual reciprocity has been observed; have conglomerates generally entered into the types of acquisitions which have given them the opportunity for this type of behavior; and under what market conditions have firms exercised reciprocity. Certainly, analyses of volume of sales and purchases of conglomerates with other companies pre- and post-merger would help to resolve this latter question. Moreover, there is sufficient raw material available to allow some fairly informed estimates of the structural industry situations most conducive to potential reciprocal dealing.[27]

To assess the anticompetitive effect of actual reciprocity, we must determine from industries where reciprocity is an observed practice whether it brings with it any changes toward a more anticompetitive market structure and worsened economic performance, *e.g.*, whether prices have become more rigid or more flexible, whether concentration has increased, entry been retarded, exit hastened, defensive mergers promoted, and whether the theory is supported which predicts that observed anticompetitive effect is most significant in those cases where reciprocal foreclosure has been the greatest.

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[26] *See* FTC REPORT at 334-97; Hausman, *Reciprocal Dealing and the Antitrust Laws*, 77 HARV. L. REV. 873, 874-79 (1964). Case material on mutual forbearance and interdependence of the non-purchasing variety is found as follows: BUREAU OF ECONOMICS, FTC, ECONOMIC REPORT ON THE STRUCTURE AND COMPETITIVE BEHAVIOR OF FOOD RETAILING 458-71 (1966); Alderson & Shapiro, *Towards a Theory of Retail Competition*, in THEORY IN MARKETING 190 (R. Cox, W. Alderson & S. Sharpiro eds. 1964).

[27] Use of fairly comprehensive existing technological data on the quantities of various industrial resource inputs required to produce the output of major U.S. industries (*e.g.*, how much steel output do chemical firms use and vice versa) together with already existing knowledge of the products which conglomerate firms produce, could be used to spotlight potential reciprocity dangers.

With respect to the question of reciprocal forbearance among conglomerate firms who share common points of contact with each other in the same industries rather than in customer-supplier reciprocal buying relationships, although it would probably be impossible to isolate actual interdependent parallel pricing or forbearance conduct, it should be possible to identify with more specificity the various product and area markets and industries wherein such conglomerate contact points which are said to induce mutual forbearance are most frequent and most important, so that anticompetitive forbearance developments in those markets and industries can be watched more closely.

Despite the paucity of systematic empirical evidence on the question of the prevalance of actual anticompetitive reciprocity as a manifestation of conglomerate market structure, certainly it must be concluded that the potential for such anticompetitive reciprocal dealing or forbearance is one of the most important characteristics of the conglomerate, more serious than in other merged firms, and is an issue with which public policy must grapple in evaluating the probable impact of a conglomerate acquisition on competition.

C. *Foreclosing Potential Competition by Conglomerate Mergers*

The existence of potential competition through the hovering of a company on the fringe of a market has always been regarded as an important factor contributing to the competitiveness of the market, often as important as an actual participant actively competing within that market. It is frequently the only realistic source for deconcentration of oligopolistically structured markets or the generation of new competitive pressures to promote or maintain the responsiveness of these markets to market forces in their price and product competition. Thus when a realistic candidate for new entry into a market through internal expansion or foothold acquisition enters that market through acquisition of an already leading competitive factor in the industry, he has added nothing to the productive capacity or diversity of competitive strategy operating within the market. If he acquires a leading position through merger in a concentrated industry, he has extinguished the possibility of injecting new competition either through internal expansion or through acquiring a toehold position through merger and building it into a competitively significant one. He has thus effectively removed the discipline of his threatened entry on the price levels and quality of product and service and competitive quality of the market. Such loss of potential competition can produce particularly acute anticompetitive consequences in hard-to-enter, tightly oligopolized industries where the number of realistic potential entrants or firms with the resources to expand foothold positions into leading ones is small and where loss of even one could forever remove the hope of some deconcentration.

The antitrust enforcement agencies, the courts and many economic theorists agree that the loss of potential competition through merger by eliminating the possibility of internal entry can be a potent anticompetitive consequence of such mergers.[28] All these sources have been largely silent,

[28] United States v. Procter & Gamble Co., 386 U.S. 568 (1967); United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964); United States v. El Paso Nat'l Gas Co., 376 U.S. 651 (1964); United States v. Lever Bros. Co.-Monsanto Chem. Co., 1963 TRADE REG. REP. ¶ 70,770 (FTC 1963); International Paper Co., No. 6676, 1957-1958 TRADE REG. REP. ¶ 25,560 (FTC 1958); Beatrice Foods Co., No. 6653 (FTC Oct. 16, 1956); Borden Co., No. 6652 (FTC, Oct. 16, 1956); National Dairy Prods. Corp., No. 6651 (FTC, Oct. 16, 1956); Foremost Dairies, Inc., No. 6495 (FTC, Jan. 17, 1956). The recent complaints of the Justice Department against "true" conglomerates also allege loss of potential competition through the challenged merger. *See* note 20 *supra*.

Among the many economists who have been concerned with the anticompetitive conhowever, on the question of lost potential competition when it takes the form of a firm acquiring a leading market position and thus being a candidate for making a foothold acquisition and expanding it in a way that helps competition. The applicability of the potential competition doctrine specifically to conglomerate mergers is rather unclear. Existing case law, besides not dealing with lost potential competition through foothold mergers, in this area is concerned largely with market and product extension mergers whose differences from conglomerate type mergers renders their precedental value somewhat problematical with respect to the doctrine of potential competition.[29] Moreover, some economists go so far as to question whether the doctrine of potential competition can have any significance with respect to conglomerate mergers. They argue, for example, that the very fact of conglomerate acquistion of a significant market share suggests that the industry holds attractions for entry which absent some special entry-blocking tactics of the conglomerate, will still exist for other companies looking for growth possibilities.[30] The validity of this argument depends largely on the premise that the merger took place for valid industrial reasons

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sequences of merger-induced lost potential competition are: J. BAIN, *supra* note 16, at 203-04; W. BALDWIN, ANTITRUST AND THE CHANGING CORPORATION 201-03 (1961).

29 With market and product extension mergers, the likelihood of entry through internal expansion is predicated at least in part on the objective resource capability of the acquiring firm to enter on its own without merger. This factor is hardly likely to be present in a pure conglomerate merger. In product extension mergers, the acquiring firm usually employs similar promotional, distributional, or product resources to make similar or related products to those made by the acquired company, thereby enhancing its likelihood of having been able to expand its own productive resources to encompass the products made by the acquired firm. In a market extension merger, the essential resources are of course substantially identical. *See* J. NARVER, *supra* note 5, at 91.

30 Reservations have also been expressed about the anticompetitiveness of merger-induced lost potential competition doctrine with respect to all mergers, conglomerate or otherwise. According to this view, there are only a very narrow set of factual conditions which will render the loss of a potential competitor anticompetitive. First, it must be shown that the lost potential competitor through either internal expansion or foothold acquisition, was one of only a few such potential competitors. Otherwise, the loss of one simply will not matter. Secondly, it must be shown that there was a high probability that even in the face of the many investment alternatives available to him, the lost potential competitor would have actually entered the market either de novo or else would have obtained a toehold through merger; for example, that his history, statements, similar resource mix, and cost advantages or prior merger behavior pattern of expanding upon acquired toeholds would have given him more incentive to develop new capacity than it would all but a few other firms. Third, it must be shown that there was a high probability that the lost potential entrant's new presence in the given market would have had a significant impact on price or product competition. Considerations such as the potential entrant's record of aggressive price competition, and his ability to transfer overall existing reputation to a product de novo, and his ability and past record of building up a toehold position into a competitively significant one would be examined. Some of these points have been made in, *inter alia*, 1968 PRESIDENTIAL TASK FORCE REPORT OF ANTITRUST, 115 CONG. REC. 5642 (daily ed. May 27, 1969) [hereinafter cited as NEAL TASK FORCE REPORT]; STIGLER TASK FORCE REPORT; Turner, *supra* note 6, at 1379-86. These authors have dealt, however, on lost potential competition through lost internal expansion rather than through lost toehold acquisitions.

and not because of some special condition, applicable to the status of the acquired or acquiring company, which motivated the merger, such as the desire to take a tax loss or to obtain a large cash reserve.

Since almost by definition all conglomerate firms are potential entrants into virtually every industry, it is clear that the applicability of the doctrine will inevitably have to involve some standard of proof beyond the objective criteria typically relied upon heretofore in product and market extension mergers. If the loss of potential competition is to have any validity as a doctrine applicable to conglomerate mergers, assuming the conglomerate acquisition of a leading position takes place for valid industrial reasons, it is important to have some analysis and systematic empirical data on the factors which make potential entry through internal expansion and or foothold acquisition likely or unlikely in an industry.

This information would seem particularly useful for the hard-to-enter industries where the loss of a completely new entrant through internal expansion or the loss through leading-firm merger of a threshold entrant who would have engendered more competition by building himself into a significant competitive factor would seem most detrimental to competition.

For instance, in those industries where lost potential competition through foregone internal expansion or foregone foothold acquisition is alleged, we need to know the characteristics of past potential entrants who have actually entered these industries either internally or through building an acquired foothold position into one of competitive significance in order that they might serve as a guide to future entry possibilities; whether it is technological, marketing, promotional, research similarity, or some other factor which causes a firm to make the leap by internal expansion as opposed to foothold or leading-firm acquisitions into a new industry; and whether the conglomerate firm possesses the same kind of resources to make the entry leap; and what forces are at work causing a firm to expand foothold positions acquired through merger into competitively significant ones. We need information on how conglomerate mergers themselves have influenced potential entry through their effect, if any, on actual entry barriers in the industries they have gone into either through merger or through internal expansion. It would also be helpful to have more abundant data on the frequency with which firms which have shown interest in industry entry actually have or have not followed through on such interest, and on the frequency with which conglomerate firms that have made foothold acquisitions have actually used that foothold entry in order to expand internally thereafter into significant competitive factors.

Unless something is learned about the actual conditions under which potential entry is competitively meaningful for conglomerates, the field of potential competition is likely to remain a nebulous one, of little help in resolving the competitive dilemma which conglomerates present.

II. Performance Dimensions of the Conglomerate: Efficiency and Progressiveness

Arguments bearing on the superior economic efficiency or progressiveness of merged firms have usually carried little weight in litigated cases deciding whether a merger is likely to lessen competition. These cases have generally focused on the damage to market structure and competitive behavior which a merger has caused or can cause, rather than on how well a merger fulfills desirable socio-economic goals. Nevertheless, the question of how efficiently and progressively a conglomerate manages its resources in achieving the goals of maximum output and economic growth are as relevant for the policy maker faced with the conglomerate as are questions of the effect of conglomerates on competitive structure and conduct in specific markets.[31]

A. *Effect of Conglomerates on Efficiency*

While considerations of efficiency have been excluded by the courts as a valid factor in determining whether a merger is likely to involve the prohibited lessening of competition proscribed by section 7,[32] they are valid and important considerations for the policy maker concerned with the fundamental question of whether conglomerate mergers should be a factor of national concern and subject, therefore, to any special regulatory measures. Questions of conglomerate efficiency bear upon such important performance dimensions of the economy as whether conglomerates contribute to inflation, whether they result in maximum output, and whether they are a more viable type of economic institution than those which they are replacing.

Economists — similarly concerned with the public policy implications of conglomerate mergers — are fundamentally divided on the extent to which conglomerate mergers result in increased efficiency. Certain types of efficiencies attributed to non-conglomerate mergers respecting production,

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[31] Of course, the efficiency and progressiveness of conglomerates can and does affect the structure of specific markets just like cross-subsidization, reciprocity, and lost potential competition. However, the efficiency-progressiveness discussion below focuses on how well conglomerates maximize current output and future growth rather than on how they specifically affect the competitive structure of given markets.

[32] Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962); Foremost Dairies, Inc., 60 F.T.C. 944, 1084 (1962).

Merger theorists have also differed over the extent to which any increased efficiency through conglomerate merger affects competitive market behavior. On the one hand are those who say that increased efficiency of a conglomerate in one or more of its markets should put pressure on other competitors in these markets themselves to cut costs and try to emulate the increased efficiencies of the conglomerate acquirer and thus increase competition. FTC v. Procter & Gamble Co., 386 U.S. 568, 581 (1967)(Harlan, J., dissenting). On the other hand are those who would say that such increased efficiency on the part of a conglomerate would, through entrenching dominant firms, intimidate new entrants through increasing entry barriers, and cause old competitors to slacken in the competitive struggle. Foremost Dairies, Inc., 60 F.T.C. 944, 1084 (1962).

marketing, distributional, and promotional efficiencies resulting from common inputs or common resource bases simply cannot accrue in the case of a "true" conglomerate merger into unrelated industries.[33] Yet there are economists who posit that conglomerate mergers into unrelated industries or product lines yield managerial and research efficiencies which are as important to the overall efficiency of the conglomerate enterprise as those more commonly attributed to non-conglomerate mergers.[34]

Other writers stress that conglomerates enhance efficiency since they are frequently directed at poor performance companies whose consequent low share prices make them attractive takeover targets for a raider who can see ways of increasing profits simply by replacing inefficient management with efficient.[35] Still another "efficiency" argument is that conglomerate mergers increase the smooth and efficient functioning of the market for capital assets by enlarging the number of potential buyers, and that this prospect of enhanced sale value of assets through an active number of large potential buyers increases the rewards of successful and efficient entrepreneurship.[36]

The counter arguments are equally worthy of consideration. One of the principal arguments supporting the view that conglomerate mergers may in fact result in decreased efficiency is based upon the difficulties encountered by conglomerate management in knowing exactly how efficiently or inefficiently it is operating. The data and records of individual profit

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33 Thus, studies which show that there are no noticeable merger-induced plant or firm scale economies resulting from many recent mergers, FTC REPORT at 87-89, and from which the conclusion has thus been drawn that mergers, therefore, do not confer superior efficiency, simply have no relevance either to true conglomerate mergers or to product extension mergers where common technical facilities by definition do not exist. *See also* THE CORPORATE MERGER (W. Alberts & J. Segall eds. 1966).

Another study showing that economies for multi-plant operation in the same industry are generally insignificant would seem to be relevant to the question of the technical efficiency of market extension mergers, for it casts doubt upon the cost savings resulting from the combination of similar plants in different regions under common ownership. J. BAIN, *supra* note 16. This study is not relevant to efficiencies from "true" conglomerate mergers either, however. Likewise, there is evidence in at least one litigated case, FTC v. Procter & Gamble Co., 386 U.S. 568 (1967), and in marketing and retailing literature of examples of promotional, distribution, and marketing efficiencies achieved through product extension or market extension conglomerate mergers, but again these do not bear upon the question of efficiency of "true" conglomerate mergers. *See* J. NARVER, *supra* note 5, at 82; Bain, *Advantages of the Large Firm: Production, Distribution, and Sales Promotion*, 20 J. MARKETING 336, 339-42 (1956).

34 With emphasis on the "new breed" of professional coordinator or entrepreneur whose skills transcend single product lines, and who is most at home overseeing and doing long-range planning for a variety of far flung unrelated enterprises, the argument is made that industry and product lines previously considered unrelated lend themselves in this era of computerized management techniques and procedures to an integrated "systems" management and research approach. *See, e.g.*, Jacoby, *The Conglomerate Corporation*, THE CENTER MAGAZINE, July 1969, at 40.

35 Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110-20 (1965).

36 Turner, *supra* note 6, at 1317.

"centers" may be so imperfect, indeed invisible, that a company's profits and earnings — the traditional measure of efficiency — cease to do their guidepost job of providing signals for proper resource allocation.[37]

Moreover, some economists evince concern that conglomerate management occasionally has no genuine interest in efficiency considerations and may instead be motivated simply by a desire to obtain inflated stock prices by using the merged assets to artificially raise per share earnings[38] or by a desire to raid through acquisition a liquid firm in order to obtain cash for new mergers. In this latter case, it is even possible that the manager who built the large cash position which was attractive to a conglomerate raider was more efficient than the conglomerate raider who will replace at least some of his management functions. Under these conditions, increased efficiency is an unlikely by-product of a conglomerate merger.

Available evidence on the efficiencies of conglomerates suggests that some conglomerates have in fact not apparently brought any demonstrably significant increased efficiency to the utilization of the assets which they acquire.[39] Indeed, there is indirect evidence that conglomerate mergers do not result in increased efficiency.[40] However, it is not as conclusive as one would like.[41] Although the thrust of the evidence seems to be that man-

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[37] *See* R. SMITH, CORPORATIONS IN CRISIS 13 *passim* (1963); Malott, *The Control of Divisionalized Acquisitions*, in THE CORPORATE MERGER 210 (W. Alberts & J. Segall eds. 1966); Whisler, *Organizational Aspects of Corporate Growth*, in THE CORPORATE MERGER *supra* at 183.

Some writers are concerned that the conglomerate management of the newly acquired entity may simply not be as capable as the previous management which was independent. Markham, *Merger Policy Under the New Section 7: A Six Year Appraisal*, 43 VA. L. REV. 498-99 (1957). See also Mason's article on managerial capitalism being substituted for decentralized decision making. Mason, *The Apologetics of "Managerialism,"* 31 J. BUS. 1 (1958).

[38] FTC REPORT at 83-84.

[39] There is evidence that at least some motivations to merge lie not in generating any real economies in resource utilization, but rather in inflating the value of equity shares through obtaining higher price-earnings ratios by way of the merger, or else in using the liquid position of the "target" to obtain cash to finance additional acquisitions. Moreover, there is evidence that many conglomerates have simply failed to generate increases in real earnings that are on a par with their non-conglomerate counterparts. *See id.* at 80-86, 95-109.

In addition, the argument (Manne) that conglomerate raiding behavior promotes efficiency through weeding out inefficient managers by sending the poorly managed potential acquired firm's stock low enough to make it attractive to a raider has simply not been proved, since acquired firms have been shown to be in general of average or above-average profitability, and thus presumably are not poorly managed. *Id.* at 99.

[40] For instance, studies have shown that mergers, though of profitable firms, do not increase the rate of return on capital, and thus, since profit rates presumably measure efficiency as well as market power, do not result either in increased efficiency or in heightened market power as a result of such increased efficiency. Other studies show that even after allowing for the influence of other determinants of profit rate diversification has a negative effect on rate of return. These are the same studies referred to and described in note 17 *supra*.

[41] The studies lumped together true conglomerates with all other types of mergers as well as with diversification through internal expansion. Thus, they do not really isolate

agerial and administrative efficiency is not promoted by true conglomerate merger, there is no strong evidence that it is impeded.

Before efficiency arguments can be used to support an overall conglomerate policy, the unsystematic and often casual case study data must be firmed up with additional instances, and the meaning of the indirect indicia of conglomerate efficiency must be more thoroughly resolved through added studies. While definitive data will be difficult to collect, some information is undoubtedly available which could be brought to bear on this very important factor in conglomerate performance.[42] For instance, a thorough study of pre- and post-acquisition profit rates on firms' assets acquired by conglomerates would be a step in the direction of answering whether such assets are being managed profitably and thus efficiently.[43]

Until the pressing need to shed more light or clarify the light that already exists on the question of conglomerate efficiency and its relation to competition is satisfied, a policy toward conglomerates which is pegged on efficiency considerations would be based on data which is simply too casual and too difficult to interpret to render it of any real value.

B. *Progressiveness*

Like efficiency, considerations of corporate innovativeness and progressiveness have no legal standing as factors militating for or against the illegality of mergers unless they are directly related in some way to competitive performance. Nevertheless, the question of how progressive conglomerates are, *i.e.*, whether their commitment to research, invention,

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the effect of true conglomerates on rate of return and thus on efficiency. Moreover, the studies do not indicate the extent to which the insignificant or negative effect of merger or diversification on rate of return may simply show absence of market power rather than lack of any additional efficiencies gained through the merger.

The inconclusiveness of the studies is reinforced by some possibly contradictory evidence cited *supra* note 17, in connection with conglomerate market power, *i.e.*, that conglomerate mergers *may* contribute to certain structural industry characteristics — size, concentration — which bring with them *higher* rates of profit and thus possibly *increased* efficiency. These studies, however, share the common fault of not showing how much if any of the effect of size and concentration is due to conglomerate merger and how much to other types of merger or to internal expansion. *See* note 17 *supra.*

42 It is probably difficult to obtain data whereby economies of conglomeration can be measured directly because of a lack of divisional reporting as well as different often non-comparable and arbitrary methods of joint cost allocation. The difficulties experienced, for instance, in the measurement of Procter & Gamble's marketing, distribution, and promotion economies as a result of its Clorox merger would suggest that an effort to measure any type of economies would indeed have to be massive.

43 Since many conglomerate firms keep separate performance data on many of their acquisitions (those that do not might be accused of managerial inefficiency), such a study appears feasible. Existing studies have been handicapped on this score since they are not backed by legally enforceable investigatory powers to obtain such data for a conglomerate's separate profit centers, and must rely on often necessarily casual estimates or inferences. In addition, an accounting study which would get at the total *real* profit picture of conglomerate firms by stripping away those profits that result merely from financial maneuvers rather than from deployment of real assets would yield a better fix on how efficiently conglomerates perform relative to the rest of the economy.

innovation, and adaptation of new products and technology compares with that of their non-conglomerate counterparts is an important dimension of conglomerate performance which policy makers must consider in their overall appraisal of the need for new regulatory patterns for these mergers.

Again, there are two conflicting "armchair" theories of the extent to which conglomerate firms are "progressive." On the one hand, some argue that the "systems" approach to conglomerate management, whereby industries operating in different product markets are viewed not in isolation, as has been the case traditionally, but rather as parts of a broadly related totality, fosters a commitment to basic and applied research which is more significant in terms of both scale and yield than the effort of non-conglomerate firms. The argument is that if an industry, *e.g.*, office copying, is viewed as part of a totality, *e.g.*, a broad communications system, as it can be in a conglomerate taking a total view of its activity spectrum, the implications for applying methods and findings from one activity area to others will be more readily apparent than for traditional, more specialized firms, and presumably conglomerate performance in the progressiveness dimension will thus be superior to that of its non-conglomerate counterparts.

It has been argued that conglomerate mergers enable investment decisions affecting future growth and progress to be made with more confidence than they could in a single line firm, since the multi-product nature of the conglomerate firm blunts the possible impact of miscalculation of investment activity in any single line. For this reason of lowered risk, conglomeration is also seen to cut the cost of raising capital for expansion purposes. Likewise the fact that conglomerate firms must simultaneously assess the efficiency of capital on many fronts means that they may make investment decisions with more confidence in their relative profitability than can single market firms.[44]

On the other hand are those who argue that there is no a priori reason to expect superior research and development or product or process innovation from conglomerates vis-á-vis more traditionally organized firms. These critics point out that viewing a given industry as part of a system constitutes no magic formula to insure superior progressiveness of that industry's performance, and in fact it may discourage those kinds of productive research and development expenditures which have no systems applicability or focus outside a given industry. These critics question whether the motivation of some conglomerate firms to obtain quick earnings and stock price increases and favorable cash balances through merger is compatible with a long run commitment to new product and process development.[45] Unfortunately, empirical data available on conglomerate progressiveness gives no real answer to the opposing theoretical views.

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[44] For discussion of various aspects of this argument, see FTC REPORT at 74; Burck, *The Merger Movement Rides High*, FORTUNE, Feb. 1969, at 79.

[45] For a related argument, see Dean & Smith, *The Relationships between Profitability and Size*, in THE CORPORATE MERGER 3, 13 (W. Alberts & J. Segall eds. 1966).

There is some unsystematic evidence for a few conglomerates that the systems approach to research and development has not led to significant product or process invention or innovation. In addition, there are some scattered indications that certain conglomerate managements' tendency to reward division managers or presidents in proportion to the rate of return on the assets entrusted to their management allegedly discourages commitment to investment in product and process development whose yield may be long-run rather than in terms of short-run profits.[46]

There is also indirect evidence which relates size, industry concentration, and diversification to various measures of research and development performance for large scale enterprise, but there is no showing how much, if any, of the effect of size and concentration on research and development is due to merger of the conglomerate or other variety and how much is due to internal expansion. Many of these studies predate the conglomerate merger movement and involve industries where the conglomerate movement has not been significant. Further, the available evidence comes to what seems to be contradictory conclusions regarding the relationships of industry structure to research and development performance. This is because the samples in the various studies are frequently composed of different industries and are for different years or groups of years, and use different measures of progressiveness, *e.g.*, patents, research and development intensity, research and development employment, and number of significant innovations.[47]

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[46] *See* FTC REPORT at 103-16; Levin, *Gulf and Western*, FORBES, Dec. 1, 1969, at 46.

[47] On the one hand, some studies show that size, industry concentration and diversification do not result in superior research and development performance for large scale enterprise. FTC REPORT at 89-95.

Several other studies have found that large size has a negative effect on intensity of research and development. In this connection see: Comanor, *Market Structure, Product Differentiation, and Industrial Research*, 81 Q.J. ECON. 639-57 (1967); Comanor, *Research and Technical Change in the Pharmaceutical Industry*, 47 REV. ECON. & STATS. 182-90 (1965); Grabowski, *The Determinants of Industrial Research and Development: A Study of the Chemical, Drug and Petroleum Industries*, 76 J. POL. ECON. 292 (1968); Horowitz, *Firm Size and Research Activity*, 27 SO. ECON. J. 298 (1962); Worley, *Industrial Research and the New Competition*, 69 J. POL. ECON. 183 (1961). Studying innovation in three industries — steel, petroleum, and coal — Mansfield found that increasing the size of a firm resulted in diminishing returns to innovation after some point for most products except coal. Mansfield, *Size of Firm, Market Structure and Innovation*, 71 J. POL. ECON. 556 (1963).

On the other hand are studies which in whole or in part come to the opposite conclusion, *i.e.*, that size, industry concentration and diversification have positive effects on at least certain measures of progressiveness. Several studies show a strong positive effect of size — which is directly increased by conglomerate merger — on research and development employment or expenditures within broady defined industries. These are frequently parts of the very same studies cited above which concluded that size had a negative effect on intensity of research and development. Comanor, Grabowski, Horowitz and Worley support this view. *See also* D. HAMBURG, ESSAYS ON THE ECONOMIES OF RESEARCH AND DEVELOPMENT (1966); Scherer, *Firm Size, Market Structure, Opportunity and the Output of Patented Inventions*, 55 AM. ECON. REV. 1097 (1965).

Many studies further show that concentration — which critics of conglomerate mergers say is increased through conglomerate merger — on an individual industry basis is pos-

Clearly, this area demands more systematic, *direct* research on how well conglomerates have performed in the dimension of technical progressiveness. There is a need to go beyond the casual empiricism of magazine articles and indirect, often contradictory, suggestions of previous research in order to find out precisely the extent to which conglomerate firms increase the research effort (as measured by number of R & D personnel, amount of expenditures or number of patents) of the firm which they acquire, whether they have accounted for as large a share of inventions or innovations in their industry group as one would expect vis-à-vis less diversified firms, and how quick they have been to adopt new inventions and technologies once introduced by someone else. The technique and theory, as well as empirical results for this sort of investigation, have already been largely set out with respect to some major American industries and products (*e.g.*, steel, coal, petroleum, chemicals, hybrid corn).[48] Thus, there seems to be no reason why such research techniques and methods cannot be applied to industries or products in which conglomerate mergers have been important.

Additional study of individual conglomerate firms is also required to determine whether the growth goals for their individual profit centers are conducive to efficient research and development and new product or process introduction. For example, we need to know whether salary and bonus incentives of conglomerates reward current profitability of the individually managed profit centers at the expense of research and investment whose payoff may be only in the more remote future.

Until such time as at least some of these questions are answered, any policy statement about the progressiveness of conglomerates would be premature.

CONCLUSION

While in the absence of a hard core of relevant empirical facts, individual conglomerate mergers must continue to be litigated on a case-by-case basis where there is a sound theoretical reason to think them anticompetitive, economics and law cannot ultimately rest on sterile doctrine or theory unrelated to the facts of the real world. The life of the law, and of economics as well, is experience and nothing will render the law — in this case antitrust law — more irrelevant, and hence something

itively related to intensity of research and development or innovation. *See* Comanor, *supra*; Horowitz, *supra*; Phillips, *Patents, Potential Competition, and Technical Progress*, 56 AM. ECON. REV. 301 (1966); Scherer, *Market Structure and the Employment of Scientists and Engineers*, 57 AM. ECON. REV. 524 (1967); Williamson, *Innovation and Market Structure*, 73 J. POL. ECON. 67 (1965).

Grabowski has found, in a single industry, *i.e.*, drugs, that diversification has a positive effect on research and development. Mansfield, looking at 12 innovations in four industries, found that large individual firms are on the average quicker to imitate important innovations than are smaller firms.

48 *See* Griliches, *Hybrid Corn: An Exploration in the Economies of Technological Change*, 25 ECONOMETRICA 501 (1957).

ultimately to be ignored or evaded, than the doctrinaire formulation or application of theoretical antitrust doctrine to conglomerate mergers without the relevant facts to support it.

Recognizing this, the Federal Trade Commission is now in the midst of just such an empirical study of the known structural facts, behavior, experiences and economic performance of conglomerates, focusing on (but not limited to) a number of specific "true" conglomerate firms. When put together with the work of other policy makers and economists in the field, both in the public and private sector,[49] the basis for a rational antitrust policy covering conglomerate mergers will hopefully emerge.

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[49] Two congressional committees have been recently engaged in holding hearings to assemble knowledge about the conglomerate merger movement: The Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary (Senator Hart's Subcommittee) and the Subcommittee on Antitrust of the House Committee on the Judiciary (Representative Celler's Committee and Subcommittee).