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CONGLomerateness: Size and MONopoly Control

Werner Sichel*

About a year ago Dr. Corwin D. Edwards, the well known economist and "antitrust practitioner," was quoted as saying that "[t]oo little attention has been paid to the economic aspect" of conglomerate mergers, that "[w]e need more precise figures" and that "most of the thinking still remains to be done."1 Since that time at least eight investigations dealing with the conglomerate phenomenon have been undertaken.2 This volume on the conglomerate merger and this Review's specific request for an article dealing with the economic aspect is further evidence that Professor Edwards' initial concern is being heeded. Unfortunately, his lament concerning "precise figures" is much more difficult to satisfy, since both the methodological problems with which we are beset and the fact that conglomerate firms present their financial statements on a consolidated basis give us little hope for rapid progress in this important area. In regard to Professor Edwards' third point, we can readily agree that a great deal of thinking about the conglomerate still needs to be done. However, much thought has recently been and is presently being devoted to this subject. In this paper I intend to present some of the results of this thinking — both that of my colleagues as well as my own.

The organization will be the following: in the first section we recognize that a great change has taken place in our economy; that large multiproduct firms growing via interindustry acquisitions have emerged and are rapidly increasing in number as well as in individual size. In the second section we pose and attempt to answer some of the important questions that arise as a consequence of this change. We are concerned with whether or not the "conglomerate movement" is consistent with extant antitrust philosophy, whether the apparent concern about the conglomerate is essentially a "type of firm," a "size of firm," or a "monopoly control" issue, and whether it is significant to differentiate between those conglomerates that are organized via external growth as opposed to internal growth. In the last section we present a summary of our analysis and draw some policy conclusions.

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* Associate Professor of Economics, Western Michigan University. B.S., New York University, 1956; M.A., Northwestern University, 1960; Ph.D., Northwestern University, 1964.


2 These are being conducted by: the House Antitrust Subcommittee; the Senate Antitrust and Monopoly Subcommittee; the Federal Trade Commission; the Federal Communications Commission; the Securities and Exchange Commission; the New York Stock Exchange; the House Ways and Means Committee; and the Antitrust Division of the Department of Justice.
Great changes have taken place in our economy. Only a century ago the United States was accurately described as an agricultural country, manufacturing being widely dispersed in small scale plants. Economic concentration was at an extremely low level. Since that time, unprecedented technological-organizational changes have entirely altered the character of the economy. The large corporation has become the dominant business enterprise and the level of economic concentration has steadily increased.

As this process evolved over the past century, there were several periods in which particularly dramatic changes occurred. These are closely associated with the major merger waves; specifically, the period around the turn of the century, the late 1920's, and the post-World War II period. While the latter wave is still continuing, it has recently acquired some new features which distinguish it from prior years; the number of mergers has vastly increased, the size of acquired firms has grown significantly, and the change in the type of mergers, from the horizontal and vertical types to the conglomerate, has been momentous.

Economic concentration, the degree of inequality of control by firms, has persistently increased since World War II. This concentration is particularly evident in the manufacturing sector, as demonstrated by Table I's comparison between the years 1947, 1954, and 1963. A very substantial increase in the "value added" contributed by the 50, 100, 150 and 200 largest manufacturing firms is readily apparent. The number of large acquisitions, i.e., those in which the assets of the acquired firm total at least $10 million, has also increased. If "assets and profits" are utilized instead of "value added," the percentages are even higher. Table II presents the percentage of total assets and profits of manufacturing corporations — and there were approximately 180,000 — accounted for by eight corporate size groups in the fourth quarter of 1962.

Similarly, the staff studies for the Cabinet Committee on Price Stability
found that the distribution of total assets of manufacturing corporations in 1968 was as follows:

The 78 corporations with assets of $1 billion or more held 43 percent of the total, and the 529 corporations with assets of $100 million or more held 73 percent. Another group of 791 medium-size corporations, with assets of $25 million to $100 million held another 9 percent. The remaining 18 percent of the assets was held by approximately 185,000 corporations. Although about 250,000 proprietorships and partnerships are engaged in some form of manufacturing, their assets are less than 2 percent of the assets of manufacturing corporations.3

It is clearly evident that this increase in the level of economic concentration has coincided with a vastly accelerating merger rate, as indicated by Table III, which compares the number of mergers in the manufacturing and mining sector of the economy from 1940 to 1968. Additionally, all previous levels of merger activity were surpassed in 1968, when the Federal Trade Commission recorded 4,003 mergers and acquisitions in all sectors of the economy. This total represents a 68 percent increase over 1967 and a 197 percent increase over 1960.4

In addition to the increase in the number of mergers, the number of large acquisitions — those where the assets of the acquired firm are at least $10 million — have likewise increased. The number of large acquisitions in manufacturing and mining and the assets involved are presented in Table IV for the years 1948-1968.

Indeed, it is anticipated that the approximately 50 percent increase in assets acquired in such large mergers from 1967 to 1968 will be repeated in 1968-1969.5 The disappearance of large firms through acquisition is further

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3 STAFF OF COMM. ON PRICE STABILITY, CABINET, STUDIES 45 (1969).
4 BUREAU OF ECONOMICS, FTC, CURRENT TRENDS IN MERGER ACTIVITY, 1968 at 8 (1969) [hereinafter cited as CURRENT TRENDS].
5 In a recent speech, Representative Emanuel Celler, Chairman of the House Antitrust Subcommittee, stated that "projections for 1969 indicate that $18 billion of large firm
### TABLE III
Numbers of Mergers, Manufacturing and Mining, 1940-1968

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Mergers*</th>
<th>Year</th>
<th>No. of Mergers*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>140</td>
<td>1955</td>
<td>683</td>
</tr>
<tr>
<td>1941</td>
<td>111</td>
<td>1956</td>
<td>673</td>
</tr>
<tr>
<td>1942</td>
<td>118</td>
<td>1957</td>
<td>585</td>
</tr>
<tr>
<td>1943</td>
<td>213</td>
<td>1958</td>
<td>589</td>
</tr>
<tr>
<td>1944</td>
<td>324</td>
<td>1959</td>
<td>835</td>
</tr>
<tr>
<td>1945</td>
<td>333</td>
<td>1960</td>
<td>844</td>
</tr>
<tr>
<td>1946</td>
<td>419</td>
<td>1961</td>
<td>954</td>
</tr>
<tr>
<td>1947</td>
<td>404</td>
<td>1962</td>
<td>853</td>
</tr>
<tr>
<td>1948</td>
<td>223</td>
<td>1963</td>
<td>861</td>
</tr>
<tr>
<td>1949</td>
<td>126</td>
<td>1964</td>
<td>854</td>
</tr>
<tr>
<td>1950</td>
<td>219</td>
<td>1965</td>
<td>1,008</td>
</tr>
<tr>
<td>1951</td>
<td>235</td>
<td>1966</td>
<td>995</td>
</tr>
<tr>
<td>1952</td>
<td>288</td>
<td>1967</td>
<td>1,496</td>
</tr>
<tr>
<td>1953</td>
<td>295</td>
<td>1968</td>
<td>2,442</td>
</tr>
<tr>
<td>1954</td>
<td>387</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* This data is limited to mergers reported by Moody's Investors Service, Inc., and the Standard & Poor's Corporation.


### TABLE IV
Large Acquisitions in Manufacturing and Mining, 1948-1968

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
<th>Assets (millions of dollars)</th>
<th>Year</th>
<th>Number</th>
<th>Assets (millions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>6</td>
<td>130</td>
<td>1959</td>
<td>64</td>
<td>1,960</td>
</tr>
<tr>
<td>1949</td>
<td>5</td>
<td>67</td>
<td>1960</td>
<td>62</td>
<td>1,710</td>
</tr>
<tr>
<td>1950</td>
<td>4</td>
<td>173</td>
<td>1961</td>
<td>59</td>
<td>2,129</td>
</tr>
<tr>
<td>1951</td>
<td>9</td>
<td>201</td>
<td>1962</td>
<td>72</td>
<td>2,194</td>
</tr>
<tr>
<td>1952</td>
<td>13</td>
<td>327</td>
<td>1963</td>
<td>68</td>
<td>2,917</td>
</tr>
<tr>
<td>1953</td>
<td>23</td>
<td>679</td>
<td>1964</td>
<td>91</td>
<td>2,798</td>
</tr>
<tr>
<td>1954</td>
<td>35</td>
<td>1,425</td>
<td>1965</td>
<td>93</td>
<td>3,900</td>
</tr>
<tr>
<td>1955</td>
<td>68</td>
<td>2,129</td>
<td>1966</td>
<td>101</td>
<td>4,100</td>
</tr>
<tr>
<td>1956</td>
<td>58</td>
<td>2,037</td>
<td>1967</td>
<td>169</td>
<td>8,222</td>
</tr>
<tr>
<td>1957</td>
<td>50</td>
<td>1,472</td>
<td>1968</td>
<td>192</td>
<td>12,616</td>
</tr>
<tr>
<td>1958</td>
<td>38</td>
<td>1,107</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Acquired units with assets of $10 million or more.


Evidenced by an examination of the familiar "Fortune 500." For example, Representative Emanuel Celler stated that 22 percent, or 110, of Fortune's 500 list for 1962 had disappeared through merger by 1968, with 26 of these

assets will be acquired." Address by Representative Emanuel Celler, American Management Association, Inc., June 12, 1969.

Since 1955, Fortune magazine has annually published a list of the 500 largest industrial firms, using sales as the determining variables. Fortune also publishes a list of the 50 largest commercial banks, the 50 largest life insurance companies, the 50 largest merchandising firms, the 50 largest transportation companies, the 50 largest utilities, and the 200 largest industrials outside of the United States.
mergers occurring in 1968. Similarly, the Federal Trade Commission also makes available a list of giant firms (assets of $250 million or more) that have disappeared through merger. While no such mergers were recorded prior to 1958, one occurred in 1959, one in 1963, and one in 1965. More significantly, however, 3 occurred in 1966, 6 in 1967, and 12 in 1968.

At the beginning of this section, it was stated that not only have the number of mergers and the size of the acquired firms increased significantly, but that the type of merger, from the horizontal and vertical types to the conglomerate, has also changed immensely. Table V presents, in percentage terms, a comparison between the horizontal, vertical, and conglomerate mergers involving at least $10 million in assets occurring in the manufacturing and mining sector from 1948 to 1968.

This very significant increase in conglomerate type mergers, relative to the other two types, is complemented by an equally significant increase in the "other" subcategory of conglomerate mergers, relative to the subcategories of "product extension" and "market extension." Table VI is illustrative of this point; additionally, it includes the percentage of acquired assets that each subcategory represented for the past four years.

The preceding data make it quite clear that the current level of economic concentration is quite high, that in the manufacturing and mining sector it has grown significantly during the past two decades, and that mergers, and more particularly conglomerate mergers, have played both an important and an ever increasing role in bringing about this change in the business environment of the United States.

PART II: THE ISSUES

Data such as presented in Part I are frequently used to support the case for a comprehensive and vigorous antitrust policy. Certain politicians, government agency officials, journalists, businessmen, and occasionally econo-

7 Celler, supra note 5.
8 CURRENT TRENDS 14.
9 The types of acquisitions will be defined and discussed in Part II of this paper.
SIZE AND MONOPOLY CONTROL

TABLE VI

DISTRIBUTION OF LARGE MANUFACTURING AND MINING ACQUISITIONS BY TYPE OF CONGLOMERATE MERGERS

1948-1968

<table>
<thead>
<tr>
<th>Type of Merger</th>
<th>1948-53 (percent)</th>
<th>1954-59 (percent)</th>
<th>1960-64 (percent)</th>
<th>1965 (percent)</th>
<th>1966 (percent)</th>
<th>1967 (percent)</th>
<th>1968 (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market extension</td>
<td>11.8</td>
<td>10.4</td>
<td>9.7</td>
<td>8.1</td>
<td>25.9</td>
<td>2.7</td>
<td>21.9</td>
</tr>
<tr>
<td>Product extension</td>
<td>79.4</td>
<td>75.1</td>
<td>74.5</td>
<td>63.5</td>
<td>48.2</td>
<td>67.6</td>
<td>43.9</td>
</tr>
<tr>
<td>Other</td>
<td>8.8</td>
<td>14.5</td>
<td>15.8</td>
<td>27.0</td>
<td>25.9</td>
<td>31.1</td>
<td>34.1</td>
</tr>
</tbody>
</table>


mists, urgently advocate new legislation expressly prohibiting conglomerate mergers on the basis of such data. Maybe they are right. Maybe their seemingly emotional outcries have great merit and our “American system” is suffering from a disease called superconcentration. But maybe they are wrong. Perhaps the recent conglomerate merger wave and the ensuing higher level of economic concentration have no harmful effect upon our economy. The answers are not obvious, and only careful analysis of the important issues involved will help us find the answers.

These issues should not be confused with one another for we must separate the evaluation of the conglomerate firm from that of the giant firm, even though there may exist an important relationship between the two. Additionally, both must be separated from the issue of the amount of monopoly control firms should be permitted to possess, as well as from the issue of internal versus external growth.

Before analyzing these issues, and in order to place them into proper context, let us briefly examine just what it is that we hope to attain through our antitrust policy. As I have previously stated:

The raison d’être of U.S. antitrust legislation is to promote a higher standard of living for the American consumer. It is reasoned that this body of law acts as an instrument for achieving this goal because it aids in allowing the market to better perform its allocative function. The market can only adequately fulfill this task (causing resources to flow to their most productive use) in an atmosphere of relatively unrestrained competition.

We believe that firms will perform better in a competitive climate; that adequate competition will avoid persistent monopoly control profits, as well as persistent production under conditions of excess capacity; that ade-

quate competition will assure the consumer of a wide variety of goods and services; and that adequate competition will stimulate a firm's research and development program into developing new and lower-cost production methods, thereby providing the consumer with new, improved, but less expensive products.

The term "adequate competition" is one of a number of terms employed to describe a real world competitive condition that provides desirable effects. There is an abundance of literature dating back to J. M. Clark's classic article in 194011 which attempts to describe this concept by utilizing such labels as "workable competition," "serviceable competition," or "effective competition." While a single definition would probably not satisfy all of the economists who coined these terms, it is apparent that they do agree that such competition should not be confused with the pure or perfect competition models of neoclassical price theory, that such competition contains elements of monopoly control, and that it describes a minimum requirement for good firm performance.

If we agree with the tenets of our antitrust philosophy, that enough competition to assure good firm performance should be maintained, we must determine methods to test that competition. The term "competition" is meaningless unless related to a particular market, and it is the relevant market that must be ascertained. We are accustomed to using "industries" to separate our markets and seldom do we realize how very unsatisfactory and arbitrary these boundaries are. To take an extreme position, we may argue that there exists only a single industry—the industry of selling to buyers. After all, buyers' incomes are finite, and they must choose among all the goods and services offered to them. To illustrate, let us imagine an American family that is now deciding whether to buy a piano, to install a sauna bath in their basement, or to take a two week vacation at a Miami Beach hotel. In fact, in a nation of approximately 60 million households there may be several families confronted with a similar decision. While the Bureau of the Census is not even tempted to place piano manufacturers, sauna bath makers, and resort hotels in the same industry classification, all three are competing for the dollars of the households in our illustration. We can now reverse positions and argue just the opposite case; namely, that all firms are monopolists; that no two firms are alike in all respects since each sells a somewhat different product, be it the quality, the design, the package, or merely the brand name. Furthermore, firms have different locations and different personnel with different personalities. Thus, one can contend that each firm is an "industry" unto itself. However, the ability to offer quite plausible arguments for both extremes leaves us rather uncomfortable with the "industry" concept. Maybe that concept should be abandoned. Walton Hamilton, as quoted by Harrison Houghton, wrote:

11 Clark, Toward a Concept of Workable Competition, 20 AM. ECON. REV. 241 (1940).
 Most economists, however, have not abandoned the "industry" concept even though the boundaries are somewhat arbitrary, simply because it is too important a concept. Therefore, vague statements like "[c]lose, competitive substitute products, which serve as practical alternative sources of supply for customers, are classified in the same industry" will have to suffice. The Bureau of the Census, on the basis of "similarity of products in terms of their uses," "similarity of processes," and "similarity of materials used," classifies the manufacturing sector into 20 broad "major industry groups"; then into 430 "industries," 1,000 "product classes," and 7,500 "products." By the Bureau's own admission, the Standard Industrial Classification (SIC) does not always conform to "the group of competing firms" which we would like to identify. Furthermore, how broad or narrow an SIC should be utilized? What is the relevant market? Economists have long relied on the "cross-elasticity of demand" concept to determine the degree of substitutability among particular sellers' products, and thus, their industry classification. While this concept was even used by the Supreme Court in United States v. E. I. du Pont de Nemours & Co. to help determine the relevant market, it suffers from at least two important deficiencies. First, even if reliable price and quantity data are available, other variables will influence the results, and second, there are other important factors, such as quality and advertising, which must be considered.

The foregoing discussion of the term "industry" goes to the very heart of the conglomerate issue. My purpose in explaining the imprecise nature of industry classifications is to impress upon the reader that there is nothing

12 Hearings on Economic Concentration Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 88th Cong., 2d Sess., pt. 1, at 156 (1964) (testimony of Harrison Houghton quoting Walter Hamilton) [hereinafter cited as Concentration Hearings Part 1].
13 SINGER, ANTITRUST ECONOMICS 64 (1968).
15 Id. Cross elasticity of demand refers to the responsiveness of the demand of one product to a small change in the price of another product, everything else being equal. If the cross elasticity of demand between two products is positive and high, they are good substitutes.
sacrosanct about them; that they are merely attempts to identify groups of closely competing firms; and that they are all too often rather poor attempts. A major reason for their imprecise nature is that classification changes do not keep pace with the technological-organizational changes that occur in American business. Since the activities of many of our leading corporations range over an increasingly wide area, the modern corporation is simply defying our old industry classifications. I believe the conglomerate merger data in Part I might look very different if we were to abandon many of the Bureau’s industry classifications and substitute some of the following: the energy industry, the aero-space industry, the resources industry, the communications industry, the amusement or leisure-time industry, the transportation industry, and the consumer-branded products industry.

What then is a conglomerate? A standard definition is that it refers to a firm that operates in more than a single industry. But from the discussion concerning the setting of industry boundries we realize that the definition of a conglomerate cannot be all that precise. Just as we previously made a case for the existence of only one industry, and then a case for as many industries as there are firms, we could argue that no firm can be accurately described as a conglomerate, and then again, that all firms are conglomerates. For example, a 1968 *Wall Street Journal* article reported that W. T. Grimm and Company, a Chicago financial consulting firm estimated “that 25% of the mergers so far this year have been these so-called conglomerate marriages, up from 15% in the first six months of 1967.” However, immediately thereafter, the article pointed out that the FTC believed that “more than 80% of 1967 mergers were conglomerate.” When two authoritative estimates range from 15 to 80 percent, the definition cannot be very precise.

The FTC classifies mergers into the three traditional categories of horizontal, vertical, and conglomerate. The conglomerate category is then divided into three subcategories: geographic market extension, product

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18 Seven years ago, before the conglomerate issue was widely raised, Minnesota Mining and Manufacturing Co. was reported to be producing 27,000 different products. *Dun's Review*, Aug. 1963, at 32.
20 Id.
21 “Horizontal mergers are those in which the merging companies produce one or more closely related products in the same geographic market, for example, two fluid milk companies in the city of Washington.” *Hearings on Economic Concentration Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 89th Cong., 1st Sess., pt. 2*, at 515 (1965) (testimony of Willard F. Mueller) [hereinafter cited as *Concentration Hearings Part 2*].
22 “Vertical mergers are those in which the merging companies have a buyer-seller relationship prior to merger, for example, an aluminum ingot manufacturer and an aluminum product fabricator.” Id.
23 “Geographic market extension mergers are those in which the acquired and acquiring companies manufacture the same products, but sell them in different geographic markets, for example, a fluid milk distributor in Washington and a fluid milk distributor in Chicago.” Id.
extension, and "other" conglomerates. There is little question that the product extension variety could be eliminated by extending industry boundaries somewhat. Indeed, a large part of the "other" conglomerates would also disappear as a result of changes in industry definitions. At a seminar last year, the well-known FTC economist Harrison Houghton stated that he realized "there is some dispute as to the use and real meaning of the term conglomerate" and that "[a]s with many things . . . it's a question of degree." He went on to explain that "the less a firm is dependent on any one or a few lines of activity for its economic welfare and the longer and wider the number of its products or its geographic markets, the more conglomerated it is." While the degree of conglomerateness approach is probably the only defensible way of dealing with the subject, it does not satisfy many "antitrusters" who want a precise definition with which they can associate certain characteristics. Corwin Edwards argues that the term conglomerate can be used in either of two ways. First, it may apply only to an enterprise that sells commodities and services which have no functional relationship to one another—which do not come from a common raw material, are not produced by the same equipment or the same technology, are not sold through the same market channels or to the same customers or for the same end uses, and are not subject to the same specialized ways of doing business—such as mail-order selling. Thus defined, conglomerate enterprises show no internal coherence of activity or function. Secondly, Edwards states that "a conglomerate enterprise may be conceived as one that operates in a series of different markets, in each of which it encounters different competitors and different conditions of demand and supply and thus may be able to charge different prices and make different profits." Thus defined, Edwards believes "a conglomerate need not be internally incoherent, [for] its strength and strategy transcend the discipline of any particular market." His second definition describes conglomerates much more broadly than does his first, since firms with substantial horizontal

24 "Product extension mergers are those in which the acquired and acquiring companies are functionally related in production and/or distribution but sell products which do not compete directly with one another, for example, a merger between a soap manufacturer and a bleach manufacturer." Id.

25 "Other conglomerate mergers involve the union of two companies that do not have any buyer-seller relationships nor are they functionally related in manufacturing or distribution, for example, a ship builder and an ice cream manufacturer." Id.


27 Id.

28 Concentration Hearings Part 1 at 38 (testimony of Corwin Edwards).

29 Id.
and vertical relationships among their divisions or segments are included, whereas they were not in the first.

Hopefully, our brief discussion of the various approaches in defining a conglomerate and the difficulties involved with each of them has prepared us for the uneasy task of evaluating something we cannot be quite sure we have satisfactorily defined. Next, we must inquire whether the conglomerate firm possesses any special characteristics which make it incompatible with our present antitrust philosophy. If we use Edwards' first definition, in which there is virtually no economic relationship among the various activities it performs in different markets, the conglomerate firm is quite compatible with our antitrust philosophy. Conglomerateness per se does not impede competition. As Morris Adelman has stated, ""[t]he fact is that a truly conglomerate merger cannot be attacked in order to maintain competition, because it has no effect on any market structure.""30 Concurring in this statement is Jesse Markham who has stated:

The argument goes that the conglomerate firm, simply by virtue of the fact that it actively engages in producing and selling in two or more reasonably distinct markets, somehow acquires a special advantage over its single-product competition in each. . . . It is . . . discretionary power over the market unchecked effectively by the market forces, and not "conglomerateness" . . . that makes possible the anticompetitive tactics often erroneously assigned to the large multi-product firm as such.31

Even Edwards, who clearly adopts his second definition in his attempt to analyze the conglomerate, states that ""[t]he mere fact that diversified goods are sold by a single enterprise is not, of itself, ground for concern.""32 If we conclude that conglomerateness per se has a neutral effect on competition, we must then determine how important that finding is. After all, we must reconcile this conclusion with the numerous and mounting attacks on the conglomerate in American business. If, indeed, only conglomerate firms possessing additional, special features bring about anticompetitive effects, perhaps we should be more concerned with these special features and less concerned with their conglomerateness.

Before making this important decision, we must identify the special features and ascertain whether conglomerates in the real world always have them. These special features are large size and monopoly control. While all conglomerate firms cannot be described as very large firms, they all possess some degree of monopoly control in the various markets in which they

31 Concentration Hearings Part 3 at 1270-71 (testimony of Jesse Markham).
32 Concentration Hearings Part 1 at 38 (testimony of Corwin Edwards). It is interesting to note that Dr. Edwards omits the term "conglomerate" when there is no "ground for concern." A recent Wall Street Journal article quoted "the head of a West Coast company that most people call a conglomerate" as saying: "Call me an SOB. Tell people I beat my kids. But please don't call me a conglomerate." Wall Street Journal, April 10, 1969, at 1, col. 40.
These two characteristics are very different and must be treated separately. Large size is a superconcentration concept which may or may not affect competition in particular markets. Large size, however, doesn’t automatically provide a firm with sufficient market power to escape the discipline of competition; and significant market power may be held by firms which are not large. This contention is validated by Jesse Markham’s statement that “[m]arket power and bigness are simply like obesity and pregnancy—different conditions requiring different remedies.”

For illustrative purposes let us examine two alternative hypothetical situations, each involving the hundred largest firms in the nation. In the first case the hundred largest firms are in a hundred different industries, so that each one is the leading firm in a different industry, accounting for 40 percent or more of the sales of that industry. In the second case, the firms are much less specialized, each serving so many markets that no firm accounts for more than 5 percent of the sales of any one industry. From this information we would confidently predict that the firms in the first case possess much more monopoly control as a result of their larger market shares than do the firms in the second case, even though firm size was the same in each.

Analogous to our argument that conglomerateness per se does not impede competition is the contention that large size per se does not impede competition either. Conglomerateness and large size, alone or together, are not sufficient to infer anticompetitive effects; a third ingredient is necessary—a substantial degree of monopoly control. This third ingredient is both necessary and sufficient, although conglomerateness and large size may play an important role in allowing a firm to use it more effectively (to the greater detriment of society). A large conglomerate firm possessing substantial monopoly control in market A may find it advantageous to temporarily use some of its monopoly profits in market B in order to enhance its monopoly control there and increase its total long-run profits. It is the necessary condition of monopoly control in this example, not conglomerateness and/or large size, that is incompatible with our antitrust philosophy. The following testimony by Walter Adams and Corwin Edwards before the Senate committee investigating economic concentration seems to argue quite the opposite and I contend that their emphasis is misplaced:

A firm possesses conglomerate power when its operations are so widely diversified that its survival no longer depends on success in any given product market or any given geographical area. Its absolute size, its sheer bigness, is so impressive that it can discipline or destroy its more specialized competitors.

A conglomerate giant is powerful, therefore, not because it has monopoly or oligopoly control over a particular market, but because its re-

83 Virtually all firms face a negatively sloped demand curve. Even where product differentiation is slight, locational differences unimportant, and the seller’s role a minor one, some consumer acceptance, and therefore monopoly control takes place.
sources are bigger than those of its specialized competitors, and because these resources are diversified over many different markets.35

A big firm has advantages over a smaller rival just because it is big. Money is power. A big firm can outbid, outspend, and outlose a small firm. It can advertise more intensively, do more intensive and extensive research, buy up the inventions of others, defend its legal rights or alleged rights more thoroughly, bid higher for scarce resources, acquire the best locations and the best technicians and executives. If it overdoes its expenditures, it can absorb losses that would bankrupt a small rival. . . .

[S]o far as diversification increases the possibility for some firms to become big relative to others, it increases the possibility that they will obtain such advantages. The power that is derived from dispersion of resources is peculiar to conglomerate enterprise. . . .

Because a large conglomerate operates in many markets, it can divert income from one market to another. It can subsidize its losses in one market from its profits in another, or make investments in production for one market with resources derived from another. This fact gives a conglomerate exceptional leeway in market policy and exceptional possibility of imposing its will upon its more specialized rivals.36

While Adams explicitly explains that conglomerate power stems from large size and conglomerateness rather than from monopoly control, Edwards does so implicitly by basing his argument on the former two and omitting the latter. This is obviously contrary to our attempted analysis of the problem.

Another important economic consideration is that the large conglomerate firm may enjoy important advantages over its more specialized competitors in particular markets as a result of horizontal or vertical relationships among the various markets in which they operate. This relates to the previous discussions of the imprecise nature of industries, and therefore, conglomerates. We have accepted the degree of conglomerateness approach and are now ready to explain its relationship to monopoly control. The smaller the degree of conglomerateness or the greater the horizontal and/or vertical relationships among the different discernible markets in which a firm operates, the greater its monopoly control in these markets.

A very helpful concept which can be utilized to express and even transcend the usual interpretation of the “degree of conglomerateness” has been introduced by John Narver. Narver explains that each firm may be thought of as a “collection of component resources and activities” which center around certain “organization — activity nodes.”37 The degree of “node commonality” that is present among the various divisions or segments of a conglomerate firm is an indication of how much monopoly control may be gained in any one market from the entire operation of the firm. The essential difference between the “node commonality” concept and what is usually

35 Concentration Hearings Part 1 at 249 (testimony of Walter Adams).
36 Id. at 42-43 (testimony of Corwin Edwards).
37 Narver, Conglomerate Mergers and Market Competition 3-6 (1967).
understood as the conglomerateness concept is that the latter refers to particular industry classifications, while the former refers to the organizational relationship within the entire firm. A firm may operate in different industries in which it sells quite different products (neither close substitutes nor good complements) and yet experience substantial production node commonality. It may also experience varying degrees of node commonality in management, promotion, distribution, and research and development. Where node commonality is high, the resulting economies, which are not enjoyed by the conglomerate’s specialized competitors, add to the conglomerate’s monopoly control.

It is important to understand that our analysis here points to a conclusion which is completely contrary to the common belief that “conglomerateness provides a special advantage.” Since the greater the degree of conglomerateness or the lower the node commonality, the less monopoly control will be enjoyed by a conglomerate firm in each market in which it operates, it is the lack of conglomerateness that enables it to achieve a high degree of monopoly control.

In order to predict the competitive effect of a firm’s conglomerate growth, it is essential to examine its impact, in terms of monopoly control, upon the firms competing in markets in which it is already involved and in those into which it is contemplating entry. Since conglomerate expansion competes with horizontal or vertical expansion for limited corporate funds, it is reasonable to expect that the increases in the latter markets may be offset by the lack of increase in the former markets. Presumably, the corporate decision will be made on the basis of the highest expected return on invested capital, adjusted for the element of risk. This provides a much better resource allocation than if corporations were limited to investment in their more narrowly defined market area. A Penn-Central executive asks: “Why put money into the railroad where the return is 3\% when we can invest in things making 15\% or 20\%?” Conglomerate growth thus performs the useful function of aiding the flow of investment funds into the newer industries, which are often characterized by high concentration levels. We can therefore expect a decrease in the degree of monopoly control held by the established firms in these industries. Furthermore, the industries need not be very new. The President of Litton Industries, for example, “points to the U.S. market for cash registers, which for many years has been dominated by National Cash Register Co. (NCR).” Litton acquired a foreign manufacturer, Sugnska Dataregistra (Sweda), which, explains Mr. Ash, “gave it the financial muscle to become the first real competition for NCR.”

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39 Data in support of this thesis are presented by Michael Gort in Concentration Hearings Part 2 at 676-77.
centers and develop new products, “Sweda would never have made it on its own.” In addition, Mr. Ash told of Litton’s acquisition of Profexray Inc., and how it was boosted by Litton “to an important place in the market for X-ray equipment, challenging General Electric, Picker X-Ray Corporation and Westinghouse, which had long dominated the field.”

A frequently raised issue in recent years has been the alleged advantage accruing to conglomerates through their use of reciprocal agreements. Edwards lists “reciprocity” as an important aspect of the power that is derived from the dispersion of resources by conglomerate firms. He claims that “[r]eciprocal buying appears to be common among conglomerates. As a diversified enterprise, a large conglomerate buys a large and varied assortment of goods and services. These purchases can be used as leverage in making sales.” In addition, Willard Mueller employs the findings of two case studies to argue that “the vertical relationships of a large conglomerate enterprise may result in competitive strategies which threaten competition. ... Although reciprocal selling is not a new business strategy, the opportunity for its exercise has increased in recent years as firms have become increasingly conglomerated.” Economic theory, however, does not support the validity of such analysis. Once again, it is monopoly control and not conglomerate per se that allows anticompetitive reciprocal agreements to occur. Monopoly control can be used directly by charging higher prices, just as monopsony control can be used directly by extracting lower input prices. Reciprocal agreements are merely a form in which they can take place. Without market power, firms can neither charge higher prices nor extract lower prices. James Ferguson, in an article in which he presents an economic analysis of reciprocity, writes:

[I]n the absence of market power, reciprocity, at best, can secure sales for the firm at equal prices. Competitors are foreclosed from sales at equal prices, but this fact is of little consequence since all firms can practice reciprocity; there will be many such agreements among mutual suppliers. In the absence of power to enforce the agreement in the presence of lower prices offered by other sellers, these agreements will not lessen competition. ...

We may conclude that while conglomerateness per se does not cause any anticompetitive effects as a result of reciprocal agreements, conglomerate firms have more opportunity to make such agreements, and if they possess

41 Id.
42 Concentration Hearings Part I at 44 (testimony of Corwin Edwards).
45 Ferguson, Tying Arrangements and Reciprocity: An Economic Analysis, 30 LAW & CONTEMP. PROB. 570 (1965).
substantial monopoly control, may find this a convenient form to exploit their position.

Thus far this section has dealt only with the economics of the conglomerate firm, and we have attempted to avoid the question of the conglomerate merger. We have concluded that conglomerateness per se does not lead to anticompetitive effects and that monopoly control is the root cause of such effects. We have also pointed out, however, that all firms have some degree of monopoly control, and that limiting it to low levels in order to maintain (or attain) viable competition in each group of competing firms is consistent with our antitrust philosophy. Therefore, the form in which conglomerate growth takes place may be very important. One way may be more conducive to monopoly control than another.

Conglomerate growth may be internal or external. Richard Heflebower has concerned himself with the basic differences between these two concepts. In 1951, before the conglomerate merger issue emerged, he wrote:

Where expansion is by building, the firm grows in the face of competition. It meets and passes market tests.

[A] corporation which grows by merger has not by that fact proved its greater ability in an open contest with rivals. It may be more efficient, but it has not demonstrated that in the impersonal processes of the market, instead by one stroke a going concern is acquired and its share of the market obtained at least temporarily. . . . [W]e can say that in and of itself growth by merger is not evidence of competitive success.46

Fourteen years later Heflebower added:

When an enterprise expands in its primary market, or enters a new one, by building, it has made a decision in light of market prospects. These are the prospective level of input prices, and of demand for the product, often in a specific geographic area, and the share of the market the firm expects to obtain. Prospective process and product changes have been estimated. Equally important are conclusions about future alternative needs for funds in the enterprise's present operations or for other opportunities that may arise. . . . If the funds have to be got by borrowing or sale of stock, the judgement of bankers or investors is superimposed on that of the corporation's management. . . . If it enters another line by the building method, it disturbs the status quo in that market.

Much of the process just sketched is minimized or sidestepped if expansion is by merger. The acquired firm is a going organization (the failing firm case is excluded here) with installed equipment and established input and product market connections. . . . In a large portion of cases the merger is consummated by an exchange of stock and by vote of the directors. The acquiring firm does not need to use its cash nor to meet the external test of bankers or of buyers of an additional issue of stock.47

It does not follow from Heflebower's line of reasoning that external conglomerate growth will always bring about socially undesirable effects. In

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47 *Concentration Hearings Part 2* at 793 (testimony of Richard B. Heflebower).
fact, it is important to remember that there are three alternatives—internal conglomerate growth, external conglomerate growth, and no conglomerate growth—and that if external conglomerate growth is blocked, no conglomerate growth (which may mean more horizontal or vertical growth) may be preferred to internal conglomerate growth.\(^\text{48}\) However, where the internal growth alternative is considered workable, we would agree with Heflebower that external growth does circumvent important market tests, and that everything else being equal, we would prefer internal growth that is subjected to these tests.

In those instances where the internal growth alternative can be used to accomplish a conglomerate growth objective, new and additional competition takes place. This is not the case when growth is by merger. Initially, only the source of control is altered, with capacity remaining the same. More precisely, internal growth brings about entry whereas external growth does not.\(^\text{49}\) In the absence of any specific information about a particular case, we can confidently predict that an additional competitor with additional production capacity in the industry will provide at least as positive an effect on competition as would be the case if this firm had entered via merger. The facts of the case, including the competitive nature of the industry, the node commonality existing between the firm’s primary activity and this one, and the market share that it would obtain, must be ascertained before one can adequately predict whether more, less, or no change in competition within the industry will result.

When internal growth can reasonably be expected, and the industry in question has fairly high entry barriers, conglomerate merger does have anticompetitive effects since it eliminates a potential entrant. It terminates the possibility that a likely entrant via internal growth (the acquiring firm) will be added to the number of competitors in the market of the acquired firm and, vice-versa, it eliminates a firm whose pattern of internal growth might very well have brought it into the market of the acquirer. This “potential entrant” point should not be confused with an acquirer’s competitive effect on the industry stemming from the degree of monopoly control that it can derive. This distinction becomes more apparent from a brief examination of the issues dealt with in two recent antitrust cases.

The first is *United States v. El Paso Natural Gas Co.*,\(^\text{50}\) decided by the Supreme Court in 1964. In 1956 El Paso Natural Gas supplied more than

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\(^{48}\) In the case of Litton Industries, discussed above, it is entirely possible that if its acquisition of Sweda had been blocked, it would not have internally entered the cash register business, and that the viable competition it offers to National Cash Register Co. would not be occurring.

\(^{49}\) Joe S. Bain, who has dealt with the concept of entry more than and better than any other economist, has defined entry as “an addition to industry capacity already in use plus emergence of a firm new to the industry . . . .” J. Bain, *Barriers to New Competition* 5 (1956).

\(^{50}\) 376 U.S. 651 (1964).
half of California's natural gas. On the other hand, the Pacific Northwest Pipeline sold no gas in California, but had shown itself to be a likely potential entrant since on several occasions it had attempted to make contracts to sell gas in California. The Supreme Court held that acquisition of Pacific Northwest by El Paso "substantially lessened competition" and therefore, violated section 7 of the Clayton Act, as amended in 1950. In the second case, FTC v. Procter & Gamble Co., the Supreme Court again ruled that an acquisition "substantially lessened competition" and therefore violated the law, but this time primarily because of the added monopoly control that it gave to the firm in the acquired's market. Procter & Gamble, a large soap products firm, had acquired Clorox Chemical Company, the largest household laundry bleach firm. It was apparent that Procter & Gamble had no intention of internally growing into the bleach market, and that the Court's decision resulted primarily because of significant promotional economies ensuing from the merger that could not be matched by other bleach firms. In contrast to the El Paso case, Procter & Gamble's potential entry status was not emphasized. Instead, the gain in the degree of monopoly control that was derived through the merger of two firms with strong promotional node commonality was given primary attention.

Our analysis very clearly suggests that competition will either be affected in the same way or be enhanced by internal conglomerate growth as opposed to external. Table VII presents some data which indicates that external growth is, however, becoming relatively more prevalent. This data includes only assets of manufacturing and mining firms with assets of $10 million or more, and encompasses all types of mergers. Nevertheless, since the FTC classifies 89 percent of the assets (in 1968) involved in "large" acquisitions as conglomerate, the "assets of large acquisitions as a percent of new investment" data provides us with a fairly good indication of the relative importance of external growth.

PART III: SUMMARY AND CONCLUSIONS

The data presented in Part I illustrates that concentration in the manufacturing sector has increased over the past two decades, and that a record number of mergers, predominantly conglomerate mergers, have been consummated in recent years. Politicians, economists, and others who suggest stern antitrust action on the basis of this data implicitly equate increases in

52 586 U.S. 568 (1967).
53 The effect that merger may have on entry is expressed in yet another way. Not only is a likely potential entrant eliminated when it chooses the merger route, but if strong node commonality exists, the merger will add to the firm's monopoly control in the industry. This will, in turn, raise the industry's entry barriers. In the Procter & Gamble case, where there was evidence of strong promotional node commonality, it was argued that the promotional economies that Procter & Gamble's division was able to enjoy made it substantially less attractive to enter the household laundry bleach industry.
### TABLE VII

**ASSETS OF LARGE Aquisitions COMPARED WITH NEW INVESTMENT, MANUFACTURING AND MINING, 1948-1968**

<table>
<thead>
<tr>
<th>Year</th>
<th>New Investment (Billions of dollars)</th>
<th>Assets of Large Acquisitions (Billions of dollars)</th>
<th>Acquired Assets as Percent of New Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>10.01</td>
<td>.130</td>
<td>1.3</td>
</tr>
<tr>
<td>1949</td>
<td>7.94</td>
<td>.067</td>
<td>0.8</td>
</tr>
<tr>
<td>1950</td>
<td>8.20</td>
<td>.173</td>
<td>2.1</td>
</tr>
<tr>
<td>1951</td>
<td>11.78</td>
<td>.201</td>
<td>1.7</td>
</tr>
<tr>
<td>1952</td>
<td>12.61</td>
<td>.327</td>
<td>2.6</td>
</tr>
<tr>
<td>1953</td>
<td>12.90</td>
<td>.679</td>
<td>5.3</td>
</tr>
<tr>
<td>1954</td>
<td>12.02</td>
<td>1.425</td>
<td>11.9</td>
</tr>
<tr>
<td>1955</td>
<td>12.40</td>
<td>2.129</td>
<td>17.2</td>
</tr>
<tr>
<td>1956</td>
<td>16.19</td>
<td>2.037</td>
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</tr>
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<td>1957</td>
<td>17.20</td>
<td>1.472</td>
<td>8.6</td>
</tr>
<tr>
<td>1958</td>
<td>12.37</td>
<td>1.107</td>
<td>8.9</td>
</tr>
<tr>
<td>1959</td>
<td>13.06</td>
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</tr>
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<td>1961</td>
<td>14.66</td>
<td>2.129</td>
<td>14.5</td>
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<td>1962</td>
<td>15.76</td>
<td>2.194</td>
<td>13.9</td>
</tr>
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<td>16.73</td>
<td>2.917</td>
<td>17.4</td>
</tr>
<tr>
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<td>19.77</td>
<td>2.798</td>
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<tr>
<td>1965</td>
<td>23.75</td>
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<td>1966</td>
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<td>1967</td>
<td>28.11</td>
<td>8.222</td>
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</tr>
<tr>
<td>1968$^2$</td>
<td>28.27</td>
<td>12.616</td>
<td>44.6</td>
</tr>
</tbody>
</table>

$^1$ Assets of $10$ million or more.

$^2$ Figures for 1968 are preliminary.


concentration levels in the manufacturing sector with decreases in competition in American industry. This is a roaring *non sequitur*. Competition can only be adequately dealt with in the context of a relevant market; and, how the relevant market is defined (the industry, the group of competing firms) determines the level of concentration. Likewise, the level of concentration may not be equated with the inverse of the level of competition. Except for some extreme cases that approach either monopoly or monopolistic competition, the examination should not be restricted to the absolute level of concentration. Some other determinants of competition that should be examined are relative concentration, rank mobility among the largest firms, product differentiation, the state of potential entry, and the degree of vertical integration.

The imprecise nature of the industry or the market with which we must deal in order to make judgments concerning the adequacy of competition, acts as a major obstacle to attaining reliable results. Since a conglomerate is

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$^{54}$ The term monopolistic competition is used here as it was described in Chamberlin's large numbers case. See E. Chamberlin, The Theory of Monopolistic Competition (1933).
a firm that operates in more than one industry, all of the difficulties that confront us when we try to define a particular industry are present and multiplied when we attempt to determine whether a particular firm is a conglomerate. Recognizing that a pure conglomerate does not exist in the real world because there is always some economic relationship between the markets that we do identify, we have adopted a “degree of conglomerateness” concept. The degree of conglomerateness is inversely related to the node commonality or the degree of horizontal and/or vertical aspects among the identified markets.

In order to deal with the competitive consequences of the conglomerate or what is sometimes referred to as “conglomerate power,” we suggested that the factors of conglomerateness, large size, and monopoly control that are associated with the conglomerate should be examined separately. We concluded that conglomerateness per se (the pure conglomerate) does not affect competition, that large size per se (superconcentration) does not affect competition, and that monopoly control is the determining factor. We recognized that the degree of conglomerateness could have important effects upon the degree of monopoly control that is obtained in a particular market, and that as a general rule, the lower the degree of conglomerateness, or the greater the horizontal and/or vertical relationships among the different discernible markets in which a firm operates, the greater will be its monopoly control in those markets. Of course, the degree of monopoly control that a firm enjoys is based upon its relative position within the group of competing firms. Therefore, if all the major firms are equally conglomerate (which indicates that we defined the industry poorly), and very low entry barriers exist, the competitive advantage of the conglomerate firm would be slight compared to the situation in which it competes with specialized firms and where entry barriers are high. Singling out conglomerateness as we have done allows us to see more clearly that conglomerateness provides no special advantage to firms, and that the concern about “conglomerate power,” which is often expressed in terms of firms being too conglomerate, should be shifted to a concern about “monopoly power.” Thus, our concern should be expressed in terms of firms not being conglomerate enough.

The market mechanism is largely relied upon in the United States to attain the best possible allocation of our scarce resources. This is a basic principle of economics that has long been expounded by the economics profession. Consistent with this theory, investment funds should be permitted to flow freely in order to attain the highest returns commensurate with risk. Resources shifting from low return to high return occupations will erode monopoly returns, while increasing returns in the areas from which they were withdrawn. Conglomerate growth should therefore be fostered. Conglomerate growth into markets served by firms possessing substantial monopoly control may be a positive competitive force even if the conglomerate has certain node commonality advantages.
We concluded that conglomerate growth may have positive, negative, or neutral effects on competition in particular markets, depending upon the state of actual and potential competition in the industries involved, and the node commonality that is present. But that still left us with the very important consideration of what form this conglomerate growth should be encouraged to take. On the basis that internal growth must pass certain market tests which are often circumvented by external growth, and that internal growth means an additional competitor in the industry, whereas external growth does not, we stated a definite preference for internal conglomerate growth. It does not follow, however, that a blanket rule blocking external conglomerate growth should be adopted. Denying conglomerate merger may achieve a less desirable result than permitting it. A firm wishing to enter a market via acquisition may not wish to do so in any other way. Therefore, the choice is not necessarily limited to whether, from society's point of view, internal conglomerate growth is preferable to external conglomerate growth, but may be expanded to include the question of whether external conglomerate growth is preferable to no conglomerate growth. Furthermore, if the firm elects no conglomerate growth, it may elect more vertical and/or horizontal growth, which may have greater anticompetitive consequences than the external conglomerate growth that was inhibited.

The analysis in this paper leads us to certain conclusions and policy suggestions. First, we should understand that our antitrust philosophy is based upon the recognition that adequate competition is essential if we wish to depend upon the market mechanism to play the major role in resource allocation. Conglomerate growth must be examined, and either condoned or condemned on the basis of its effects on competition in the relevant markets. No general rule can be applied, as conglomerate growth may enhance competition in one instance and substantially lessen it in another. Very important differences in the degree of conglomerateness as well as the competitive environment of the relevant markets are responsible for these variations. Our analysis does indicate that the more conglomerate a firm is, the less likely it is to adversely affect competition in the markets in which it operates.

In order to determine the difference between the competitive consequences of internal versus external conglomerate growth, the most important information to have is the likelihood that internal growth will take place if external growth is denied. If internal growth can be reasonably expected and the market is characterized by fairly high entry barriers, the potential entrant should be prohibited from acquiring any but a failing firm in the industry.

Policy makers should focus their attention not upon the "evils of conglomerateness," but, instead, upon the "evils of monopoly control." The term conglomerate is presently being used in conjunction with rather narrowly defined markets. If new and broader industry classifications reflect-
ing the great number of technological-organizational changes that have occurred in our economy, are devised, many firms that possess substantial node commonality between their various divisions or segments, and which, through their activities, possess a substantial degree of monopoly control, would be eliminated from the ranks of the conglomerates. When high degrees of production node commonality exist between divisions or segments of what are now considered conglomerates, so that they obtain substantial advantages over their more specialized competitors, it should be interpreted as indicating that the present industry classifications are inadequate and that a broader definition should be introduced (or already has been by the market). The specialized firms which find themselves at a competitive disadvantage are consequently compelled to either grow to include the necessary operations or to cease to exist. Government policy should actively foster their growth by either internal or external means so that they can become viable competitors in their industry. In this way the degree of monopoly control held by individual firms in the industry can be minimized.

Since the antitrust laws in the United States are aimed at combating monopoly control, the root-cause of anticompetitive effects, it seems advisable to add new legislation against conglomerates which, in the absence of substantial monopoly control, have no adverse competitive effects. What is needed is more viable enforcement of present antitrust laws.