Financial Congenerics and Antitrust Policy

Wm. Paul Smith
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INTRODUCTION

Although far from new, the one-bank holding company (OBHC) movement gained public attention about two years ago.1 Since then, both the OBHC movement and the attention given it — by bankers, bank regulatory officials, members of potentially affected industries, and Congress, as well as the public at large — have accelerated. The motivation for, the eventual extent and consequences of, and appropriate public policies toward OBHCs are of professed concern.

The one-bank holding company movement and the discussion surrounding it may be separated into two facets: (1) the acquisition and control of banks by non-banking organizations; and (2) the bank initiated OBHCs — the “financial congenerics” whose operations are confined to banking and markets closely related to banking.2 Where the organization is primarily non-banking, the one-bank holding companies fall into the “conglomerate” category, thereby posing many analytical as well as policy problems not encountered in a treatment of financial congenerics. The former are most numerous and, admittedly, pose a number of questions of possible public policy import.3 Notwithstanding, the present paper’s scope is limited to the


2 Frequently these facets of the OBHC movement are not distinguished. As a result, much of the data, as well as public debate, are misleading in that large industrial complexes controlling relatively small banks are aggregated with large banks which are subsidiaries of holding companies with few or no nonbank subsidiaries. See House Comm. on Banking and Currency, The Growth of Unregistered Bank Holding Companies — Problems and Prospects, 91st Cong., 1st Sess., 115 Cong. Rec. 10,545 (daily ed. Nov. 5, 1969).

3 The impact on banking markets of the “‘conglomerate’ one-bank holding companies” might be considered in the same manner as the financial congenerics’ impact on “nonbanking” financial markets is treated in this paper. However, the “‘conglomerate’ one-bank holding companies” may pose an additional issue of political philosophy — that of the overall concentration of economic power within the economy. In my view, the available data suggest that this cannot be properly ascribed to the financial congenerics. Thus, the approach to public policies towards financial congenerics outlined in the present paper might be properly subordinated to that issue of political philosophy insofar as application to “‘conglomerate’ one-bank holding companies” is concerned.
bases for "antitrust"-type policy towards financial congenerics. Furthermore, the latent jurisdictional problems of the complementary and competitive roles of the various banking agencies and the Department of Justice in implementing the proposed criteria are ignored.

The present discussion reflects the author's views concerning the appropriate goals of antitrust policy and enforcement and of commercial bank regulation. Both should be directed toward influencing industry structure and operating environment so that the resulting rivalry among firms will lead to the establishment of prices, outputs, product specifications, and allied economic variables which serve to maximize social welfare as viewed by final consumers (not producers). The preponderance of bank regulation which is designed to protect bank customers from the losses and disruptions of bank failures and not to protect management and stockholders from rivalry or their own incompetence suggests that I do not stand alone. These views are not the only ones possible nor, indeed, necessarily always shared by those in a position to make policy decisions. My reading of the congressional hearings and debate on the one-bank holding company bill, for example, suggests that many congressmen and witnesses were more con-

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4 Although antitrust policy towards financial congenerics is an issue of considerable consequence, it is overshadowed by other public policy issues relating to the proper scope of the operations of financial congenerics, i.e., of banks and bank related enterprises. However, once the larger issues concerning the limits on the scope and extent of banks', or of financial congenerics', operations in markets generically related to banking have been established, "antitrust"-type policy issues will be of major significance.

5 In language closely paralleling section 1 of the Sherman Act, 15 U.S.C. § 1 (1964), and section 7 of the Clayton Act, 15 U.S.C. § 18 (1964), the Bank Merger Act of 1966, 12 U.S.C. § 1828(c) (Supp. IV, 1968), and the Bank Holding Company Act of 1956, 12 U.S.C. § 1842(c) (Supp. IV, 1968) provide that the responsible banking agency must consider "antitrust"-type issues in passing on applications for bank acquisitions. Somewhat less explicitly, H.R. 6778, 91st Cong., 1st Sess. (1969), as reported by the House Banking and Currency Committee would involve a similar mandate to the Board of Governors of the Federal Reserve System which "may take into consideration whether entry is to be on a de novo basis or by acquisition of an existing company" in its approval of a bank holding company's application to acquire any company performing any activity that the Board has determined ... is functionally related to banking in such a way that its performance by an affiliate of a bank holding company can reasonably be expected to produce benefits to the public that outweigh possible adverse effects. The greatly amended version of H.R. 6778, 91st Cong., 1st Sess. (1969), passed by the House provides that "the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole, or in part, of a going concern" in its approved of carrying on an activity by a particular company or generally in the case of regulation if the Board finds ... that the carrying on of the activity in question ... will be functionally related to banking and can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects such as undue concentration of economic resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

cerned with sheltering firms from the rigors of competition with financial congenerics.

Subsequent sections of this paper consider: (1) the definition and characteristics of financial congenerics along with the motivations underlying the financial congeneric movement; (2) the available evidence concerning the scope and consequences of financial congenerics' entry into related markets; and (3) the rationale and guidelines for antitrust policy with respect to financial congenerics' entry into related markets by merger. The proposed guidelines, which are behavioral in nature, are developed in the context of financial congenerics' entry into laterally related markets by merger.

THE NATURE OF FINANCIAL CONGENERICS

"Financial congenerics," as the term is used here, consist of bank initiated one-bank holding companies whose "nonbanking" (in the traditional sense) interests are confined to markets that are related to banking by jointness of production, jointness of demand, and similar or parallel managerial and market functions. The markets that financial congenerics have entered, or have expressed an intent to enter, largely have been financial ones. Where non-financial markets were involved, they also were related to banking in the same manner. Frequently, as with data processing services, for example, the banks involved also were attempting to utilize excess capacity.

6 Entry into vertically related markets and entry into markets related to banking by jointness of consumption both pose analytical problems, occasionally elaborate ones, that are not investigated in the present article. Some facets of the argument might have to be modified in order to fully account for the problems raised by entry into such markets. However, without a full treatment of the problems, which would be both lengthy and intricate, we cannot be confident that the modifications are other than ambiguous. For example, vertical integration through monopoloid markets—assuming profit maximizing behavior—would ceteris paribus lead to lower "downstream" prices; but, under the severe assumptions that all firms in a market are affiliated with banks and that all or most banks are so affiliated, independent entry into that market may require internal credit sources and a fortiori the greater barriers to entry would lead to higher prices. The net results of such countervailing developments are not obvious, depending, inter alia, upon the nature of the cost functions in each industry, optimum firm scale, credit requirements of the firm, relative size of the markets involved, and demand elasticities.

7 As we are concerned with a general outline of the appropriate antitrust policy towards financial congenerics, specific delineation of "banking," "nonbanking," "financial," "nonfinancial," and "related" markets is not crucial to the argument. The specific limits of "bank" and, in turn, "nonbanking," for example, have never been delineated, nor does it seem either possible or desirable to do so. Illustrative of the ambiguity is a list of "nonbank activities engaged in by 1-bank holding companies formed on or after Jan. 1, 1965," 115 Conc. Rec. 9,779 (daily ed. Oct. 21, 1969), listing long standing commercial bank activities of agricultural lending, commercial loans, factoring, and loans to insurance companies, and long standing commercial bank trust department activities of fiduciary accounts, escrow services, and pension fund trustees.

8 For the most part, the financial and nonfinancial product or service markets thus far entered by the financial congenerics—data processing, equipment leasing, factoring, mortgage servicing, etc.—are ones that some banks had previously operated in under the "incidental powers" provision of the National Bank Act, 12 U.S.C. § 24, § Seventh (Supp. 1970). Thus, the financial congeneric movement might be more aptly labelled a legal bookkeeping phenomenon rather than a functional change in financial institutions.

9 In this particular case, the excess capacity stems from both the fact that the banks'
The commercial banking industry has a unique history and, in addition, is enshrouded in highly restrictive legislation as well as the confining regulatory and judicial interpretation of that legislation. Were it not for this history, legislation and interpretation of the legislation, it is likely that the economic evolution represented by the financial congeneric movement not only would have been long completed, but would have drawn little public notice. The diversification process by firms in other non-financial industries certainly has not excited the same sort of intense interest. But, despite the myriad changes in financial markets and in the overall functioning of the economy over the past four decades, the prevailing banking legislation and the interpretation of that legislation still are based largely on responses to developments during the Great Depression.\(^1\)

The financial congeneric movement constitutes an extension of banks' responses to the changes in their environment, given the legislative and regulatory restraints imposed upon banks. The Glass-Steagall Act severely circumscribes the ability of banks—but not that of organizations controlling a single bank—to enter related markets.\(^1\) As a result, banks have internal requirements were not sufficient to fully utilize their own facilities—the size of which was circumscribed by technological indivisibilities—and the concentration of internal requirements during the banks' normal business hours, leaving the data processing installation underutilized at other times. A "laundry list" amendment to H.R. 6778 introduced by Congressman Blackburn prohibits "bank holding companies or subsidiaries thereof" from, \textit{inter alia},

\begin{itemize}
  \item engaging in the business of providing data processing services except (A) as an incident to banking services such as the preparation of payrolls, or (B) to the extent necessary to make economical use of equipment primarily acquired and used for the bank holding company or its bank subsidiaries.
\end{itemize}


It may be noted that the legal status of the offering of data processing services by banks, in contrast to financial congenerics, under the above mentioned "incidental powers" provision of the National Bank Act is presently being challenged by the Association of Data Processing Service Organizations and member organizations. \textit{See} Wingate Corp. v. Industrial Nat'l Bank, 288 F. Supp. 49 (D.R.I. 1968); Association of Data Processing Serv. Organ., Inc. v. Camp, 279 F. Supp. 675 (D. Minn. 1968), \textit{aff'd}, 406 F.2d 837 (8th Cir.), \textit{cert. granted}, 395 U.S. 976 (1969).

\(^{10}\) The Banking Act of 1933 (Glass-Steagall Act), 12 U.S.C. § 378(a) (1964), and the Banking Act of 1935, 12 U.S.C. § 371 (1964),—enacted in response to the economic chaos then prevailing—were designed, \textit{inter alia}, to restrict the scope of the operations of commercial banks. The popular, somewhat incorrect, belief then (as now) was that banks' involvement in activities other than "commercial banking" was responsible for the widespread bank failures of the late 1920's and early 1930's. This belief ignores the effect of the overall collapse in 1929 of the economy upon individual banks and the banking system. The persistence of the sentiment underlying the banking legislation of the 1930's as a rationale for current public policies toward the scope of commercial bank operations ignores \textit{pari passu} the Employment Act of 1946, 15 U.S.C. § 1021 (1964), and the efficacy of modern tools of monetary and fiscal policy.

\(^{11}\) With certain exceptions, corporations controlling two or more banks are subject to the Bank Holding Company Act of 1956, 12 U.S.C. § 1841 (1964). Under this law, the ownership of non-bank subsidiaries by registered bank holding companies is limited to any company all the activities of which are or are to be of a financial, fiduciary, or insurance nature and which the Board . . . by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto . . .

\textit{Id.} § 1843(c)(8) (Supp. IV, 1968). The standards to be applied under H.R. 6778 as
initiated the formation of holding companies to control the initiating bank and to control other subsidiaries which would operate in related markets.

The environment in which banks operate has changed markedly over the past few years. In large part, the motivation for banks to enter the related markets, and in turn for the financial congenerics movement, stems from the changes in environment. Banks have been subjected to increasingly intense inter-bank and non-bank competition in the markets in which they have traditionally operated. The development of the commercial paper market, for example, has signified increased competition for commercial banks in both factor (deposit) and product (loan) markets. To some extent, commercial banks have been able to compensate for non-bank competition by developing new product lines or new financial instruments, e.g., the large denomination Certificates of Deposit and bank credit cards.

Increased competition has meant an erosion of the individual and collective market positions of banks, i.e., whatever monopoly power banks once may have had is declining. By contrast, firms operating in a number of markets that banks have sought to enter — e.g., insurance sales — are highly sheltered from many forms of rivalry within the market and from competition from other product lines due to the nature of the product involved. Thus, rather than attempting to extend their monopoly power, banks, via the financial congenerics vehicle, are attempting to enter less intensely competitive markets.

reported by the House Banking and Currency Committee were intended to be less constricting. Although the standards to be applied by the Board in passing on activities not on the prohibited "laundry list" in the House-passed version of H.R. 6778 closely parallel those in the Committee version of the bill, it is not entirely clear that the intent to be less constricting was retained. See House Comm. on Banking and Currency, Bank Holding Companies, H.R. Rep. No. 387, 91st Cong., 1st Sess. 14-16 (1969); 115 Cong. Rec. 10,560 (daily ed. Nov. 5, 1969); note 5 supra.

The earlier efforts of banks to capture a portion of the burgeoning consumer credit market in the 1940's and of both the residential mortgage and savings deposits markets in the 1950's demonstrate that the development is neither new nor dependent upon tight money. See D. Alhadeff & C. Alhadeff, The Struggle for Commercial Bank Savings, 72 Q.J. Econ. 1 (1958).

It may be noted that both the Committee and House-passed version of H.R. 6778 would prohibit bank holding companies from acting as insurance agents, except for credit life insurance. In the Committee version, a "grandfather clause" would exempt companies "lawfully acquired and owned on February 17, 1969," but the House passed version provides a cut-off date of May 9, 1956, and would require divestiture by an earlier formed "one bank holding company with bank assets of more than $30,000,000 and non-bank assets of more than $10,000,000." As the Board has approved the acquisition of insurance agencies by registered bank holding companies, H.R. 6778 would restrict the scope of operations by multi-bank holding companies. H.R. Rep. No. 91-387, 91st Cong., 1st Sess., 9-10, 15-16 (1969); 115 Cong. Rec. 10,545-53, 10,566 (daily ed. Nov. 5, 1969).

The problem of tie-in sales has been raised in connection with the possibility that banks might package services. It has been shown many times that tie-in sales are effective for the firm only where the firm is able to charge an above competitive price for the tied product. Thus, some critics may be right in suggesting that there is a potential problem here, but their identification of the basis for that problem is at the very least badly confused. See Bowman, Tying Arrangements and the Leverage Problem, 67 Yale L.J. 19-36 (1957); Burstein, The Economics of Tie-In Sales, 42 Rev. Econ. & Stat. 68 (1960).
CONSEQUENCES OF CONGENERIC ENTRY INTO RELATED MARKETS

The extent of commercial banks', and of financial congeneric operations in traditionally "non-banking" markets is not fully documented. Nonetheless, it is clear that the scope of bank, and of financial congeneric operations has been steadily expanding in the past few years. Indeed, for some time, virtually every issue of The American Banker, the daily trade paper for the industry, has contained some reference to a contemplated, in process, or consummated expansion of financial congeneric operations into traditional "non-banking" areas. As yet, no one has ventured a serious, carefully reasoned forecast as to the ultimate extent of banks and of financial congeneric operations in traditional "non-banking" markets.

Comparatively little is known of the performance effect of bank or financial congeneric entry into related markets. Indeed, in only one case has serious study been devoted to the potential impact of commercial bank entry into a related market — municipal revenue bond underwriting. Three independent studies have been devoted to a quantification of the savings to public authorities that would result from commercial bank entry into municipal revenue bond underwriting. While the data employed and the variables utilized in the analysis differed, each study found that commercial bank entry into revenue bond underwriting would have a statistically significant and, I think, a quantitatively appreciable impact upon the interest costs of municipal revenue bond financing.

The studies of the potential impact of commercial bank entry into revenue bond underwriting are suggestive of the potential benefits of bank, and of financial congeneric, entry into related markets. But these studies do not necessarily indicate the form of the benefits stemming from entry into other markets. Whereas market performance in municipal bond underwriting has but one dimension, in most markets that commercial banks are attempting to enter performance is multi-dimensional. Moreover, in many cases the performance variables which may be affected by the firms'

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15 Considerable data, however, are presented in, inter alia, THE GROWTH OF UNREGISTERED BANK HOLDING COMPANIES — PROBLEMS AND PROSPECTS, supra note 2, and HOUSE COMM. ON BANKING AND CURRENCY, BANK HOLDING COMPANY ACT AMENDMENTS, 91st Cong., 1st Sess. (3 vols. 1969). See also Hall, supra note 1.

16 See Hall, supra note 1.

17 In most cases, of course, the product line or service was not a novel one for commercial banks or for financial congeneric, albeit an extension of the particular organization's products or services. See note 8 supra and accompanying text.


19 It may be noted that the most common formulation of market performance in municipal bond underwriting markets, net interest cost, is not an unambiguous measure of the burden of interest payments over the life of new municipal debt such as would be given by a discounted present value calculation. See W. SMITH, supra note 18, at 45-47.
behavior are of a service, non-quantifiable nature. Insurance premiums, for example, typically are established by a state authority, and, in such markets, the dimensions of performance under control of the individual firms and perhaps of the market as a whole are of the service nature.\textsuperscript{20} In other industries one may very well find changes which would normally be regarded as improvements in the product or service associated perhaps with increases in rates. Hence, where market performance is multi-dimensional it is most difficult to appraise by quantitative methods the welfare effects of changes in the market and in the firms that operate in the market.\textsuperscript{21}

The available evidence suggests that bank entry into related markets will have a favorable impact upon the performance of those related markets; however, since the direct evidence on performance relates to a market in which performance is uni-dimensional, it is only suggestive. Further, the available evidence relates to de novo entry rather than the acquisition of firms in nominally distinct markets, the focus of antitrust policy with respect to financial congenerics. Nonetheless, the limited number of antitrust cases involving even vaguely analogous situations forces one to conclude that present antitrust statutes, as clarified by case law, provide a less adequate base for charting the appropriate contours of antitrust policy towards financial congenerics.

**ENTRY INTO RELATED MARKETS BY MERGER**

A financial congeneric's entry into a new market via merger does not affect the usual measures of that market's structure.\textsuperscript{22} Nonetheless, financial congenerics' entry into new markets can be expected to affect the socio-

\textsuperscript{20} An exception perhaps to the above statement that in only one instance has serious study been devoted to the potential impact of commercial bank entry into a related market, is an August 1, 1969, report. NATIONAL ASS'N OF INS. AGENTS, THE POSSIBLE IMPACT ON COMPETITION OF BANK ENTRY INTO THE INSURANCE AGENCY BUSINESS: NORTH CAROLINA—THE ECONOMISTS REPORT (1969). This Report is referred to in the "Summary and Conclusions" of an "investigation" by lawyers for the NAIA placed in 115 CONG. REC. 10,568-73 (daily ed. Nov. 5, 1969), by Congressman Patman. As summarized, it appears that the authors of the Report failed to acknowledge the essential dynamics of market structure where resale price maintenance with free entry prevails. Accordingly, the authors' conclusions may well be invalid.

\textsuperscript{21} An analysis of the impact of financial congeneric's entry into most markets also would pose problems in quantifying market structure and changes in it. See Rosenbluth, Measures of Concentration, in BUSINESS CONCENTRATION AND PRICE POLICY 57-95 (Am. Econ. Ass'n, 1955); W. Smith, Measures of Banking Structure and Competition, 51 FED. RESERVE BULL. 1212-22 (1965).

\textsuperscript{22} An exception perhaps is the "barriers to entry"—"potential competitor" dimension of market structure. Entry by acquisition does eliminate a potential entrant, a matter of greater significance where the potential entrant is an established firm rather than a de novo organization. Hence, entry by acquisition may affect the "barriers to entry" dimension of market structure, but, at best, both the direction and magnitude of that effect are uncertain. Successful entry in itself allays some of the uncertainty for other potential entrants as to the ease of entry; hence, the elimination of a potential entrant may have the seemingly perverse effect of lowering the barriers to entry. See Hines, Effectiveness of "Entry" by Already Established Firms, 71 Q.J. ECON. 132 (1957); Osborne, The Role of Entry in Oligopoly Theory, 72 J. POL. ECON. 396 (1964).
economic performance of those markets. The behavior of firms acquired by financial congenerics is likely to be highly influenced by the banks even where the acquired firms are large relative to the banks and to the markets in which they operate. The changes in behavior of the acquired firms would affect market performance directly and by influencing the forms and nature of rivalry among all firms in the market. The relevant public policy question, therefore, directly relates to the banks' impact on the acquired firms' behavior as it affects the socio-economic performance of the market(s) served by the acquiring firm.

Let us consider separately some "typical" cases, classified by the market position of the acquired firms and the nature of the market(s) in which they operate. The cases considered here each involve oligopolistic markets, broadly defined. While not all markets that financial congenerics might enter are oligopolistic, the analytical treatment developed here should encompass the other relevant market forms. In addition, implicit in the discussion is an assumption that the markets are laterally, not vertically, related to commercial banking. The modifications of the analysis and policy conclusions necessary to encompass financial congenerics' entry into vertically integrated markets are considered in the subsequent section.

**Dominant Firm**

The acquired firm's position as "dominant firm" may stem from its preponderant market share or from the unique dynamics of rivalry within its market(s). This situation poses perhaps the least policy interest as well as the greatest ambiguity of the cases to be considered.

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23 Although taking diametrically opposite views concerning its significance, both critics and defenders of the financial congeneric movement agree that the motivation for OBHC's entry into allied financial markets stems from the profit opportunities of control and operation, in contrast to simple stock investments.

24 For example, markets which might be labelled as monopoly or duopoly may legitimately be grouped with the "dominant firm" case, while "competitive" and "monopolistically competitive" markets might, with only slight changes, be grouped with the "fringe firm" case.

25 The use here of the expression "dominant firm" is intended to denote dominant, not merely prominent. In terms of the impact of an acquisition upon a market's functioning and performance and, therefore, of appropriate public policy, the distinction is an important one. Nonetheless, the cases often are not differentiated in the antitrust literature. See, e.g., Campbell & Shepherd, Leading-Firm Conglomerate Mergers, 13 Antitrust Bull. 1361 (1968).

A classic example of a "dominant firm" is the R.J. Reynolds Tobacco Company, which perhaps four decades following the dissolution of American Tobacco Company, established the forms of rivalry within the cigarette industry. To be sure, Reynolds' unique, and successful, behavior led to a market share of 45 percent in 1923. But it is Reynolds' earlier behavior (the "Camel" revolution) and the impact of that behavior on the rest of the market that make the firm a prototype of market leader, within the context of the unique dynamics of rivalry within its markets that I wish to emphasize. See W. Nichols, Price Policies in the Cigarette Industry 35-72 passim (1951); R. Tennant, The American Cigarette Industry 70-110 passim (1950).

26 The profits — beyond, and in addition to, the return from simple stock investments — to be realized from financial congenerics' acquisitions of other firms depend upon real
The financial congeneric's acquisition of a "dominant firm" (in the above senses) can be expected to affect the forms of rivalry of firms within the market and a fortiori the total complex of socio-economic performance variables. Unlike other cases to be considered, we are not able to derive general propositions indicating that market performance would either improve, or deteriorate, as a result of the financial congeneric's entry into a market via acquisition of the dominant firm. One might expect an improvement in performance by some indices and a deterioration in performance by other norms, with the necessity of weighing the former against the latter in order to evaluate the net impact of the acquisition upon market performance.

Such evaluation of necessity requires data generated by consummation of the merger and some period of operation by the financial congeners. Even so, the requisite history would confront the appropriate authority with knotty empirical and analytical difficulties of quantifying various dimensions of market performance as well as the difficulties in establishing a weighting schema for deriving the net effect on market performance.

There are perhaps two sufficient pragmatic reasons for an antitrust program designed to forestall such acquisitions and in turn to avoid the problems inherent in assessing the impact of the acquisition on market performance. First, divestiture proceedings are socially costly and, even if nominally successful, cannot be expected to reverse history fully; management may have been shifted within the congeneric organization, some managerial or other operating functions of the acquired firm may have and pecuniary advantages reflecting, for example, joint production, enhancement of demand, or vertical integration through a monopoloid market, as discussed below. There is no reason to believe that the acquisitions of "dominant firms" per se provide exceptional opportunities for augmenting profits vis-à-vis acquisitions of firms with less eminent market positions. By contrast, the purchase prices for "dominant firms" will reflect the value of the going concern either as a monopolist or as an aggressively managed firm (for which there may be little opportunity for improving internal performance).

It is conceivable that in some cases the "facts" and nature of rivalry within the market might be sufficiently similar to those in FTC v. Procter & Gamble Co., 386 U.S. 568 (1967) (Clorox case) for this case to constitute a legal precedent for cases involving financial congeners' acquisitions of dominant firms. In most financial markets, however, promotional efforts are a less crucial element of inter-firm rivalry, making Clorox, at best, a debatable precedent for the treatment of financial congeners under section 7 of the Clayton Act, 15 U.S.C. § 18 (1964).

This is not to say that such general propositions cannot be derived for particular markets or industries that commercial banks might enter. The entry of large commercial banks into geographically distinct markets via merger, for an analogous case, has a predictable impact upon rivalry and performance. Within commercial banking, feasible behavior of the banks are constrained by size as it affects, inter alia, both the ability to acquire, train and keep specialized management personnel, and the capacity of the bank, e.g., lending limits to individual customers, and the proportion of total resources that can be utilized to acquire risk assets. As a result, larger banks are "risk takers" compared to smaller institutions in the same or geographically separate markets. The implications of these relationships are well illustrated in the district court's opinion in United States v. First Nat'l Bank, 301 F. Supp. 1161 (S.D. Miss. 1969).

As noted above, it may not be possible to quantify many of the relevant dimensions of market performance. See note 19 supra and accompanying text.
consolidated with that of other firms within the system, etc., making the reincarnation of the initially self-sufficient acquired firm impossible. Second, and perhaps of greater significance, should the acquisition not enhance market performance, an irretrievable loss in social welfare will have occurred.

Thus, an arbitrary rule for antitrust policy with respect to financial congeneric expansion would be to bar acquisitions of dominant firms in the senses outlined above. (This qualification, as the following section shows, is of the utmost importance.) However, it should be recognized that forestalling dominant firm acquisitions by financial congeners in many cases would involve relinquishing (potential) net gains in social welfare. Some consideration can be given this possibility either by the Antitrust Division of the Department of Justice’s exercise of discretion in deciding whether to contest a contemplated acquisition or by amending the antitrust laws to permit a social welfare defense in contested cases. The first may be difficult, if not impossible, to defend without a change in the law providing the Department of Justice with a mandate to consider social welfare as distinct from “restraint of trade,” “substantially to lessen competition,” and “tend to create a monopoly” as now viewed. Precedent for the second is found in the “convenience and needs” defense provided in the Bank Merger Act of 1966 and the Bank Holding Company Act of 1956.

Core Firms

Financial congeners’ acquisitions of firms in related industries perhaps are most likely to involve “core firms.” “Core firms” consist of the few—

30 "Examining old relief decrees does not carry one to ebullient heights on the efficacy of Section 7 relief." Elzinga, The Antitrust Law: Pyrrhic Victories, 12 J. Law & Econ. 43, 74 (1969).

31 One might argue that operating under the Sword of Damocles of threatened divestiture proceedings, the behavior of the acquired firm, and the resultant market performance, would not be the same as would be the case later when the firm might believe that it had survived some implicit statute of limitations. (Precisely this argument was made by the NAIA. See note 20 supra.) As a result, those charged with evaluating market performance for the purposes of possible initiation of divestiture proceedings would be given eventually misleading data. While this may be a problem, I would be more concerned about changes in the philosophical predilections, and a fortiori the weighting schema, of the evaluators.

32 Both alternatives admittedly eliminate some of the element of “certainty” provided by single valued criteria — market share “guidelines,” for example — for deciding merger cases.

33 12 U.S.C. § 1828(c) (Supp. IV, 1968); 12 U.S.C. § 1842(c) (Supp. IV, 1968). H.R. 6778 as passed by the House provides for an examination by the Federal Reserve Board of offsetting public welfare considerations, in addition to competition, when the Board must make a determination relative to bank holding companies’ “non-banking” operations. However, it is not expressly provided that the courts would employ the same criteria in judicial review of, say, acquisitions of “non-bank” subsidiaries contested by the Antitrust Division of the Department of Justice. In any event, that a social welfare argument such as “convenience and needs” was provided by Congress as a defense against the (presumption or) allegation of, and administrative or judicial determination of a lessening of “competition,” inextricably raises a question as to the purpose of the relevant “antitrust” laws.
none of which are "dominant firms" in the above senses—whose interactions collectively establish the nature and forms of rivalry and in turn performance within the market. Although of sufficient relative size to be of consequence in its own primary market, these "core firms" typically have only a limited scope of operations—i.e., a single or few product lines.\(^3\)\(^4\) Hence, the behavior of "core firms" to be acquired by financial congenerics is largely conditioned by the firms' interests in a single market. As a financial congeneric subsidiary, however, the firm's behavior in part would be conditioned by the congeneric's operations in other markets, particularly commercial banking. Furthermore, the requisite resources—financial, managerial, etc.—for implementing changes in behavior would be more readily available to (if not initially under the control of) the financial congeneric subsidiary.\(^3\)\(^5\)

Thus, the acquisition of the "core firm" again is likely to materially affect the firm's behavior in the market(s) in which it operates. Although price may be affected, the principal avenues of change are likely to be of a "service" or product attribute nature. Depending on the market(s) involved, the changes may be reflected in new terms, a tailoring of terms to meet customer requirements, provision of services not previously provided as a part of transactions (the acquired firm, for example, may be able to supply services performed by other members of the financial congeneric complex), etc.\(^3\)\(^6\) All such changes, of course, are designed to gain customers, but as they also signify a preferable package to individual, and groups of customers, such changes are not empty frills. The relevant policy question is whether the resultant change in the nature and forms of rivalry within the market can be expected to provide a socially preferable complex of socio-economic performance variables.

The expanded total complex of socio-economic performance variables in the market following the financial congeneric's entry into related markets by merger would include the initial complex of performance variables.\(^3\)\(^7\)

\(^3\) The latter attribute is not a definitional characteristic of "core firms," but, rather, what seems to be an empirical property of the majority of firms in related markets acquired by banks and by financial congenerics. For purposes of the present argument, it is necessary only that the sphere of interests bearing on the firms' behavior of the resulting complex be materially different from that of the acquired firms.

\(^4\) The point here is in direct conflict with the contention by Campbell and Shepherd that if a leading firm in a concentrated industry is acquired by a firm with significant market power in another industry; this will probably... reduce the scope and intensity of competitive activity, by increasing the leading firm's ability to threaten or sustain competitive strategies. Campbell & Shepherd, supra note 25, at 1371.

\(^5\) The significance of a more comprehensive package of services in particular is bitterly contested by detractors of the financial congeneric movement who see this ability of the financial congenerics in terms that range from "unfair advantage" to "illegal tie-in sales" to "coercion." See 115 CONG. REC. 10,492-514 (daily ed. Nov. 4, 1969); 115 CONG. REC. 10,544-75 (daily ed. Nov. 5, 1969); and, for a less polemical, and often favorable, discourse, Hall supra note 1, at 83-88 passim.

\(^6\) For purposes of discussion of the present case—financial congenerics' acquisitions of "core firms"—it is a sufficient, but not necessary, assumption that (at least a substantial
The entry of financial congeneric into related markets by acquisition of “core firms” therefore must be viewed as socially desirable.

Before one can establish that antitrust policy should be totally permissive towards a financial congeneric’s acquisition of “core firms,” one must consider whether there are preferable alternatives from a social welfare point of view. That is, would acquisitions of “fringe firms” by financial congeneric have a more pronounced impact on market performance? In the next section, the relative merits of acquisitions of “fringe firms” and de novo entry are considered.

The effect of financial congeneric’s acquisitions of “core firms” on market performance may well be direct and immediate insofar as established customers of the acquired firm are concerned. The effect of the acquisition of a “core firm” would be felt throughout the market as other firms react to the financial congeneric affiliated firm’s changes in policies. How soon depends upon the nature of changes in behavior by the financial congeneric affiliated firm and the (perhaps new) dynamics of rivalry in the market. Unfortunately, while temporal magnitude of “sooner or later” is significant, it is not possible to quantify the time involved, at least in a general case.

38 In recent bank merger cases, the Antitrust Division of the Department of Justice has contended that where a less “anticompetitive” solution is available—say, as an alternative to a particular bank merger advanced to “solve” management problems—the courts should bar the merger proposal at hand. The treatment of (1) the internal, usually managerial, facets of bank mergers; (2) the “competitive” impact of bank mergers; and (3) the “convenience and needs” benefits to the communities affected resulting from the mergers, as separate and distinct phenomena does not seem to me to be a legitimate taxonomy. (Admittedly, the Bank Merger Act of 1960, 12 U.S.C. § 1828 (Supp. IV, 1966), and the Bank Merger Act of 1966, amending 12 U.S.C. § 1828(c) (Supp. IV, 1966), appear to dictate such separations, but the legislative record often suggests a confusion of, and a less sharp demarcation of, these facets of bank mergers.) Management in part determines the behavior of the firm and, in turn, the competitive impact of a merger. Moreover, “convenience and needs,” whatever else the term might denote, clearly has performance dimensions that, in all models of markets, reflect an interaction of firms—be it called competition, conduct, behavior or rivalry. Even the most naive models of markets rely upon a behavioral assumption to derive the effect of structure upon performance. Moreover, it is only in the most naive model employing particular assumptions as to cost functions, to demand functions, to behavior of one and all firms, that there is a unique connection between market structure and performance. Regrettably, it is this model that underlies the Antitrust Division’s approach to, especially, bank merger cases.

39 Ordinarily there would be some inertia in policy during a transition period following the acquisition and perhaps a short delay in the initiation of major changes in policy. In any event, not all eventual policy changes would be made immediately, as the congeneric affiliated firm would react to the changes in behavior of other firms as the latter responded to the changes initiated by the former.

40 Among the many relevant considerations are: (1) the time period covered by individual transactions, e.g., short- or long-term contracts, or “spot” sales; (2) the frequency...
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Nonetheless, in comparison with acquisitions of fringe firms (and de novo entry), the effect of the acquisition of a “core firm” would be pronounced and immediate. Hence, in assessing “core firm” acquisitions vis-à-vis “fringe firm” acquisitions, the anticipated public benefits stemming from “fringe firm” acquisitions should be more heavily discounted.41.

**Fringe Firms**

Is de novo entry by financial congenerics into related markets socially preferable to entry by acquisitions of “fringe firms”—firms without individual effect on the nature and forms of rivalry in a market due to small relative size42 or lethargy43? It might be argued that acquisitions of “fringe firms” also necessitate a positive defense if the often empirically precarious assumptions are granted that all acquisitions eliminate a competitor, actual or potential—but however remote—and that acquisitions are initially void of the salutary effect of increasing aggregate industry capacity.

By definition, acquisitions of “fringe firms” per se would not have a deleterious effect upon the rivalry within, and performance of the market(s) involved. The crucial policy question therefore is the desirability of acquisitions of “fringe firms” relative to de novo entry, say, at a comparable scale.44 Again, by definition, if de novo entry is on a “fringe firm” scale,

of purchase, e.g., repetitive or one-time purchases; (5) the nature and extent of crucial non-price variables; (4) the importance of specialized labor inputs and the time required to train or pirate such personnel; and (5) the (closely interrelated) degree to which capital goods such as computers can augment, or be substituted for, specialized personnel. A knowledgeable student of the industry with concerted study and analysis, of course, could probably derive some well reasoned estimates as to the time involved. Of necessity, such estimates would depend upon the analytical framework employed and the buttressing data utilized, drawn both from the particular industry’s history directly and from the experiences by analogy.

41 One objective of discounting might be to choose the market changes providing the greatest present social value of the benefits, a procedure dependent upon a confident forecast of the future. A more compelling rationale for discounting is found in the circumstances engendering the financial congeneric movement. As noted earlier, the environment in which banks operate (in part, the related, competitive markets—financial and otherwise) has been changing rapidly over the past few years and one can expect this change to continue and if anything, at an accelerated rate. It is surely not an enlightened public policy that opts for future benefits in markets that may have atrophied by the time that “future” arrives.

42 It is not possible to specify a priori the maximum relative size of a “fringe firm.” The maximum relative size would depend upon, inter alia, demand elasticity and flexibility of the scale of production (individually and collectively) of firms in the industry; thus, the maximum relative size of a “Fringe Firm” is small where demand is more inelastic, and production becomes more inflexible.

43 This, of course, is not to say that “fringe firms” collectively do not affect rivalry within, and performance of a market. See Arant, *Competition of the Few Among the Many*, 70 Q.J. ECON. 527 (1956); Wellisz, *The Coexistence of Large and Small Firms: A Study of the Italian Mechanical Industries*, 71 Q.J. Econ. 116 (1957).

44 It is sometimes contended that merging firms bear, or should bear, the burden of proof in demonstrating that a proposed acquisition has net socially beneficial results. However, even the most zealous “trust-busters,” who tend to presume all acquisitions undesirable until demonstrated otherwise, ignore—due to priorities, a lack of resources, and perhaps a lack of judicial standing—“trivial” cases. Accordingly, I also dismiss this contention as being of little pragmatic concern.
it would not have an immediate impact upon rivalry within, and performance of the market. The issue a fortiori turns on the time-path of, and possible ultimate differences in, the influence of the different methods of entry upon the rivalry within, and performance of the markets involved.

Entry into, and growth within new markets — whether by established or de novo organization — inevitably involves pecuniary and temporal "start-up" costs. The possible private pecuniary advantages, if any, of entry by acquisition are largely, if not totally, irrelevant socially. However, where highly specialized and experienced labor, other limited specialized resources, fixed licenses and so forth are absolutely mandatory for entry, acquisition may be the only route by which the composition of firms within an industry can be modified (i.e., the private pecuniary costs of de novo entry are "infinite"). The principal social advantage of entry by acquisition in most cases would be from the diminution in temporal "start-up" costs. The extent of the reduction in lags would depend upon the characteristics of the industries and firms involved, with the relevant factors including, *inter alia*, the extent to which required resources can be transferred from established operations, the lead-times for training or manufacture of specialized resources, the difficulties in obtaining licenses (if necessary and available), and the nature of any specialized promotional and marketing problems. Further, in almost all cases, de novo entry would involve an appreciably longer "shake-down" period than would be true of entry by acquisition.

In many cases, the time required for financial congnerics to enter related markets de novo will be markedly greater than that for entry by acquisition, and in some cases de novo entry may be absolutely blockaded. To be sure, the time required for de novo entry by financial congnerics perforce would be less than for many other potential entrants. However, the pecuniary and temporal costs of ultimately achieving a market position of influence on rivalry within, and performance of, a market are crucial, unlike those of entry on an irrelevant "fringe firm" scale.

Any diminution in time required for entry on a "fringe firm" scale permits *pari passu* a comparable diminution in time required to achieve a market position of influence on rivalry and performance. Moreover, financial congnerics, as relatively large established organizations, can transfer already controlled, or acquire (often more readily) resources required for expansion. Indeed, it is likely that the comparative advantage of financial congnerics will often be, depending upon the industry and organization involved, in expansion of scale rather than in entry per se.

Even though all firms within an industry would qualify as "fringe

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45 It should be recognized that the private pecuniary advantages of entry by acquisition (where the entering firm's financial resources are limited and capital markets are less than perfect) may permit, for example, modifications in behavior of and expansion of scale by the acquired firm. While social benefits would stem from private advantages in this event, the argument is neither necessary nor sufficient to establish the desirability of an acquisition, except perhaps in exceptional cases.
firms" (an industry similar to, though not necessarily equivalent to the “competitive” industry of economic theory), the optimum scale for a financial congeneric may be larger than that of independent “fringe firms.” In such cases, the initial effects of financial congeners’ acquisitions would be limited to those stemming from advantages of integration. These advantages may stem from economies of scale or joint production in a stage of production in an activity common to both industries.46

If the financial congeners’ optimum scale of operations is drastically larger than that of independent “fringe firms,” it is conceivable that entry into that market by financial congeners would lead to a break-down in the prevailing market structure, leading perhaps to an “oligopoly” or “monopoly.”47 In this event, the anomalous result is a price determined in an “oligopolistic” or “monopolistic” market that is lower than the initial “competitive” price, with the latter serving as an upper limit on the former. For a contrary result, it is necessary that barriers to entry be raised for firms that might potentially enter as the independents initially operated.48 Such barriers to entry, resulting from the change in market structure or from the nature of rivalry, that develop within the market might be, so it is implied, a denial of credit, product differentiation, or full-time forcing. None of the latter possibilities, despite their polemical merits, approach the plausible. For them to prevail, unlawful collusion aside, it would be necessary (a) that all credit suppliers were operating subsidiaries in the instant industry, (b) which necessarily denies the required level of product differentiation, and (c) that the dearly held and vigorously enforced prohibitions against full-time forcing be discarded as dead letters.

CONCLUSIONS

The proper stance for “antitrust”-type policy towards financial congeners can be best labeled “sympathetic,” in contrast to either “permissive” or “restrictive.” The social costs of a permissive policy towards “dominant firm” acquisitions in some (but not necessarily all or even most) cases may be substantial, and the remedial problems encountered in such cases may be insurmountable. A restrictive policy towards “core firm” and “fringe firm” acquisitions most frequently would substantially delay if not deny the

46 While equilibrium in a competitive market requires increasing costs to the firm, this does not preclude unexploited economies of scale in one of many stages of production, i.e., increasing costs for the firm may reflect indivisibilities or decreasing returns to scale in only one or a few of many vertically or laterally related stages of production.

47 This result depends upon a shift in scale, not merely a reduction in the level of costs. To be sure, if costs are merely lower through some range of output without a concomitant drastic shift in the optimum scale of operations (at prevailing product and factor prices), the financial congeners entering the market would realize profits analogous to “rent” in economic theory. However, this would not dictate the above changes in market structure.

48 It is irrelevant that such potential entrants would suffer cost disadvantages vis-à-vis financial congeners, i.e., that they realize only a competitive rate of return whereas the financial congeners realize a higher return.
salutary effects of rivalry from firms with different behavioral motivations and the resources to influence market rivalry and performance by acting upon those motivations. It is not possible to defend, as a basis for decisions to permit or forestall particular acquisitions, per se rules based on specific market shares of acquired and acquiring firms, and thereby ignore the nature of rivalry within the affected markets and the impact of the acquisition upon rivalry and social performance.