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CONGLOMERATES: ANOTHER WAVE OF BUSINESS DEVELOPMENT OR THE BEGINNING OF A NEW ERA?

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A student of the history of business will be amazed to find how many times and for how many different reasons, the amalgamation of smaller business units into larger ones through mergers and acquisitions was the order of the day. He will find many different motivating factors — from political to economic, from sociological to technological. However, he will soon be aware of one fact transcending all the succeeding waves of business accumulations and mergers: that their motivating factors were relatively easy to recognize, easy to understand, and, consequently, clearly accepted as justified in the period when they occurred or very shortly thereafter.

Indeed, as with most other human developments, there are always a select few who can see emerging needs and new possibilities and take action on them before the rest of us become aware of the same needs and accept them as logical developments. The big merger movements of the past, particularly in our modern economic history, were all clearly defined and understood very shortly after their start and immediately related to the most visible and most logical motivating factors as their correct and complete justification.

Another aspect of these merger movements stands out very clearly. In most cases they related to a certain segment of the economy, to a particular industry which shortly before saw large proliferation of small enterprises and because of the interest in the final product, major technological developments justified or necessitated amalgamation and merger of units. Later on, the evolving larger and broader markets had the same effect on non-industrial activities, such as distribution, or even agglomeration and merger of the economic enterprises supplying the resources, whether they were natural or financial.

The unique quality of the merger wave which started in the late 1950's and really took its major strides in the 1960's, is that the clearly visible material and technical motivations of the earlier merger waves cannot be identified in the present movement. Further, our legislation has long provided ample protection against horizontal amalgamations which possessed the capacity to destroy market competition. Lacking a positive explanation for the present wave, it was an easy "out" to believe that the impossibility of horizontal mergers and restrictions against vertical combinations are the justification or the reason for "conglomeration." Indeed, when we use this

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word "conglomeration," we practically admit that we mean mergers for which the reasons are surely not clear, and in most cases, hardly understandable.

Is this really so? Could it not be that the dynamics of our economy and society produce conditions and needs to which we must respond? Over the ages, the various forms of human association are continually evolving and changing, but there is one such form which outstandingly is subject to change and, in fact, finds its justification in change. That is business. Business is the only human institution which can survive only if it caters to tomorrow instead of trying to preserve yesterday. Since its performance is clearly measurable in terms of profitability, which depends, in turn, on the continuation of such performance, business must and will change to capture tomorrow's profit.

In the earlier merger movements, tomorrow's profit was clearly defined by motivations which were both recognized and accepted. These motivations were lucid because they all referred to the material aspects of the business involved. When we see today 15 completely different, unrelated segments of medium or small sized businesses gathered into a single new conglomerate, it is evidently a puzzling experience, defying understanding under the historical experience factors.

On the other hand, more than ever before, the investing public became deeply involved with the problem of this new and poorly understood phenomenon. Since specific areas of business were used to determine where a certain company's activities belonged, and indeed, are still used by most of our statistical and regulatory agencies, the investing public and its advisory services became accustomed to this method of handling and appraising the economic functions of business enterprises. Suddenly, the new conglomerates defy any such classification. How do we analyze something if we neither know nor understand either its activities or its reasons for existence? Although we are unable to categorize, analyze, or visualize them without utilizing the customary calibrators, conglomerate mergers do occur — many thousands of them — with the typically mixed results of new developments: very successful ones, less successful ones and the ones which are doomed to failure. There are nearly as many justifications and explanations as there are mergers. For their methodology or lack of it, there are theories by the dozens — simple ones and highly questionable ones.

Even if we are unable to attain an understanding of the new conglomerates, our next step is to determine their justification. We begin by analyzing a number of the old, established, large companies, suddenly discovering that they are indeed conglomerates, in the sense that they are engaged in a great number of completely unrelated or only remotely related activities. Quite arbitrarily, we then attempt to distinguish between the so-called historical conglomerates, *i.e.*, companies which conglomerated and expanded over a long period of time, and the new conglomerates. We also discuss highly centralized, completely decentralized, management sup-

ported, or financial conglomerates. Again, there are a myriad of theories and opinions available.

When some of the new conglomerates prove to be unprecedented, rapid successes, extraordinary enthusiasm is created, thereby benefiting all diversified companies. Conversely, when unexpected downturns, failures and errors occur, they produce tremendous disillusionment which is just as erroneously contagious as the previous excess of indiscriminate enthusiasm. A host of new theories and so-called explanations emerge, the worst of which involve allegations of deception and abuse of accounting principles, until finally there develops a credibility gap affecting all conglomerate companies. Congressional and other forms of governmental investigation become the fad of the day, along with myriad demands for new regulations, and so on.

What seems to be peculiar, however, is that in spite of this outcry for investigation and regulation, there does not appear to be any accepted definition of the type of business phenomena we want to investigate or regulate — nor any meaningful criteria by which we should be guided.

Since we are accustomed to quantitative definitions, it is simple to talk in terms of bigness and the dangers assumed to be inherent in bigness. Again, however, it is not an easy task to define bigness. Where does it start? Wouldn't bigness be defined very differently according to the constituent elements? How can we define absolute sizes if we do not know how relative sizes interact?

Leaving, for a moment, the products of the new conglomerate wave, let us examine the daily plight and problems of individual businesses, small and large. A relatively recent problem, introduced into our economic life more by political than by other considerations, involves the shortage of money. Even more discussed, however, is the shortage of skilled labor, of middle-management and — most critical of all — responsible, talented, upper middle- and top-management prospects. Peculiarly, these shortages of human talents are not concentrated in any one sector of any one industry. The highest quality specialists in any given field are easily discerned, but "generalists," *i.e.*, top managers, are acutely lacking. In view of all our new business schools and the tremendous number of people we educate in them, one may well question how this is possible. The only answer which seems logical is that the growth in the number of people who are becoming producers and consumers is outstripping the development of the upper-echelon businessmen needed to conduct the expanded businesses required to meet these needs.

In addition, there has been much discussion (although admittedly not recently) about automation taking over to the detriment of the labor force. More recently, however, we have begun to realize that automation requires a more highly educated, more skilled labor force to handle the most automated, and consequently, the most complicated, highly developed, technologically perfect machinery. We had presumed that much of our managerial

responsibilities would be assumed by the computer and computerized business management. To our surprise, we now realize that the higher the level of the computers to which we address ourselves, the more capable human managers we need to effectively utilize the computer's capability in the management of our daily affairs. Thus, despite the fact that computers are available, we have found it nearly impossible to man them, and consequently, to make them serve the purposes for which they were developed.

Our social developments have also imposed awesome demands upon business (and justifiably so), resulting in a multitude of legislation affecting every aspect of our daily economic activity. A recent study by one large organization revealed that in a not really too large company, the number of forms and reports requested to be filed with governmental or government-related agencies amounted to more than 3,000 a year. It is a guess, but probably a modest one, that 20 percent of managerial and clerical effort is expended in satisfying legal requirements. And it is becoming even more difficult to develop or retain an understanding of such requirements.

We attempt to grapple with the complexities of the modern business world by delegating work in small portions to many more people. This creates another, ever increasing pressure on our profit margins, as well as our ability to produce and move; more and more administrative detail is suffocating our productive economic activities. Inevitably then, along with the many other pressures on our profit margins, we are creating one more.

Thus, by examining our only clear measuring device in business, which is profitability—the return on our capital—we find diverse but unmistakable signs of diminishing returns on capital investment. We accepted in the last decade the tremendous proliferation of mutual funds as the individual investor's short-cut to capital appreciation. Since we accept the fact that even the clearly understandable, single-purpose companies are numerous and complex, we can abdicate our individual right of judgment and understanding to the mutual fund manager. The realization of this by the manager of an enterprise whose profitability will influence the mutual fund manager to invest or not to invest, creates a very normal question. Why shouldn't the individual business manager try to seek diversity and profitability by channeling available resources into the most profitable part of the enterprise? If he subsequently discovers that he does not have the necessary diversity under the given conditions, and that further agents are needed to assure the best return on capital, one can already envision the birth of a future conglomerate leader. Add to this the realization by the same person of the scarcity of managerial talent and the absolute need for superlative capability in every segment of the business, whether it is research, production, distribution, marketing, the use of computers, plain business management, or competition for the capital dollar—all talents in admittedly absolute short supply—and that vision becomes much more lucid. Perhaps these realizations could provide us with a better understanding of the motivation of and justification for a conglomerate.

There has recently been extensive discussion of business decentralization. It is no coincidence that the conglomerate form, by its very nature, must be a decentralized business. Talents are rare, and they must be kept where they can best produce. Thus, a modern conglomerate, with its completely decentralized structure of profit centers and completely centralized support and control functions, serves a useful purpose. What would be impossible for the individual profit producing economic unit is much easier and much more economical for the parent company, which is better equipped to effectively utilize the scarce general management talent. It is really not the economic factor of lower costs that has created this new phenomenon; rather, it is simply the scarcity and unavailability of managerial talent that has created the need to merge, so that many independent economic units can take advantage of the limited supply of top flight managerial talent.

There are many other factors that have contributed to the rise of conglomerates — *e.g.*, whether assets are being used for optimum, minimum return, over- or under-valued stock market conditions and many others.

We can not reasonably argue a case for all conglomerate companies as a class, any more than we could for all steel or all cement companies. We enjoy no license for survival. Whether we do, as individual companies or as a type of business structure, will depend on our ability to define properly our aims, purposes and reasons for existence in a changing society. If our present times are undergoing a dramatic change from a materialistic society towards one which is concerned essentially with man and his relation to others, as well as to the material elements, then the "conglomerate" may be the form of business which was originated and developed because of these general sociological changes. Basically, a conglomerate could very well represent these much more subjective and human-related trends as an excellent and productive motivating factor in business easier than the historical, centralized, single-purpose business entity. However, it is up to the conglomerates to prove that the case is so. And a mere exhibition of historical profit performance will be insufficient. Instead, numerous soul-searching definitions, as well as basic agreement on form, purpose and methodology will be required. Accordingly, if a conglomerate, to have a real right of survival, desires to oppose a monolithic historical business form with a very coherent but much more subjective and interrelated system, as the new business unit, it will have to establish its own rules, its own disclosure methods and, in effect, its own code of ethics (which will be its own code for survival).

Individual human excellence, which can give rise to great movements and institutions, represents a tremendous initial power; however, in our society, which is definitely a system, and not a monolithic society, only individual creativeness which can involve, motivate, and gain full participation from the system which it creates, will survive. The prerequisite of the business of tomorrow seems to be a system in which the most de-

sirable individual responsibility and creativeness coordinate and attempt to both achieve and more effectively advance human aims which are not measurable by profitability alone.

It is submitted that if the type of business which may exist behind the nameless and really undefined facade of "conglomerate" is the new type of business of our future society, then it will have the power to express itself and make itself understood. If it is really an individual-centered system of interlocking and sustaining human relations, as contrasted to the historical monolithic business empires, it should also have the ability to communicate these facts. It should be able to dramatize its advantages and its identity of purpose with our social evolution to the individual investor as well as to the individual working for the company. The following comparison demonstrates the potential difference in human management between the monolithic business and the evolving new form:

SUMMARY OF THE MANAGEMENT METHODS TO WHICH WE ASPIRE

Usual Way— for us the OLD WAY	OUR NEW WAY
1. Authoritarian planning: "Central Management" makes plans, budgets, forecasts.	Cooperative planning: Planning and budgeting is decentralized as much as possible. Staff fully participates but line has last word and responsibility.
2. "From the Top" management: Staff sets goals, controls, checks.	"From the Roots" management: Line develops the goals, self-controls, checks.
3. Exaggerated requisitions and forecasts: Request twice as much as you need — predict half of what you can produce.	Non-bargaining allocations: Costs are mutually arrived at and requests reflect actual needs and economically supportable, long range improvement planning and forecasting.
4. Line-staff conflict: All line-staff contact a competitive, win-lose clash.	We win — you win: Line is responsible; its judgment prevails, while staff serves and supports. Both aim for common goals, sound growth, and qualitative-quantitative improvements.
5. Line fights the system: System imposed by staff to suit its wishes; line tries to beat it.	Line needs the systems: Staff offers innovative, professional support. Line and staff agree on best.
6. Minimum supplementary education.	Maximum education: Greatest help possible in meeting new standards, ever higher goals.
7. "Bargain Counter Theory": How little can we pay?	What is the MOST a man can make — and be more valuable to company?
8. How far can we go and get away with it? Line personnel in informal conspiracy to outwit accounting.	Self-controlled expenses: Line profit responsibility and participation creates self-control and absolute intra-structural honesty.
9. Secret financial data: "What you don't know won't hurt you."	Fullest disclosure of any information that affects individual's area of concern, or over which he exercises control, as well as to our outside partners-shareholders.
10. Damn the shareholders — they are all outsiders.	We own our company and work for ourselves as well as our public-owners, who share our confidence in our company.

Basically, we are all living a great experiment; so are we in this new business methodology. New experiments are great and exciting events. We know already that we have another sure measure of our effectiveness, compared to the historical business form. This measure of effectiveness is not only profitability, but the allegiance, support and the individual satisfaction and happiness of the people comprising the new type of business, as well as the acceptance by the public, and the consequent human and economic success of the organization.

part



**FINANCIAL
DISCLOSURE:**

Accounting and
Securities Considerations

