St. John's Law Review

Volume 44
Issue 2 *Volume 44, October 1969, Number 2*

Article 2

December 2012

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ANTITRUST POLICY AND THE CONGLOMERATES

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I. Definition

The conglomerate firm may, for working purposes, best be defined as one involved in the production, distribution and/or sale of goods or services that have no direct economic relation to one another.[1] A conglomerate merger, then, is one which brings together two (or more) firms into a diversified business entity.[2]

By definition such a firm, whether it be the result of internal growth, *i.e.*, entry into alien markets without acquisition, or merger, cannot have available to it most of the efficiencies usually cited as an advantage of size. There can, it would seem, be no manufacturing economies of scale in the traditional sense; nor can such entities be justified, for example, primarily on the ground of permitting fuller utilization of distribution or sales networks. This is noted so that focus can be more clearly directed at the advantages conglomerates may provide.

II. The Data

First, the public policy controversy surrounding conglomerates has been cast in terms of the competitive impact of conglomerating *mergers*, not of conglomerating via internal expansion. Second, in 1968 these mergers accounted for 84 percent of the number and 89 percent of the assets of all recorded large (over $10 million in assets) acquisitions.[3] Finally, as Richard W. McLaren, Assistant Attorney General, has noted: "The rules with respect to horizontal and vertical mergers

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This article is based upon remarks delivered at the McDonnell & Co. Institutional Research Conference, June 30, 1969, New York.

1 The term "conglomerate" will not be used here in what has been described as "a strongly pejorative sense — to suggest wide or narrower meanings." *See* Address by Robert W. Haack, *Takeovers and Tenders: A Stock Exchange Viewpoint*, National Conference of The American Society of Corporate Secretaries, San Francisco, June 17, 1969.

2 One observer has noted that the word "diversification" has the same root as the word "diversion," which latter word carries the following dictionary definition: "the act of turning a person aside from this course; that which relaxes and amuses; a sport or pastime." Cramston, *Diversification of Ownership in the Regulated Industries — The Folklore of Regulation*, 68 Pub. Util. Fort. 456 (1961).

3 Bureau of Economics, FTC, Statistical Report No. 3, Current Trends in Merger Activity, 1968, at 3, 10 (1969) [hereinafter cited as Statistical Report].

are rather generally known and occasion little comment."[4] Commentators on mergers are thus left with conglomerates on which to ply their trade.

There can be no doubt that the level of merger activity in the recent past has been at an all-time peak. The Federal Trade Commission reported 4,003 mergers in 1968, as compared with 2,384 a year earlier and 1,345 in 1960.[5] And these figures are by no means dominated by minor acquisitions or insignificant acquirers. In 1968 almost 200 industrial firms with assets in excess of $10 million each — with assets aggregating some $12.6 billion — were acquired. And the 200 largest firms accounted for seventy-four of these large acquisitions, with aggregate assets of almost $7 billion.[6] It has been estimated that the value of assets acquired as a result of sell-outs by firms in the $19 million-plus asset category may reach $18 billion in 1969, about fifty percent above the 1968 level.[7]

Whether this level of merger activity is troublesome or not depends very much on the frame of reference of the observer. If one is concerned with the traditional problem of concentration in specific markets, these aggregate data are uninformative: they tell us nothing about concentration and, presumably, the effectiveness of competition in the steel, cement, textile or any other industry. If, on the other hand, one's focus is the aggregate level of concentration of industrial assets — what has been termed "super-concentration" — these figures are cause for alarm. Our Attorney General sees in them a threat to "our economic, political and social structure":

> Concentration of this magnitude is likely to eliminate existing and potential competition. It increases the possibility for reciprocity and other forms of unfair buyer-seller leverage. It creates nationwide marketing, managerial and financial structures whose enormous physical and psychological resources pose substantial barriers to small firms wishing to participate in a competitive market.
>
> And, finally, super-concentration creates a "community of interest" which discourages competition among large firms and establishes a tone in the marketplace for more and more mergers.[8]

[4] Address by Richard W. McLaren, *Current Antitrust Division Policy on Mergers, Acquisitions and Joint Ventures*, Town Hall of California, Los Angeles, May 27, 1969, at 6 (mimeo).

[5] STATISTICAL REPORT, *supra* note 3, at 8.

[6] *Id.* at 12.

[7] Address by John N. Mitchell, Georgia Bar Association, Savannah, Georgia, June 6, 1969, at 3 (mimeo). *Business Week* has a somewhat contrary view, noting that a combination of threatened tax code revisions, declining stock prices, tight money and high acquisitions has caused a slowing in "the pace of the more spectacular, conglomerate-type mergers. . . ." BUS. WEEK, June 21, 1969, at 35.

[8] Mitchell, *supra* note 7, at 4.

An appraisal of this view follows, but it should first be noted that it is most difficult to place these data in perspective. On the one hand, it has been pointed out that acquired assets of large firms were equal in amount to 44.6 percent of new plant and equipment expenditures in 1968, as contrasted with about fifteen percent in most earlier years.[9] On the other hand, the 4,000-odd business corporations that disappeared by merger during 1968 has been termed

> a small number compared with the twelve thousand that disappeared by failure, or the two hundred and seven thousand new corporations formed. Even the forty-three billion dollars in securities exchanged in mergers that year was less than four per cent of the market value of corporate securities.[10]

Even the "super-concentration" data lead different skilled observers to different conclusions. The Attorney General notes that the share of manufacturing assets controlled by the 200 largest industrial corporations has risen from forty-eight percent to fifty-eight percent since 1948, and concludes that this poses a "danger."[11] But the Presidential Task Force on Antitrust Policy cites the rise to fifty-eight percent from fifty-five percent since 1957 in support of the view that "concentration of aggregate economic activity . . . has changed only slowly over time."[12]

The guidance offered by these aggregate data in formulating policy toward conglomerates is, in any event, unclear. For nowhere has it been shown that mergers in general, or conglomerate mergers in particular, have substantially contributed to any trends which may exist.

III. CAUSES

One fundamental cause of the wave of mergers in general, and of conglomerating mergers in particular, is a change in the view of the managerial function. There is a rising school of thought which holds that business experience in a specific field is a less important ingredient of success than general intelligence and managerial skill. Backed by the rising usable capability of computers, increasingly well-trained business managers feel themselves specialized in techniques with broad applicability: capital budgeting; personnel administration;

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9 The figures for 1960-68 were: 11.1%; 14.5%; 13.9%; 17.4%; 14.2%; 16.4%; 14.4%; 29.2%; and 44.6%. STATISTICAL REPORT, *supra* note 3, at 17.

10 Jacoby, *The Conglomerate Corporation: Monster or Model of the Future?*, THE CENTER MAGAZINE, July 1969, at 43.

11 Mitchell, *supra* note 7, at 4.

12 1968 PRESIDENTIAL TASK FORCE REPORT ON ANTITRUST, 115 CONG. REC. S 5642 (daily ed. May 27, 1969) [hereinafter NEAL TASK FORCE REPORT].

management systems. Their capabilities are, they feel, usable across traditional industry lines.[13] From this it follows that a well-managed firm should be able to apply its skills to improve the performance of any firm it may acquire. Two caveats are worth examining in this regard: first, whether this theory is consistent with the theory that existing management must be retained if a merger is to be successful; second, the extent to which this view of the transferability of management assumes the existence of excess managerial capacity in the acquiring firm.[14] But consideration should also be given to the question of whether one's views concerning the correctness of this theory of management are relevant to the formulation of antitrust policy, particularly if market forces provide correctives.

A second factor which has been responsible for many mergers, and one which may temporarily be dominant, involves a combination of stock market and tax considerations. High multiple companies can offer extraordinary attractive capital gains deals, particularly to otherwise locked-in owners of closely-held corporations; they can, apparently, transfer their multiples to the earnings of less well-regarded companies by what one observer has termed "the chain-letter effect";[15] tax-deductible interest payments can be substituted for dividends (which must come from after-tax earnings) to permit take-overs at little or no cost to the acquirer. It would appear that a combination of stock market conditions, tightened regulation by the New York Stock Exchange,[16] and tax code revisions will act to reduce the influence of these factors.

A third set of forces, closely related to the second, might be termed financial factors. It has long been recognized, even by those suspicious of the consequences of increased concentration and business size, that the superior access of large firms to the capital markets is a "genuine economic saving."[17] In addition, conglomerates often view potential acquisition candidates as sources of cash and borrowing power. Cash-rich, debt-free companies become take-over candidates for that reason alone. But keep in mind that the basic reason these companies find themselves in such a position is their failure to find growth opportunities which would employ that untapped financial strength, and a disinclination to return these funds, in the form of dividends, to the

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13 In this connection see Jacoby, *supra* note 10, at 45.

14 See my earlier statement on economic concentration, *Hearings on S. 2560 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 88th Cong., 2d Sess., 181-204 (1964).

15 Burck, *The Merger Movement Rides High*, FORTUNE, Feb. 1969, at 81.

16 *See* Haack, *supra* note 1, at 7-8.

17 G. W. STOCKING & M. W. WATKINS, MONOPOLY AND FREE ENTERPRISE 76 (1951).

stockholder-owners of the enterprise, *i.e.*, to people who might *themselves* find alternative investment outlets for these funds.

A fourth force behind conglomeration is the ever-present desire to reduce business risk, particularly that arising from broad long-term changes in market demand. Certainly, recent acquisitions made by cigarette manufacturers have been the result, in part at least, of a desire to hedge against possible secular declines in demand for cigarettes.[18] There is no question that the economy has seen and will continue to see different products rise and fall in consumer favor. For this reason diversification into multiple-product lines does promise a reduction of risk in the sense of reducing the exposure of the firm to shifts in consumer tastes.

A final cause of conglomeration is to be found, paradoxically, in antitrust policy, at least as it was conceived prior to the current change by Mr. McLaren. A survey recently conducted by National Economic Research Associates revealed that many businessmen felt that the then-existing merger guidelines of May 30, 1968 severely limited their ability to consummate horizontal or vertical mergers, but did not so restrict conglomerate mergers.[19]

IV. Public Policy

The public policy controversy surrounding conglomerate mergers must be divided into two broad areas — traditional antitrust considerations and broader socio-economic problems.

The antitrust problem associated with the traditional merger case — increased concentration of a share of a definable market — is almost non-existent. A conglomerate merger, by definition, does not increase the market share of the acquiring firm. Perhaps the only real dangers are (a) reciprocity and (b) subsidization.

There is no question that diversification enhances the possibility of reciprocity. But neither is there any question that reciprocity is now a widespread practice (although probably declining on a formalized basis),[20] and one which can be dealt with without preventing the mergers which create the potential for reciprocity. In fact, *if* it is reciprocity which the Justice Department fears, it will also have to prevent diversification via internal growth, *i.e.*, via new entry into various markets.

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[18] There is also a desire, if possible, to reduce risks incident to cyclical fluctuations specific to an industry. *See* G. E. HALE & R. D. HALE, MARKET POWER: SIZE AND SHAPE UNDER THE SHERMAN ACT 266 (1958).

[19] *See* National Economic Research Associates, *Corporate Reaction to the Merger Guidelines*, June 1969. *See also* NEAL TASK FORCE REPORT, *supra* note 12.

[20] Mitchell, *supra* note 7, at 9.

But this it does not wish to do. Consequently, it should, to be even-handed in the matter, take steps against the practice — reciprocity — and not the mergers which, like internal growth, create the potential for such a practice. And the Justice Department's belief that reciprocity as a practice can be deterred without dissolution of the diversified enterprise itself is reflected in its willingness to enter into a consent decree to that effect with U.S. Steel. In fact, we again find a curious dichotomy in antitrust policy. The slightest suggestion of potential reciprocity brings a move against a conglomerate merger. But at the same time the Justice Department sees no such danger inherent in one-bank holding companies — this in a period of tight money and, in many states, interest rate ceilings.

The second specific danger is that of subsidization. Professor Neil H. Jacoby has cited the following as one of "several types of gains from mergers [which] are, at least potentially, of value to society."[21]

> In addition, having a "long purse," it [the conglomerate] is in a position to finance temporary operating losses of a subsidiary that would bankrupt the latter if it were an independent firm. . . .[22]

But this view seems to me untenable. It involves stockholders in losses they should not be called upon, often unknowingly, to bear; and it results in a misallocation of resources, as well as in competitive injury to the efficient, nondiversified competitor. The latter finds himself faced with the competition of a division immune from the market test of its efficiency, and from the penalty for inefficiency. A major step toward the elimination of subsidization is divisional profit reporting, which should re-establish pressure on management to perform or exit.[23] Or perhaps, vigorous and novel enforcement of Robinson-Patman[24] price discrimination prohibitions might help to prevent such subsidization.

It should be noted that I have not listed the threat to potential competition among the real dangers of conglomerate mergers. This is because I am uncertain in my own mind as to its reality. Apparently, it is hoped that by prohibiting entry-via-merger, we can induce conglomerates to enter an industry de novo. There can be no question that, if these are indeed the alternatives, de novo entry would at least provide a decrease in structural concentration. The firm which diversifies by merger, in essence, enters the market "in the preferred position

21 Jacoby, *supra* note 10, at 47.

22 *Id.*

23 *See* SEC Securities Act Release No. 4,988 (July 14, 1969). In addition there have, of course, been many instances of spin-offs of unprofitable divisions.

24 15 U.S.C. § 13(2) (1964).

of an established competitor."[25] But this leaves two important questions unanswered. First, would the impact on competitive behavior (as opposed to structure) not perhaps be greater if the new management had available to it an on-going organization to use as a competitive weapon? Second, how realistic is it to assume that de novo entry is an alternative in a significant number of instances? Parenthetically, one might wonder about a policy which is so concerned with the impact of conglomerate mergers on potential competition, while at the same time deems it to be perfectly appropriate for companies to make major acquisitions of firms directly in competition with the acquirer. I have in mind the lack of expressed concern by the Justice Department with oil company acquisitions of firms in the coal and nuclear industries. A policy which permits dominant firms in one phase of the energy business to acquire others in closely competitive phases, while at the same time seeks to prevent a copper company from acquiring a coal company so as to preserve "potential competition," seems curious.

These, then, are the more or less traditional antitrust criteria. An equally important factor advanced in support of the drive against conglomerate mergers is the fear of "super-concentration." This argument rests on the view that our antitrust laws are rooted in a social philosophy which abhors excessive concentration of economic power. Mr. McLaren, for example, has noted that the antitrust laws seek to preserve competition because "it protects our political system by promoting a broad dispersion of economic power among the many, rather than concentration in the hands of a few."[26]

The conglomerate problem thus conceived arises, then, from our reluctance to encourage further concentration of control of business assets and decision making, in the face of our desire to obtain the competitive advantages to be gained by the entry of often already-powerful newcomers into a specific field. This reluctance to encourage "super-concentration" is, as Mr. McLaren suggests, entirely consistent with our antitrust statutes: the Sherman Act,[27] and the legislation subsequently adopted to extend it, had a social purpose at least coordinate with its economic purpose.[28] This has long been recognized by the jurists charged with the interpretation of our antitrust laws. Mr. Justice

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[25] J. BUTTERS, J. LINTNER & W. CARY, EFFECTS OF TAXATION: CORPORATE MERGERS 224 (1951).

[26] McLaren, *supra* note 4, at 3.

[27] 15 U.S.C. § 1 *et. seq.* (1964).

[28] For a full and excellent discussion of this, see H. THORELLI, THE FEDERAL ANTITRUST POLICY (1954).

Peckham, as early as 1897, noted that greater efficiency and lower prices which might result from "trusts" might restrain trade "by driving out of business the small dealers and worthy men whose lives have been spent therein";[29] Judge Learned Hand referred to the belief "that great industrial consolidations are inherently undesirable, regardless of their economic results";[30] Mr. Justice Douglas graphically listed "loss in citizenship" and dilution of "local leadership" as prices paid when "[c]lerks responsible to a superior in a distant place take the place of resident proprietors beholden to no one."[31]

What these jurists are saying, in essence, is that *even if* the preservation of small, independent businessmen involves a sacrifice of efficiency — and nowhere has such an argument been conclusively proved — such a sacrifice is a small price to pay for the social-political benefits of a society in which economic power is widely diffused. And most economists would be inclined to agree. Thus, Joel B. Dirlam and Alfred E. Kahn have noted that conflicts between "economic welfare" and other values "are the order of the day. They are resolved pretty much on the assumption that neither one side nor the other invariably takes precedence. The resolution of these conflicts of interest and values is a political, not an economic function."[32] They go on to note:

> Clearly we are not devoted to a competitive system only for "economic" reasons. It is also associated with such social and political ideals as the diffusion of private power and maximum opportunities for individual self-expression. If the economy will run itself, governmental interference in our daily life is held to a minimum.[33]

But the social arguments are not unambiguous in the case of conglomerates. First, it is not at all clear that conglomerate merger between large firms reduces the probably already-non-existent scope of enterprise available to individual entrepreneurs. Second, it is entirely possible that this form of enterprise provides an opportunity for newcomers to rise to positions of economic power, introduce new ways of financing and managing businesses, and unseat entrenched managements. This may be just the fluidity the antitrust laws seek to preserve. As noted previously, Attorney General Mitchell has admonished that conglomerate mergers may "indeed be a threat to our . . . social struc-

29 United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 323 (1897).

30 United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

31 Standard Oil Co. v. United States, 337 U.S. 293, 319 (1949) (dissenting opinion).

32 J. Dirlam & A. Kahn, Fair Competition: The Law and Economics of Antitrust Policy 8-9 (1954).

33 *Id.* at 9.

ture."[34] But they may be a "threat" in a very different sense from that implied by the Attorney General. When the respected London *Economist* reported on the move against the LTV-Jones & Laughlin merger, it noted:

> Outside Washington a discreet cheer for the suit against Ling was raised in the boardrooms of the big steel companies; the steel trade unions liked it too. A raider like Ling-Temco-Vought is an instant and unwelcome competitor to the established giants, and with its higher earnings multiples can even threaten to buy them out. As for the unions, they find it harder to bring a multi-product company like Ling to its knees in a dispute than a mammoth but almost single-product company.[35]

The Economist further reported that denizens of "crustier boardrooms . . . resentful or fearful old-line businessmen" were enthusiastic in their support for statutory and other changes needed "to block the new men," and had warned that the LTV-Jones & Laughlin suit "can be criticized as protecting established industry (and the highly concentrated steel industry at that) against a newcomer."[36] And Senator Philip A. Hart, Chairman of the Senate Antitrust and Monopoly Subcommittee, wondered about the sudden spurt in interest in attacking new, but not "established," diversified firms in an attempt "to maintain the status quo."[37] There are, after all, "close to a dozen apparently traditional U.S. corporations . . . which possess a breadth of unrelated diversification at least as great as that of the so-called conglomerates."[38]

The direction in which policy is pushed by social considerations, is, then, not clear. Conglomerate mergers would appear to provide, in many instances, the only realistic possibility of entry by a newcomer — management with, perhaps, a different view of things such as the efficacy of price competition — into concentrated industries. They often provide, in their take-over bids and threats, an opportunity for stockholders to unseat otherwise all-but-impregnable, self-perpetuating managements.[39]

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[34] Mitchell, *supra* note 7, at 3.

[35] *Biting the Hand of Business*, THE ECONOMIST, April 5, 1969, at 35.

[36] THE ECONOMIST, *supra* note 35, at 36. *See also* Cameron, *It's open season on conglomerates, and established business couldn't be happier*, FORTUNE, May 1, 1969, at 43.

[37] Remarks by Senator Hart, Lawyers Club of the University of Michigan, Ann Arbor, Michigan, April 8, 1969, at 2 (mimeo).

[38] *The Multicompanies: Conglomerate, Agglomerate and In-Between*, FORBES, Jan. 1, 1969, at 77.

[39] "The recent merger wave, especially the take-over bid, has powerfully revived the influence of stockholders." *Got A Light, McLaren?*, FORTUNE, May 1, 1969, at 62 (editorial).

CONCLUSIONS

The social factors which must be given consideration in the formulation of antitrust policy are, in the case of conglomerate mergers, an ambiguous guide. It is not at all clear whether the open economic society which is generally accepted as a legitimate goal can best be achieved by opposing or permitting this form of asset turnover. I am not persuaded that it would be wise to restrict conglomerates from acquiring companies which are leaders in their industries, as has been suggested both by the *Task Force Report on Antitrust Policy*[40] and the Attorney General.[41] These companies are often "sleeping giants," perhaps ranking among the top ten in their industry, perhaps long accustomed to "going along and getting along." A new view of price policy, delivery schedules, inventory policy, backed by the financial and managerial muscle possessed by conglomerates, might prove a breath of fresh air. Textron, for example, long made it a practice to acquire firms that dominated their (small) industries.[42] I have seen no demonstration that competition in any relevant market was injured thereby.

Nor do I see as real a danger of long-run unprofitable operation of divisions as once existed. First, divisional profit reporting should have some effect. Second, institutional investors are becoming both more sophisticated and more powerful; witness the impact of their reported reaction to Dillingham's flirtation with the purchase of United Fruit.[43] We may well see a widespread emulation of Textron's practice of weeding out its less successful divisions.[44]

The stimulus to conglomerate mergers provided by tax policy and stock market conditions will be much diluted in the future. Such mergers as will nevertheless occur will, I would guess, run into antitrust flak and will survive it if they can mount more-or-less traditional defenses. The next several years should provide some indication of the economic viability of the conglomerates which have been assembled. Indeed, we shall see whether the new breed of managers can manage, as well as assemble, large, diversified enterprises.

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40 NEAL TASK FORCE REPORT, *supra* note 12. The reasoning of the Report on this point is obscure. It apparently deems purchase of a small firm "more likely to increase competition and to decrease concentration in a concentrated industry than if the large firm simply acquired a leading firm in the industry and settled for maintaining or modestly increasing the market share of that firm." This is, of course, true; but we have no basis for assuming that growth-oriented conglomerates will settle for maintenance of their market shares.

41 Mitchell, *supra* note 7, at 15.

42 *Call It "Phase Three,"* FORBES, Dec. 1, 1968, at 23.

43 *Bring on the Big Five*, FORBES, Dec. 1, 1968, at 38.

44 Biel, *Stock Analysis*, FORBES, Feb. 15, 1968, at 62.