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CONGLOMERATE MERGERS AND
COMPETITION

JULES BACKMAN*

Conglomerate mergers are alleged to be anticompetitive because they create the possibility of reciprocal dealings and predatory pricing, and reduce the number of potential competitors. Indeed, the courts have given considerable weight to these charges in recent years and the antitrust agencies have practically equated potentiality with actuality. These alleged possible offenses have been overemphasized and given excessive attention. As will be noted below, it is often costly, and hence bad business policy, to engage in reciprocity and predatory pricing.

Conglomerate mergers also have been criticized as anticompetitive because they contribute to the reported increase in the proportion of assets held by the largest companies, so-called aggregate concentration. Aggregate concentration has not been considered "central either to the interpretation of existent antitrust statutes, or for that matter, to the traditional analysis of economic behavior." However, the Supreme Court has referred to the congressional concern over increasing aggregate concentration. Nevertheless, the emphasis in the Court's merger decisions has been upon the extent of concentration in specific product and geographic markets — market concentration. The pertinent data and factors affecting the significance of aggregate concentration and market concentration are reviewed below.

Before examining the areas in which conglomerates are alleged to affect competition, it is useful to review briefly the definition and relative importance of conglomerates.

RELATIVE IMPORTANCE OF CONGLOMERATE MERGERS

The Federal Trade Commission (FTC) considers conglomerate mergers to include:

1. Market extension mergers — "acquiring and acquired companies

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2 In Brown Shoe Co. v. United States, 370 U.S. 294 (1962), the Court noted that "[t]he dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a rising tide of economic concentration in the American economy." Id. at 315. See also 96 Cong. Rec. 16,450 (1950) (remarks of Senator Kefauver).

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manufacture the same products, but sell them in different geographic markets."

2. *Product extension mergers*— the two companies "are functionally related in production and/or distribution but sell products which do not compete directly with one another."

3. *Other conglomerate mergers*— "involves the consolidation of two essentially unrelated firms." 4

It seems that the inclusion of these three groups is stretching the definition of conglomerate. In market extension mergers, the company already makes the product and hence is completely knowledgeable regarding its production and marketing problems. When a company produces a family of products and acquires a company making other products in that family (product extension merger), it is dealing with products with which it is generally familiar and which usually will be sold to the same customers. They can be advertised together, sold together, and delivered to the same location. They do not raise the same questions concerning efficiency and application of managerial know-how that arise when the merging partners are in widely dissimilar industries. I would consider only the latter to be conglomerates.

The significance of these comments is shown when the composition of so-called conglomerate merger data is examined in Table I below.

<table>
<thead>
<tr>
<th></th>
<th>Percent of Assets in Large Mergers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product extension</td>
<td>37.8</td>
</tr>
<tr>
<td>Market extension</td>
<td>8.0</td>
</tr>
<tr>
<td>Other conglomerates</td>
<td>17.1</td>
</tr>
<tr>
<td></td>
<td>62.9</td>
</tr>
</tbody>
</table>


The estimate that 88.6 percent of the assets acquired in 1968 were in conglomerate mergers reflects the inclusion of product extension and market extension mergers in this group. While pure conglomerate mergers have been increasing in relative importance, they accounted for 21.2 percent of total assets of large acquired companies from 1964 to 1967 and 43.6 percent in 1968, rather than the much higher ratios usually cited.

**Reciprocity**

Since the Supreme Court's decision in *FTC v. Consolidated Foods Corp.* 5 reciprocity has emerged as "one of the congeries of anticompetitive

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5 380 U.S. 592 (1965).
practices at which the antitrust laws are aimed." In 1966 a district court held that a reciprocity arrangement involving General Dynamics and Liquid Carbonic violated section 1 of the Sherman Act, since at the time of the merger both companies intended to use reciprocity to increase sales of Liquid Carbonic, the acquired firm. The district court held reciprocity based on either coercion or on mutual patronage to be anticompetitive when it affects an amount of commerce that is considered to be substantial.

The FTC has sought to use reciprocity as one factor in evaluating the competitive effect of mergers since the early 1960's, and it has obtained consent decrees to stop the systematic reciprocity practiced by a number of companies. The FTC pointed out in 1969 that "it has been engaged in the past few years in an extensive investigation into the practice of systematic reciprocal dealings which might constitute an unfair method of competition and be in violation of Section 5 of the Federal Trade Commission Act."

In its Merger Guidelines, the Department of Justice described reciprocal buying as "an economically unjustified business practice." It stated there was "a significant danger" of reciprocity whenever approximately 15% or more of the total purchases in a market in which one of the merging firms (“the selling firm”) sells are accounted for by firms which also make substantial sales in markets where the other merging firm (“the buying firm”) is both a substantial buyer and a more substantial buyer than all or most of the competitors of the selling firm.

The Department would challenge a merger undertaken to practice reciprocity or "any merger creating the possibility of any substantial reciprocal buying" where one or both of the firms has "actually engaged" in reciprocity.

In 1969, reciprocity and the so-called "reciprocity effect" were among the reasons advanced by the Department of Justice in seeking to prevent several big conglomerate mergers. The Government sought to make Ling-Temco-Vought divest itself of Jones and Laughlin Steel Corporation on several grounds, including the charge that the merger might substantially lessen

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6 The Court found that "Consolidated did undertake to assist Gentry in selling. . . . Reciprocity was tried over and over again and it sometimes worked." *Id.* at 594.
9 In the 1930's, reciprocity had been designated as an unfair trade practice by the FTC in three cases involving railroads. California Packing Corp., 25 F.T.C. 379 (1937); Mechanical Mfg. Co., 16 F.T.C. 67 (1932); Waugh Equip. Co., 15 F.T.C. 232 (1931).
12 *Id.*
competition because "[t]he power . . . to benefit from reciprocity and reciprocity effects in the sales of their products will be substantially enhanced." Preliminary injunctions on the same grounds were also sought by the Department of Justice to prevent the Northwest Industries takeover of B.F. Goodrich, and the proposed mergers of International Telephone and Telegraph (ITT) with Grinnell Corporation and Hartford Fire Insurance Company.

**Nature of Reciprocal Dealings**

Reciprocity refers to the practice of two companies buying each other's products. According to an FTC report: "A firm has an incentive to engage in reciprocity when doing so permits it to make a sale that it could otherwise not make or could make only at greater cost." The term has been used to cover a wide spectrum of relationships. At one extreme is the formalized system involving coercive use of buying power to assure sales to suppliers. Lists of purchases and sales are kept and compared, while suppliers of goods and services are told forcefully that their failure to purchase will mean the loss of future sales. The greatest leverage to such coercive reciprocal dealings is present when the volume of purchases is relatively large. In *Consolidated Foods*, the Supreme Court defined reciprocity as "[a] threatened withdrawal of orders if products of an affiliate cease being bought, as well as a conditioning of future purchases on the receipt of orders for products of that affiliate . . . ."

At the other extreme is the buying and selling which may develop without any formal determination, for example, as different divisions or subsidiaries happen to buy from and sell to the same independent non-affiliated company simply because each company is the most desirable source of supply for the other company. These relationships usually are fortuitous or unsystematic.

Between these ends of the spectrum there are many possible situations including: non-coercive mutual understandings to engage in reciprocal dealings; efforts by salesmen independent of, or contrary to, company policy to increase sales to suppliers of goods and services; and unilateral attempts to build up sales by meeting purchasing needs from potential customers and

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16 Id. (Hartford Ins. Co.).

17 BUREAU OF ECONOMICS, FTC, ECONOMIC REPORT ON CORPORATE MERGERS 323-24 (1969) [hereinafter cited as FTC REPORT].

18 380 U.S. at 594.

19 In *Consolidated Foods*, the Court held that "[r]eciprocal trading may ensue not from bludgeoning or coercion but from more subtle arrangements." Id.
hoping for sales in return. Clearly, all of these relationships should not be condemned as being anticompetitive under a broad umbrella labeled reciprocity.\textsuperscript{20}

When the element of coercion is present, reciprocal buying is held by the antitrust enforcement agencies to be analogous to tying arrangements. And since tie-ins generally are condemned as suppressing competition, the FTC has concluded that coercive reciprocal buying should be similarly condemned. The real problem, however, arises not when coercion is present, but when it is only implied by the market setting. It makes no sense to say that a company should not buy from a supplier who also is a good customer. If quality, service, and price are equal among competing sellers, it is illogical to hold that a company is guilty of an anticompetitive act when purchases are made from its friends.\textsuperscript{21} Moreover, as Professor Phillips has observed: “The ‘corporate friendship’ among purchasing agents is fragile when a stranger offers better prices or higher quality.”\textsuperscript{22}

\textit{Reciprocity Effect}

Reciprocity effect “refers to the tendency of a firm selling or desiring to sell to another company, to channel its purchases to that company.”\textsuperscript{23} In \textit{United States v. Ingersoll-Rand Co.},\textsuperscript{24} the Third Circuit concluded:

\begin{quote}
It is not overly speculative to assume that the judicious use of its steel-purchasing power by Ingersoll-Rand could immeasurably increase the sales of the acquired companies of machinery and equipment to the coal mining companies which acutely need the continued goodwill of the steel industry.\textsuperscript{25}
\end{quote}

However, where there is either a company policy against reciprocity, or no history of reciprocity, the courts have refused to find the “reciprocity effect” to be anticompetitive.\textsuperscript{26} Such an action is unilateral. There is neither pres-


\textsuperscript{21} In response to the following question: “When those features may all be equal . . . would you say that the company would be free to deal with its friends or should they toss up a coin. . . ?”, Rufus E. Wilson, chief of the FTC Division of General Restraints answered: “I don’t see anything wrong with going along and helping out your Yale brothers or your fellow Shriners or your friends.” \textit{A Look at Reciprocity Today}, Address by Rufus E. Wilson, Trade Relations Ass’n, Inc., Sept. 26, 1968.


\textsuperscript{23} Plaintiff’s Memorandum in Support of Motion for Preliminary Injunction at 12, United States v. International Tel. & Tel. Corp., 306 F. Supp. 766 (D. Conn. 1969) (Grinnell).

\textsuperscript{24} 320 F.2d 509 (3d Cir. 1965).

\textsuperscript{25} Id. at 524. See also Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc., 294 F. Supp. 1269 (D. Del. 1969).

sure on, nor obligation by, the second firm to buy the products of the first. The unilateral unreciprocated purchasing policy of a firm will not long be continued by businessmen who act rationally, unless the purchases are economically attractive on their merits. Such unilateral purchases do not result in reciprocity and involve no market foreclosure. Thus it does not adversely affect competition. A seller may not prevent a buyer from unilaterally seeking reciprocity through such purchases, but it aborts the effort when it fails to make purchases in turn.

Moreover, purchases and sales involve different personnel. Thus, the fact that a customer deals with sales personnel does not mean he will receive favorable consideration by the purchasing department. The theory of "reciprocity effect" is exaggerated beyond all relationship to its possible economic importance. Professor Ferguson appropriately described this one-sided type of activity as "being irrelevant or at least beyond the scope of a realistic antitrust policy. . . ."27

Extent of Reciprocal Dealings

How widespread is the use of reciprocal dealings in American industry? Professor George J. Stigler reported in 1969 that a "systematic quantitative study of the extent of reciprocity has never been made."28 However, there has been considerable evidence that reciprocity has been used in some industries:

1. Purchasing reported in 1961 that a survey to which 300 purchasing agents replied showed that 51 percent worked for companies in which reciprocity was "a factor in buyer-seller relations." This was not a scientifically determined sample.29
2. In 1965 it was estimated that "[a]bout 60 percent of the companies on Fortune's 500 list . . . conduct reciprocal affairs."30
3. It has been reported that reciprocity was "traditional" on the American railroads31 and "widespread" in the tire industry.32
4. Other illustrations are found in the cases cited earlier.33

Most of these surveys and illustrations antedate the recent court cases. Thus, they do not indicate the extent to which reciprocity is now practiced. It is probable that both corporate attitude toward, and the use of reciprocity,
have changed — probably significantly — because of the activities and attitudes of the antitrust enforcement authorities and the court decisions.\textsuperscript{34}

**Anticompetitive Effects**

The anticompetitive effects alleged to attend reciprocity include: a preemption of part of the market to the favored seller; an increase in market power for large diversified firms; a discouragement of potential entrants into the industry; a concealment of secret rebates;\textsuperscript{35} and a reduction in competition and efficiency.\textsuperscript{36} In effect, it is claimed that bigness breeds bigness, with reciprocal buying contributing to this result.

It has also been concluded that "[i]t is difficult to conceive of reciprocity under conditions of pure and perfect competition."\textsuperscript{37} If the test of anticompetitive acts were to be departures from "pure and perfect competition" as those terms are used in economic theory, then every company in the United States is in an anticompetitive posture. This is so because the postulates of pure and perfect competition do not prevail for any industry.\textsuperscript{38}

Because of the diversification characteristic of pure conglomerates, it is claimed that such organizations are peculiarly reciprocity-prone. This has been a key charge in the suits brought against several conglomerate mergers in 1969.\textsuperscript{39} While such diversification may create the opportunity for reciprocity, it is still a far cry from the actual practice of reciprocity. On the contrary, there are very strong reasons — apart from antitrust reasons, which are very important — why conglomerates would not practice reciprocity: (1) many products are not susceptible to reciprocity; (2) many other factors influence purchasing decisions; (3) reciprocity can be a costly business practice; and (4) use of profit centers inhibits reciprocity. These factors reduce the area of potentiality and create high barriers to the conversion of potentiality into actuality.

**All Products Not Susceptible To Reciprocity**

The economic characteristics of products play a significant role in their competitive behavior and in determining the extent to which they may be subject to alleged anticompetitive actions, such as reciprocal dealings. All

\textsuperscript{34} "M]any companies have abandoned organized reciprocity, abolished the office of 'trade relations director' and flooded their employees with memoranda forbidding the practice." Davidow, *Conglomerate Concentration and Section Seven: The Limitations of the Antimerger Act*, 68 Colum. L. Rev. 1231, 1267 (1968).

\textsuperscript{35} See cases cited in note 9 supra.


\textsuperscript{38} These conditions are: so many buyers and sellers that none can influence the price, homogeneous products, operating at full capacity, ease of entry and exit, and unchanging population, money income, habits and customs, and tastes.

\textsuperscript{39} See, e.g., notes 15-16 supra.
products do not lend themselves readily to reciprocal dealings. For such relationships to be acceptable and effective, both companies should be able to measure the value received in their purchases from one another. If this is impossible or very difficult, they cannot determine whether they are benefiting or losing from the practice.

Such a measurement would require that a company be able to determine whether it has paid the same, more, or less than it would have had to pay to another supplier for goods of equivalent quality and service. This can most readily be done for homogeneous or standardized products which are identical or virtually identical in quality. But where service or delivery is important, it becomes much more difficult to make the necessary comparisons, particularly if such services are relatively important.

It is also necessary to be able to obtain meaningful price quotations from other suppliers for comparative purposes. Some homogeneous industrial raw materials and some services, such as publicly regulated railroad transportation, provide illustrations for which these comparison tests can be met. However, as the product becomes more and more fabricated, the price comparisons are increasingly complicated by important considerations of quality, timeliness of delivery, and other factors. For branded consumer products reciprocity would appear to be unimportant. The most difficult problem is encountered when products are custom built. Here, there are serious limitations to comparisons of the relative value of the products of two suppliers because there are so many ways in which such products may differ, despite the fact that functionally they are designed to meet the same broad needs. And where such custom-built products require continuing service, the possibility of making precise comparisons of cost or value received becomes virtually impossible.

In our economy we have a range of goods and services from the homogeneous at one extreme to the custom built with continuing service at the other. The ability to determine the value received on a comparative basis becomes steadily smaller as we move from the former to the latter. Thus, the feasibility of engaging in reciprocity without economic disadvantage becomes steadily smaller and may virtually disappear when custom built products are involved.

Many Other Factors Influence Purchasing Decisions

Purchasing decisions are influenced by a large number of factors, including: price, quality, service, availability of supplies, past performance of suppliers, cooperative capability of suppliers, credit terms, transportation costs (where prices are quoted f.o.b.), volume required, financial responsibility of the supplier, desirability of having several sources of supply, etc. However, reciprocity has been practiced for sanitary ware (American Standard) and tires which are fabricated products. FTC REPORT 354-72, 383-86. Austern, Expanding Distribution, in THE IMPACT OF ANTITRUST ON ECONOMIC GROWTH 26 (Nat'l Indus. Conf. Bd. ed. 1965). See also Ferguson, supra note 20, at 568. PURCHASING HANDBOOK passim (2d ed., G. Alijan ed. 1966).
These are all vital business reasons affecting purchasing decisions which must be subordinated if reciprocal dealings are to be practiced. Where these elements of the purchasing decision are substantially realized, it is difficult to understand how reciprocal dealings can be considered to be anticompetitive where coercion is not exercised.

Reciprocity also must overcome the hostility of purchasing agents.\textsuperscript{43} It requires strong affirmative action by central management to obtain the necessary cooperation from the purchasing agents.\textsuperscript{44} Their hostility becomes an important barrier to overcome before reciprocal dealings are arranged or before the reciprocity effect can be converted into actual reciprocity, particularly for companies which have a negative policy in this regard.

Moreover, purchasing and selling functions are carried out by separate departments which may either be at different locations or at the same location but without necessarily close proximity. These two groups do not have the same objectives. The purchasing agents are judged by their success in holding down costs and assuring the steady flow of goods and services required by the production department, while salesmen, on the other hand, are usually concerned primarily with volume—and have been known to sacrifice price in order to obtain it. To the salesman reciprocity may appear to be a means of breaking down sales resistance and hence a short cut to obtaining volume. Reciprocity readily can fit in with his objective. But to the purchasing group, reciprocity means much less flexibility and hence less opportunity to hold down costs of production. Therefore, there is no incentive for the two groups to cooperate, since it is against the interest of the purchasing agents to do so. Thus, they will work together on reciprocal dealings only when ordered to do so by top management. But where there is a corporate policy against reciprocal dealings, top management does not issue the necessary order. This does not mean that some eager salesmen may not learn the names of some suppliers and then seek them out and suggest that they become customers of the corporation. However, such sporadic and informal situations obviously cannot be regarded as an economically significant foreclosure of markets.

\textit{Reciprocity Can Be a Costly Business Practice}

To the extent that reciprocity reduces or eliminates the buying options available to a company, it may be a costly business practice.\textsuperscript{45} Companies


Purchasing agents who are charged with purchasing materials on the basis of price, quality, and service, respond poorly to interjection of reciprocity considerations into sales negotiations. . . . Rudimentary logic suggests that he [the purchasing agent] would be an inappropriate person to contact.

\textit{Id.} at 45.

\textsuperscript{44} In connection with the reciprocity practices of General Dynamics and Liquid Carbonic, it was reported that "contacts with potential reciprocity partners were to bypass purchasing agents and take place only at high levels of management." FTC REPORT 345.

\textsuperscript{45} Harsha, \textit{The Conglomerate Merger and Reciprocity—Condemned by Conjecture}, 9 ANTITRUST BULL. 201, 210 (1964).
that recognize this probability will be reluctant to be partners to such arrangements. Ben W. Heineman has testified that when he became president of the North Western Railroad he had the railroad stop reciprocity because he had found it "to be essentially uneconomic, costly to those who practiced it . . . putting in built-in inefficiency . . . it builds in hidden costs into your sales." 46

Usually the cost of reciprocity is hidden.47 The reciprocity-prone buyer may have less tendency to bargain on price. He may be willing to accept list price or "market" price as the going price and thus fail to obtain the lower prices which often are obtainable by shopping around or by driving a hard bargain among competing sellers. With pre-tax margins in manufacturing industries averaging about 10 percent, it would take about $10 in increased sales to yield a before-tax profit equal to $1 extra in purchasing costs. Such relationships raise basic questions for management concerning the economic viability of reciprocity.

Reciprocal dealings in substantial volume with a number of companies are very difficult because each company would find itself compartmentalizing both its buying and selling to such a degree that it would lose considerable flexibility in its operations. This, too, is costly. Moreover, it would be necessary to match up many operations on some balanced basis. Otherwise, one partner or the other could refuse to participate. The name of the game is specialization to maximize efficiency and profits, not the balanced purchases and sales required by reciprocity.

Use of Profit Centers Inhibits Reciprocity

Where a large, diversified enterprise is divided into independent profit centers, reciprocity is not a viable policy because it contributes to a distortion of the profits record. This is true for many conglomerates.48 Under the profit center concept, the performance of each department, division, and/or subsidiary is judged by the profits it earns and contributes to the corporate total. The heads of each profit center are rewarded with compensation and promotions determined by their performance. Reciprocity usually involves buying and selling by different profit centers rather than within a profit center. Thus, reciprocity may involve a direct conflict with the profit center concept.

Profit center managers will be reluctant to forego part of their profits by paying excessive prices or buying goods and services of poorer quality in order to increase the volume and profitability of another division.49 The

46 Record, supra note 31, at 2341, 2350.
48 Harold S. Geneen, President of International Telephone and Telegraph Corporation, has stated that ITT has 200 reporting profit centers. Diversification — The New Road to World Competition, Address by Harold S. Geneen, ABA National Institute, New York City, Oct. 23, 1969.
relative performance of a division within a company is important. The profit center concept requires that the individuals who run them act essentially as independent business managers. They must have full responsibility for their area or the profit center approach loses meaning as a test of their performance. Such managers do not readily cooperate with policies which will not help their own performance. They will obviously be particularly alert to any practices which can hurt their own sales volume or increase their costs, and will be reluctant to alienate customers who might resent favored treatment to other customers through reciprocity.

A loss of volume usually tends to have a relatively large adverse impact on profits and hence policies which may cut volume are shunned. Where profit centers are established, they represent a major barrier to be overcome before reciprocal dealings are practiced and particularly before the "reciprocity effect" results in actual reciprocity. This is especially true where these units are separate subsidiaries, as in most conglomerate mergers, and where the managers are given authority to operate their companies.

Reciprocity and Market Power

Against a background of the recent court decisions and the resulting company policies against reciprocity, the forces which inhibit the use of reciprocity become increasingly significant. It is difficult to understand, therefore, why the possession of market power must be equated with the use of reciprocity. The conclusion of a special study prepared for President Nixon is pertinent:

The economic threat to competition from reciprocity (reciprocal buying arrangements) is either small or nonexistent: monopoly power in one commodity is not effectively exploited by manipulating the price of an unrelated commodity.\(^5\)

The charge that reciprocity results in an increase in market power has the cart before the horse. If a company can coerce its suppliers into reciprocal buying, its ability to do so indicates that it already possesses great market power. The market power made possible the reciprocity. Market power was not created or significantly enhanced by reciprocity. As Joel Dean has concluded: "Reciprocity doesn't add anything to the market power. It is just a way to exercise it. Market power is a prerequisite for reciprocity to have anti-competitive effects."\(^5\)


\(^5\) Dean, Economic Aspects of Reciprocity, Competition, and Mergers, 8 Antitrust Bull. 843, 846-47 (1963). James F. Rill has noted: "Reciprocity assumes anticompetitive proportions only when, through some form of 'leverage,' the policy of mutual accommodation is enforced vigorously by means of such devices as special sales or trade relations programs." Rill, Conglomerate Mergers: The Problem of "Superconcentration," 14 U.C.L.A. L. Rev. 1028, 1048 (1967).
Moreover, the question may be raised as to why a company should use its market power to force reciprocal dealings. If it has the power it can "coerce suppliers to sell at lower prices rather than indirectly to coerce suppliers to buy his products at prices above those available from other firms." Why should it be assumed that a company will travel a route declared to be illegal when it can achieve its objectives of greater profitability through legal means?

In the absence of elements of coercion, the practice of reciprocal buying does not appear to be inherently anticompetitive although it may give an advantage to the seller involved. The development of profit centers and the recognition that it can be a costly business practice reinforce the tendencies of conglomerate mergers to reduce rather than to increase the role of reciprocal dealings.

The possibility that market power may lead to reciprocity does not mean that it will do so. It is a giant step from the existence of market power to the probability that reciprocity will be practiced. The relationship is not automatic. There is also a wide gap between the probability of reciprocity and its actual implementation. Under these circumstances, the mere creation of a company operating in diversified markets by a conglomerate merger should not be equated with the probability or actuality of reciprocity. In the first place, there is no assurance that the merger will result in an increase in the conglomerate's power in any market, and secondly, if such market power does develop, it need not be translated into reciprocity.

Where there is a substantial history of reciprocal dealings by the acquiring company, the probability of its use in a conglomerate merger is greater than where there is no such record. And I hasten to add, that history should not be equated with an occasional illustration of reciprocal dealings in a company's past. The assumption that market power results in reciprocity should not be converted into the presumption that it will do so. The antitrust agencies should "stop, look, and study" instead of jumping to the conclusion, as they have done in recent months, that reciprocity automatically inheres in conglomerate mergers. To stretch the anticompetitive argument to cover the "reciprocity effect," as the Department of Justice has done, involves an even more tenuous assumption that should be given no credence by the courts.

Potential Competition

In recent years, the concept of potential competition has assumed an increasing role in antitrust policy. In its Merger Guidelines, the Depart-

52 Ferguson, supra note 20, at 567.
ment of Justice stated that potential competition "may often be the most significant competitive limitation on the exercise of market power by leading firms as well as the most likely source of additional actual competition."\(^{54}\)

In 1969, the Department of Justice attacked several mergers as being anticompetitive on this ground. Thus, in its complaint concerning the LTV-Jones & Laughlin Steel merger it stated:

Potential independent competition by LTV and J&L Steel may be diminished in the steel industry, in other markets in which only one of them presently competes, and in certain other markets in which neither of them presently competes.\(^{55}\)

This charge illustrates the extent to which the alleged impact of potential competition is being stretched. The complaint was not limited to potential competition in the markets in which the merger partners operated. Rather, it was extended to other markets as well. How important is the concept of potential competition for "markets in which neither competes?" If anything, wouldn't there be a greater possibility of entry into a new market by the combined firm than by either one acting alone? In other words, wouldn't such a merger increase, rather than decrease, potential competition in markets in which they now do not operate?

Role of Potential Competition

Potential competition refers to all the firms which are not operating in a market presently but which, under appropriate circumstances, may enter that market. Decisions to enter will depend upon many factors including anticipated profits; these profits in turn will be influenced by the actions taken by companies already in the market.

The extent to which companies within an industry can take actions to forestall the entry of new competitors varies. For industries with many producers, there is no inducement for any one seller to pay much attention to potential new entrants. On the other hand, in an oligopoly there would be greater reaction to the threat of potential competition. As Fritz Machlup has pointed out:

The oligopolist would . . . not only consider reactions of existing rivals but also the probability of attracting new rivals. The latter consideration, however, would be of substantial influence only if sellers were very few. Only if the single seller has a substantial share of the market will it pay him to forego present profits in order to diminish the attractiveness of his trade to possible newcomers and thus to maintain his "control."\(^{56}\)

Potential competition influences the activities of active competitors in a negative manner. Its existence creates a barrier to the ability of active

\(^{54}\) **MERGER GUIDELINES**, *supra* note 11, at 22.

\(^{55}\) Complaint at 14, United States v. Ling-Temco-Vought, Inc., Civil No. 69-438 (W.D. Pa., filed April 14, 1969).

competitors to take advantage of their position by raising prices,\textsuperscript{57} deteriorating quality, using antiquated marketing methods, limiting output, or refraining from innovation.\textsuperscript{58} According to Corwin Edwards, potential competition also tends to

reduce the likelihood of collusive agreement, to moderate the restrictions in agreements actually made, to lessen the restrictive effect of concentrated control over production or purchases, and to diminish the advantage which the most powerful enterprise can obtain through coercion.\textsuperscript{59}

It is easy enough to enumerate the benefits that allegedly flow from potential competition but it is virtually impossible in most situations to determine the extent to which they are effective. What yardstick will establish that collusion is reduced or that prices are lower and quality better than they would be in the absence of potential competition? There is a fairly sizeable zone within which prices could be set before their height triggers the entry of new competitors;\textsuperscript{60} and in markets characterized by competitive pressures, price will probably be held below the level at which potential competition will have any real significance.\textsuperscript{61} In other words, while the actions of actual competitors can have prompt results, particularly in areas such as price, quality, market shares,\textsuperscript{62} and innovation, the restraints exercised by potential competition are very much weaker and often may not be too effective.

Barriers To Entry

The number of potential competitors will be influenced by the magnitude and type of barriers to entry which in turn are affected by the economics of the industry. These barriers include: capital requirements, technology,\textsuperscript{63} patents, tariff and non-tariff barriers, control of scarce re-

\textsuperscript{58} “[I]f energetic and imaginative rivals cannot enter, the boldest and most rewarding innovations may be excluded.” REPORT OF THE ATT’Y GEN.’S NAT’L COMM. TO STUDY THE ANTITRUST LAWS 326-27 (1955).
\textsuperscript{59} C. EDWARDS, MAINTAINING COMPETITION 186 (1949). See also STIGLER TASK FORCE REPORT 6476.
\textsuperscript{60} In FTC v. Procter & Gamble Co., 386 U.S. 568 (1967), Justice Harlan, in his concurring opinion, noted that economic theory teaches that potential competition will have no effect on the market behavior of existing firms unless present market power is sufficient to drive the market price to the point where entry would become a real possibility. . . . So long as existing competition is sufficient to keep the market price below that point, potential competition is of marginal significance as a market regulator.
\textsuperscript{61} Id. at 593-94 (concurring opinion).
\textsuperscript{62} Justice Harlan also noted: “So long as the optimum price is below the entry-triggering price, the threat of entry has no real impact on the market.” Id. at 593 n.12 (concurring opinion).
\textsuperscript{63} Justice Harlan noted in Procter & Gamble Co. that “[p]otential entry does not control the market share of dominant firms or prevent them from expanding their power to force others to accede to their practices.” Id. at 596 n.14 (concurring opinion).
\textsuperscript{64} In United States v. Wilson Sporting Goods Co., 288 F. Supp. 543 (N.D. Ill. 1968) it
sources, transportation costs, product differentiation, and scarce technical personnel. Expanding industries tend to attract more new entrants than more static industries.

Freedom of entry into an industry makes an important contribution to effective competition. It is through entry, and withdrawal, that changes can be made to reflect the requirements of a dynamic economy and to achieve the best results for the economy. However, conditions of entry and the nature of the barriers to entry vary widely among industries. Contrast the technology required to enter computer production with the relative unimportance of this factor in the chemical industry where turnkey plants can be bought. Contrast the enormous capital required to enter the steel and aluminum industries with the small amount required in the apparel industry. Contrast the importance of building up company image in connection with highly advertised products as compared with its lack of importance for private brands. Thus, the economic characteristics of an industry play a key role in determining ease of entry. These barriers may be overcome by entering through the merger route; they are most significant when considering entry de novo by the establishment of a new plant by an existing firm or by the creation of a new company.

In FTC v. Procter & Gamble Co., the Court found that "[t]he acquisition may also have the tendency of raising barriers to new entry." This conclusion was based on Procter's ability to use advertising on a very large scale. "Thus, a new entrant would be much more reluctant to face the giant Procter than it would have been to face the smaller Clorox." Similarly, both the FTC and the Third Circuit agreed that General Foods' acquisition of S.O.S. has raised to virtually insurmountable heights entry barriers which were already high. . . . The fact that these high entry barriers to potential entrants and the impairment of the competitive vitality of the market arises in part because of the impact which General Foods' advertising, promotional and distributional resources had on potential and actual competitors in this market did not make its acquisition any less anticompetitive.

was found that "[the] technological and capital requirements for entry [into the gymnastic apparatus market] are not substantial, and a number of companies have become relatively serious competitors after entering with a nominal capital investment." Id. at 560.  
64 J. Bain, Barriers to New Competition 15-16 (1956); J. Bain, Industrial Organization 240-49 (1959); C. Kayser & D. Turner, Antitrust Policy 73 (1959); C. Wilcox, Competition and Monopoly in American Industry 7-8 (TNEC Monograph No. 21, 1940).  
65 "New allocations of economic effort can most easily be brought about when investment is expanding vigorously and changed forms of equipment can be furnished by using uncommitted capital resources." J. M. Clark, Competition As a Dynamic Force 112 (1961).  
66 R. Caves, American Industry: Structure, Conduct, Performance 22 (1964); M. Masell, Competition and Monopoly 199, 201 (1964).  
68 386 U.S. 568 (1967).  
69 Id. at 579.  
70 Id.  
71 General Foods Corp. v. FTC, 386 F.2d 936, 945 (3d Cir. 1967).
CONGLOMERATE MERGERS AND COMPETITION

The number of potential competitors and freedom of entry tend to be inversely related: the lower the barriers to entry, the greater the number of potential entrants. Under these conditions, it would facilitate the attainment of more effective competition if the emphasis were given to removing or reducing barriers to entry rather than to attempt to determine whether a specific firm is a potential competitor in a specific market.

Potential Competition Versus a Potential Competitor

It is important to distinguish between potential competition and a potential competitor. Potential competition embraces all the companies which may enter a market. The containing effects of potential competition reflect the entire composite potential. A potential competitor is only one member of the group. The group may include 5, 10 or 20 potential competitors. The effects of potential competition are neither eliminated nor necessarily diluted because one potential competitor is eliminated, unless it is the only company or the only important company which may enter the market. The containing effects of potential competition are the same whether there are 4 or 5 companies in that position, or whether the number is 9 or 10.

The role of one potential competitor should not be equated with that of the entire group. In Procter & Gamble Co., the Court recognized this point in its conclusion that "the number of potential entrants was not so large that the elimination of one would be insignificant. . . Procter was found by the Commission to be the most likely entrant." Presumably, the elimination of one potential competitor out of a larger number would not be anticompetitive.

However, in United States v. Wilson Sporting Goods Co. it was held that:

Loss through merger of one of a recognized small group by significant potential entrants, lessens the likelihood of future deconcentration for it removes a company which could have been expected to furnish significant competition to the leading firms in the industry had it entered.

Here the emphasis is not upon the effect of potential competition upon the behavior of companies already in the market. Rather, it is upon the impact

74 In a California bank merger case, a district court held:

The effect of the loss of the mere presence of a potential competitor, even of the size of Crocker, on the periphery of the Los Angeles market is minimal at best. The fact that . . . the potential competitors included some of the world's largest banks shows that the presence or absence of one potential competitor could have no material effect upon the conduct of those companies in the market, no effect upon the tone of competition in the market and no effect upon the price or supply in the market.

76 Id. at 562.
on concentration, and hence market shares, if a potential competitor becomes an actual competitor. As will be noted later, the impact of an active competitor is significantly greater than that of a potential competitor.

It has been pointed out that "the greater the economies of scale in the industry, the more likely it is that the influence of potential entry would remain substantially the same even though the merging firm was one of very few potential entrants." This is a useful reminder that the question of potential competition is not a numbers game. Rather, a proper determination of the competitive effect requires a careful analysis of the economics of the industry and market involved.

Who are the potential competitors? They usually cannot be identified in advance. The willingness and ability of a company to enter a market will be determined by its past experience, the products now handled, technical know-how, its appraisal of growth rates in the industry, cost-price-profit relationships, funds available for investment, competing opportunities to use capital funds, and the philosophy of management (is it expansionist-minded or not). Moreover, the number and identity of potential competitors change as economic conditions change. An improvement in cost-price-profit relationships, for example, will increase the number of potential competitors, while a narrowing of profit margins will have the reverse effect. The emergence of a philosophy of growth as in the 1960's, will increase the number in contrast to those available in the stagnant 1930's. As companies have become research conscious, entry has become easier in many industries and the magnitude of potential competition both from identical products and from closely substitutable products has been increased.

In connection with the identification of potential competitors, the Stigler Task Force Report suggested:

The identity of potential entrants should not be established by introspection. If the producer of X is truly a likely entrant into the manufacture of Y, the likelihood will have been revealed and confirmed by entrance into Y of other producers of X (here or abroad), or by the entrance of the firm into markets very similar to Y in enumerable respects.

Although this seems like a very sensible approach to the identification of potential competitors, it has one significant weakness. If no producer of X has yet made or rejected a move into Y, it does not mean that under the right conditions such an entry will not take place. Thus, it cannot be a complete test as to whether a company is a potential competitor in any given market.

77 See notes 83-88 infra and accompanying text.
78 Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1363 (1965).
79 Companies already producing the product in another geographic area would have the experience. However, as was seen in Penn-Olin there may be other factors which dictate that a company does not enter a new geographic market.
81 Stigler Task Force Report 6476.
The inability to identify specific potential competitors is one reason why economists have been more concerned with the conditions of entry than with the identity of the entrants. Who would have been willing to predict 30 years ago that some 6 or 7 companies would enter the aluminum industry with its heavy capital investment, or that companies such as Eastman Kodak, W. R. Grace, and many others would, in a short period of time, obtain one-quarter or more of their sales volume from the production and sale of chemicals?

**Actual Compared with Potential Competition**

The differing impact of actual and potential competition on a market also must be emphasized. The competitive effects differ significantly in intensiveness and in effectiveness. The primary role of potential competition, as noted earlier, is negative. In contrast, actual competition makes a positive contribution because it stimulates affirmative competitive responses to counter possible gains by the new competitor.

Thus, when Pacific Northwest Pipeline Corporation sought to become an active competitor to El Paso Natural Gas Company by entering into an agreement with Southern California Edison to supply it natural gas, "El Paso responded, offering Edison a firm supply of gas and substantial price concessions." The price was cut from 40 cents per million cubic feet to 30 cents. It is difficult to understand the Court's characterization of Pacific Northwest "merely as a potential competitor" in this transaction when that company was actively seeking the contract and had reached "a tentative agreement" with Southern California Edison. This is another illustration of the Court's fuzzy handling of the concept of potential competition. A potential competitor is one who is not in the market. When it seeks to enter the market by making firm offers to buyers it becomes an active competitor even though it may not be fully successful in those efforts.

*United States v. Penn-Olin Chemical Co.* also provides a good illustration of the difference between actual and potential competition. Although the presence of potential competitors undoubtedly was known to Hooker, its competitive reactions in the sodium chlorate market did not take place until **after** Penn-Olin was formed:

After Penn-Olin's plan to build a plant at Calvert City became known, Hooker employed a new salesman who was a specialist in pulp

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82 See, e.g., note 58 supra.
83 For homogeneous products, J. M. Clark has pointed out that potential competition "needs to be accompanied by active competition to furnish more positive price-reducing forces. . . ." J. M. CLARK, supra note 65, at 297-98.
85 Id. at 654-55.
86 Id. at 655, 659.
87 The Court also noted that after Pacific Northwest had its tentative agreement with Edison terminated, it "renewed its efforts to get its gas into California." Id. at 655.
and paper sales, and installed a pulp and paper research laboratory for its customers. It offered its customers five-year contracts guaranteeing them a firm price during the contract period. It also proposed to increase its selling efforts generally.89

These are expected competitive responses to actual competition. Hooker did not undertake these developments while Olin and Pennsalt were “pondering.” They were undertaken only after both companies had acted by organizing Penn-Olin. Clearly, we should not consider potential competition to be equivalent to actual competition. The effects are significantly different.

Conditions for Potential Competitors

To determine the impact on potential competition, more specific guideposts are required than the fact that a large company may have the resources to enter many industries. The Supreme Court has cited several situations which have been utilized to identify potential entrants:

1. Where two companies produce or market the same product in different parts of the country (market extension mergers).90
2. A company’s history suggests that it is likely to enter a market (product extension mergers).91
3. Where a joint venture is formed and both firms would have entered the market separately or one would have entered “while the other continued to ponder.”92

The Department of Justice in its Merger Guidelines goes far beyond these specific situations. It stated that to determine whether a firm represents a potential entrant, “primary significance is given to the firm’s capability of entering on a competitively significant scale relative to the capabilities of other firms . . . and to the firm’s economic incentive to enter.”93 Evidence of economic incentive includes: “a) general attractiveness of the market in terms of risk and profits, b) the firm’s manifested interest in entry, c) any special relationship of the firm to the market, and d) the natural expansion pattern of the firm.”94

The third factor would be covered by market extension mergers and the fourth would be similar to product extension mergers. However, inclu-

89 217 F. Supp. at 126.
91 FTC v. Procter & Gamble Co., 386 U.S. 568 (1967). “[T]he potential competition argument is most potent when leveled against a market or product extension merger rather than a purely conglomerate acquisition.” Davidow, supra note 34, at 1241.
93 MERGER GUIDELINES, supra note 11, at 24.
94 Id. at 23.
sion of the first factor—the general attractiveness of the market—and reference to a "firm's capability" would place most large firms in the category of potential competitors.

It is probably true that every large company has either the resources or ability to command sufficient resources to permit it to enter practically any industry. Thus, collectively the largest companies (non-industrial as well as industrial) can provide a number of potential competitors for practically every industry. But, and this is a big but, no company, not even the largest, can actually enter all or most industries. Every time a decision is made to enter one industry, a company is precluded from entering a large number of others because it has used up all or part of its available resources.

In search for opportunities to expand, a company may review the prospects for many industries. Lengthy studies of these situations may be found in its files. However, the existence of such studies is not evidence that the company is really a potential competitor in every industry studied. It does not qualify for the Guideline's "manifested interest" standard although it appears to be so treated. In fact, when a firm chooses what it regards to be the most favorable opportunity, it ceases to be a potential competitor in many other industries it has studied. Moreover, many of the industries studied may not be considered relatively attractive for entry.

While it is undoubtedly true that all large companies as a group contain a number of potential entrants for every industry, usually it would be very difficult to determine which industries any company will enter, except possibly where product extension and market extension are involved. While entry through merger may eliminate one potential competitor, there remain other unidentified potential competitors who would provide the hoped-for restraints of potential competition.

The 1968 White House Task Force Report on Antitrust Policy warned that excessive effort to identify the industry which a firm would enter must . . . be ineffectual or dependent on fictitious premises contrary to fact in many instances. If the potential competition doctrine under section 7 is expanded to the extent indicated by the Guidelines and current enforcement policy, such firms may well be disqualified from expanding by merger into many markets, including some in which they might make contributions of general benefit to the economy. These contributions might take the form of new technology and competitive innovation, reduced

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95 For example, a number of big companies including Honeywell, RCA, and General Electric have entered the computer industry despite the technological and capital requirements. The smaller companies which have entered this market include Control Data and Scientific Data Systems.

96 "The largest firms are the leading actual competitors of one another and they are the leading potential competitors of one another." *Hearings on Economic Concentration Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary (Concentration Hearings)*, 89th Cong., 1st Sess., pt. 2, at 523 (1965) (testimony of W. Mueller) [hereinafter cited as *Concentration Hearings Part 2*].

costs, or simply the introduction of new and forceful competitive pressures.98

Mergers May Increase Competition

Not all economists agree that potential competition is as significant as the courts, and some economists have so argued. Some feel that the role of potential competition must be more carefully explored.99 Yale Brozen has noted that a change in ownership can stimulate competition even if the new owner may have been a potential de novo entrant.100 Restraints upon acquisitions may also reduce the incentive to form a new company.

Potential competition plays significantly different roles depending upon the market structure of an industry. In industries with many competitors, entry is probably relatively easy and the role of potential competitors is minor and unimportant.101 On the other hand, it can be most important in oligopolistic markets which have only a few producers. It has been suggested that in such markets

to have exerted competitive influence the acquiring or acquired firm must have been recognized by firms in the market as a potential competitor. Recognition is not proved by the mere fact of absorption or entrance by merger. . . . In short, some quantitative basis should exist for the conclusion that the entrant had an actual pro-competitive pre-merger effect on the relevant market and that it would probably have entered by internal expansion had not entry by merger occurred.102

The role of potential competition is being emphasized excessively in antimerger cases. Its significance as a pro-competitive force has been exaggerated and the standards used to identify potential competitors are excessively loose. The assumption that any big company is a potential competitor in most markets is highly unrealistic. Moreover, the assumption that the elimination of a potential competitor weakens or destroys potential competition has no meaning except in those instances where it can be established that only one or two important potential competitors are available. But such an assumption negates the assumption that most large companies are potential competitors in most markets. It is difficult to escape the conclusion that the role of potential competition and potential competitors have been confused and that the significance of the elimination of a potential competitor has been overstressed as an anticompetitive factor.

Predatory Pricing

Predatory pricing refers to situations in which a company cuts the price of a product in one area while maintaining it in another. It is a form of

98 Id. at 5644.
101 Turner, supra note 78, at 1363. See generally F. MACHLIJP, supra note 56.
102 Rill, supra note 51, at 1057-58.
price discrimination. The objective is “to kill off or repress rivals of the sellers, or at least bring them to terms.” Usually, it is stated or inferred that the price is cut below costs and the resulting losses are financed out of the profits made in other areas or divisions.

According to Joseph E. Sheehy, former Director, Bureau of Litigation, FTC:

[T]he law hits at the practice of throttling local competition by lowering prices in one geographic area while maintaining prices in other areas. It seeks to prevent a large seller, with an interstate treasury, from subsidizing a diminution or complete elimination of profits occasioned by discriminatory price cutting in one area, by maintaining — or perhaps raising — its normal profitable pricing structure in other areas.

Usually, the price cutter is larger and much stronger financially than the local companies which must bear the brunt of the price cut. However, all price differences between areas are not predatory. A firm’s geographic price pattern may vary for many reasons including: transportation costs, volume, availability of imports in some markets, experimental promotional price cuts in some areas, and meeting local price cutting by other companies.

A price cut to be considered predatory must be intended to cause a small number of companies in some designated area to lose a substantial volume of business to the price cutter. As Fritz Machlup has concluded:

[Discriminatory pricing which diverts trade from many unknown sellers is called promotional and considered respectable; discriminatory pricing (of substantially equal products) which diverts trade from a few known sellers is regarded as predatory and obnoxious.]

Price cutting in any market to drive out competitors in order to raise prices subsequently is illegal. Proscription of price discrimination in the Clayton Act in 1914 was specifically intended to prevent such actions.

The conglomerate with its participation in a number of markets is said to be in an especially strategic position to carry out predatory pricing. However, in its recent drive against conglomerate mergers, the Department of Justice has not cited predatory pricing in its complaints. Probably the

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105 “This type of competition ... is not likely to occur between competitors of approximately equal size and strength.” T. ANDERSON, supra note 80, at 13.

106 Machlup, supra note 103, at 426.

107 “[U]nder Sections 2(a) and 3 of the Robinson-Patman Act, predatory below-cost pricing is illegal, and subjects the offender to injunction, treble damage liability, and possible criminal prosecution.” Davidow, supra note 34, at 1256.


109 FTC REPORT 398-405.
reason for this omission is found in Corwin Edwards' conclusion that "loss of sales by competitors apparently must be proved rather than inferred and hence must be found in the past rather than predicted in the future."110

Several facets of this type of anticompetitive behavior projected for conglomerates are indicated below:

1. Elimination of competitors with consequent ability to raise prices.111
2. Sales below costs in some markets financed by the losses "through excessive profits made in other lines of activity."112
3. A conglomerate has "... the power to lose money with impunity if the company chooses to do so."113

These assumptions concerning anticompetitive pricing by conglomerates rarely are supported by the behavior pattern of business.

**Extent of Predatory Pricing**

Predatory pricing was reported to have been used extensively by the trusts,114 including the old Standard Oil Trust and American Tobacco115 around the turn of the century. According to most writers, the Standard Oil Trust used local price cutting to drive rivals out of business. Smaller firms were forced to meet these ruinous prices while Standard Oil was able to earn in a market where it had monopoly prices what it lost in other areas through cutthroat competition.116 However, after studying the record of *Standard Oil Co. v. United States*,117 John S. McGee concluded that the company "did not use predatory price discrimination to drive out competing refiners, nor did its pricing practice have that effect. . . . I am convinced that Standard did not systematically, if ever, use local price cutting in retailing, or anywhere else, to reduce competition."118

110 C. Edwards, supra note 104, at 454.
See also J. Narver, supra note 67, at 112.
113 Concentration Hearings Part 1 at 261 (testimony of W. Adams). See also id. at 44 (testimony of C. Edwards); R. Caves, supra note 66, at 49-50.
114 "Such practices were employed by the early trusts to build up positions of monopoly in oil, sugar, tobacco, meat packing and tin cans." C. Wilcox, PUBLIC POLICIES TOWARD BUSINESS 94 (1955).
115 The Court found that American Tobacco Company had lowered "the price of plug [tobacco] below its cost." As a result "the company acquired . . . control of important plug tobacco concerns [and] others engaged in that industry came to terms." United States v. American Tobacco Co., 221 U.S. 106, 160-61 (1911).
116 M. Lindahl & W. Carter, CORPORATE CONCENTRATION AND PUBLIC POLICY 517 (3d ed. 1959). The U.S. Commissioner of Corporations in 1907 pointed out that Standard Oil charges "a price which is proportionate to the extent of its monopoly in a given place, and reduces prices in proportion to the degree of competition which it may meet." Cited in C. Edwards, supra note 104, at 350 n.1.
117 221 U.S. 1 (1911).
After the passage of the Clayton Act\textsuperscript{119} there were relatively few cases involving price discrimination.\textsuperscript{120} Since the Clayton Act was amended by the Robinson-Patman Act\textsuperscript{121} there have been several cases involving predatory pricing. Thus, A&P was charged with having practiced predatory pricing between 1925 and 1943,\textsuperscript{122} and the Seventh Circuit concluded that "[t]here is evidence in this record of how some local grocers were quickly eliminated."\textsuperscript{123} However, Professor Adelman examined in detail the charges and concluded that "[t]here is no evidence of even one elimination [of a competitor], or even one attempt to eliminate."\textsuperscript{124} The Adelman and McGee studies have raised important questions of fact concerning two of the most widely cited illustrations of predatory price cutting and suggest that it could be very helpful for a judge in a major antitrust case to have an experienced economist help him analyze the economic evidence.\textsuperscript{125}

In \textit{Moore v. Mead's Fine Bread Co.},\textsuperscript{126} Mead sold bread both locally and interstate. It maintained prices in interstate trade but reduced prices in Moore's locality and drove him out of business. Moore brought suit for damages. The Court held that "[t]he profits made in interstate activities would underwrite the losses of local price cutting campaigns."\textsuperscript{127} In this case, there was only one company which was adversely affected in the price cutting area.\textsuperscript{128}

In \textit{Fry Roofing Co. v. FTC},\textsuperscript{129} the court of appeals upheld the cease and desist order against the concern. It noted that "[t]he Commission's findings that Fry acted with predatory intent is [sic] supported by the evidence."\textsuperscript{130}

\textsuperscript{120} It has been reported that between the passage of the Clayton Act (1914) and 1936, "only 8 valid cease and desist orders were issued [by the FTC] in price discrimination cases, and the courts reversed the Commission in every case that reached them."
\textsuperscript{C. Edwards, supra note 104, at 6 (footnotes omitted).}
\textsuperscript{123} 173 F.2d 79, 88 (7th Cir. 1949).
\textsuperscript{125} Judge Wyzanski appointed an economist, Carl Kaysen, as his "law clerk" in the United Shoe Machinery case. C. Kaysen, United States v. United Shoe Machinery Corporation: An Economic Analysis of an Anti-Trust Case vii (1956).
\textsuperscript{126} 348 U.S. 115 (1954).
\textsuperscript{127} Id. at 119.
\textsuperscript{128} In E. B. Muller & Co. v. FTC, 142 F.2d 511 (6th Cir. 1944), there also was only one competitor who could be adversely affected by the price cutting. The court of appeals found that Muller "made up its loss" on low prices for granulated chicory in New Orleans "by selling at higher prices in other general trade areas." Id. at 518. See also A. Sawyer, BUSINESS ASPECTS OF PRICING UNDER THE ROBINSON-PATMAN ACT 82 (1963).
\textsuperscript{129} 371 F.2d 277 (7th Cir. 1966).
\textsuperscript{130} Id. at 282.
It indicated that Fry charged lower prices in the Knoxville area than in other locations for several years. Volasco, a major competitor, had its plant in Knoxville. The circuit court pointed out that “Fry’s consistent under-cutting of Volasco’s prices permits an inference of predatory purpose.”

The most important merger case involving this issue was Reynolds Metals Co. v. FTC, which concerned Reynolds Metals’ acquisition of Arrow Brands. This acquisition was held to be in violation of section 7 of the Clayton Act since Arrow accounted for about one-third of the volume of florist foil. The court of appeals held:

The power of the “deep pocket” or “rich parent” for one of the florist foil suppliers in a competitive group where previously no company was very large and all were relatively small opened the possibility and power to sell at prices approximating cost or below and thus to undercut and ravage the less affluent competition.

The FTC had found that retroactive price cuts for Arrow’s florist foil resulted in a decline in sales of from 14 to 47 percent for five out of seven competitors while Arrow’s sales advanced by 18.9 percent. Consequently the court ordered divestiture by Reynolds.

Despite the small number of cases, a member of the FTC concluded that “predatory pricing is a fact of industrial life both old and current in antitrust experience.” If this is so, one wonders why the FTC hasn’t engaged in more “search and destroy” missions against these illegal practices.

On the other hand, most students after examining the sparse record have concluded that “proved instances of predatory or below-cost pricing remain a great rarity.” Similarly, the Stigler Task Force Report concluded:

There is now an impressive body of literature arguing the improbability that a profit-maximizing seller, even one with monopoly power,

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131 Id. See also Anheuser-Busch, Inc. v. FTC, 289 F.2d 835, 843 (7th Cir. 1961).
132 309 F.2d 223 (D.C. Cir. 1962).
134 309 F.2d at 229-30.
135 Id. at 230.
136 Id. at 230.
137 Id. at 230.
139 Instances of predatory pricing by Safeway, National Dairy, and Anheuser-Busch are described in the FTC Report, at 406-44. The Report incorrectly describes these as “case studies of cross subsidization by conglomerate firms.” Id. at 403. Safeway is a retail grocery chain, National Dairy is a producer of food products, and Anheuser-Busch produces beer. Certainly none are pure conglomerates and it appears to be stretching definitions to describe a national retail food chain and a beer producer selling nationally as a conglomerate.
would or could use below-cost selling to monopolize additional markets.
Yet . . . the alleged danger of predatory pricing remains a principal
prop of its [the FTC] vertical and conglomerate antimerger cases.\textsuperscript{139}

Similarly, the Attorney General's National Committee to Study the Anti-
trust Laws observed: "[T]he accusation of 'predatory' or 'cutthroat' prac-
tices often turns out on examination not to stem from the abuse of significant
degrees of market power, but from the uncomfortably active pressures of
competition itself."\textsuperscript{140}

\textbf{Market Structure and Predatory Pricing}

Why have there been so few cases? The reason probably is that the
opportunity to practice predatory pricing is much more limited than critics
would seem to imply. A brief review of alternative market structures and of
the nature of competitive activity indicates that most market structures are
not conducive to predatory pricing.

In a market with many sellers and ease of entry, predatory pricing
would be a futile exercise. If a low price did drive out any competitors, the
subsequent rise in price would attract new entries. Thus, such price sub-
sidization would not be profitable.\textsuperscript{141} However, Robert C. Brooks, Jr. holds
"that a predatory pricing policy itself can serve to provide the barriers to
entry needed to protect the gains resulting from a successful use of the
policy."\textsuperscript{142} The barrier is "the fear of losses which would be imposed on
those who dared to enter."\textsuperscript{143} However, no support is offered for this con-
clusion.

In an oligopolistic industry with a small number of big companies (e.g.,
tin cans, tobacco, primary aluminum) a would-be price cutter is faced by
other powerful competitors and hence cannot exert enough pressure to force
any companies out of the industry. Other competitors also have financial
muscle; hence, price subsidization can play little or no role.

In an oligopolistic industry consisting of a few very large companies
and a number of smaller ones (e.g., chemicals, steel), such price cuts would
be met by other large and small companies. Thus, any volume that was
diverted, if some small companies were forced out, would have to be divided
among a number of companies. As a result, the net increase in volume ob-
tained by the predatory pricer probably would be too small to offset the
costs involved. Where a product has high overhead costs (e.g., steel), small
companies could live on their capital for a considerable period of time if
the price were too low to cover all costs but was more than adequate to
provide a good margin above variable costs.

Actually, the only market structure conducive to predatory pricing

\textsuperscript{139} \textit{Stigler Task Force Report} 6474.
\textsuperscript{140} \textit{Att'y Gen.'s Report, supra} note 58, at 328.
\textsuperscript{141} See \textit{Concentration Hearings Part 2} at 559-60 (testimony of C. Kaysen).
\textsuperscript{142} Brooks, \textit{supra} note 103, at 44.
\textsuperscript{143} \textit{Id.} at 46.
would be an industry with one relatively large producer and many small ones distributed over a wide geographic area. Under such conditions, the big company could cut prices sharply in one or more areas and drive out some smaller producers whose volume might be captured to a substantial extent. Hopefully, the price cutter could then recoup by raising prices. But this gain would be temporary if entry were relatively easy — which is probable in light of such an industry's structure. The constant search for new opportunities by other large companies provides yet another barrier to such monopolistic price increases.

**Role of Non-Price Competition**

The framework of competitive tactics also affects the probable success of price subsidization. As is well known, a considerable part of American industry emphasizes non-price, rather than price competition. Price cutting for such products, unless extremely deep, will tend to be less successful in diverting business from competitors. For products characterized by a high degree of differentiation (e.g., toothpaste, detergents, drugs), price cutting would not be too effective in diverting business. This would also be true for products for which style and quality are important (e.g., apparel).

**Substitute Products and Foreign Competition**

There would also be problems for products with many readily available substitutes (e.g., plastics, flexible packaging materials) and for those for which there are many foreign competitors (e.g., transistor radios, copper). In these circumstances, there are many competitive alternatives which would complicate the ability of a predatory price to achieve the goal of monopolization. Any attempt to raise prices after the smaller competitors had been driven out would be thwarted by these competitive alternatives.

**Why Subsidize Unprofitable Operations?**

The probability that large companies will deliberately engage in illegal predatory pricing is highly questionable. Donald F. Turner has noted:

> [T]he belief that predatory pricing is a likely consequence of conglomerate size, and hence of conglomerate merger, is wholly unverified by any careful studies; research and analysis suggest that in all likelihood this belief is just wrong. To sum up, predatory pricing seems so improbable a consequence of conglomerate acquisitions that it deserves little weight in formulating antimerger rules based on prospective effects.

The belief that conglomerates may engage in predatory pricing is based

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144 Concentration Hearings, 89th Cong., 1st Sess., pt. 3, at 1702 (testimony of J. Dean).
146 Turner, supra note 78, at 1340.
147 Id. at 1346.
upon a one-dimensional view as to how a business enterprise operates. It is assumed that the profits derived from successful products will be used to subsidize an increase in market penetration for less successful items. But why should a company use such resources to pursue illegal tactics?\textsuperscript{148} It has available many alternatives to use resources profitably and many claims on those resources; subsidization would appear to be the least desirable. Why should a company exercise "the power to lose money with impunity" as Walter Adams has charged?\textsuperscript{149} The same resources could be used to finance expansion of dynamic, growing sectors of the business. They could be plowed back to make even more profits on successful products with less risk and the probability of greater gain. Such resources could be used to finance greater selling effort or greater research and development or to finance new acquisitions.\textsuperscript{150} These would seem more probable alternatives than price subsidization for dynamic expanding conglomerates.

Moreover, why should a conglomerate — or any company — continue to operate departments which are persistently unprofitable? Would it not be sounder business policy to close down or sell off those facilities, as some companies do, rather than to "pour good money after bad"?\textsuperscript{151} The disposal of such facilities improves the total profitability of the company\textsuperscript{152} and may release resources for use in the expanding parts of the company.

Role of Diversification Exaggerated

There is another fallacy which underlies the assumption that predatory pricing will be probable for conglomerates. It is assumed that price subsidization is indigenous to a diversified company and that diversification sets the stage for its use. But as Professor Whitney has observed: "subsidizing is made possible by reserves rather than by the diversification as such."

When American Tobacco practiced price cutting to drive out smaller

\textsuperscript{148} It has been suggested that "[a]ttribution of specific behavior, much of it illegal, is an illegitimate exercise in probabilities." Harsha, \textit{supra} note 45, at 229. See also Rill, \textit{supra} note 51, at 1056.

\textsuperscript{149} Concentration Hearings Part I at 260-61.

\textsuperscript{150} McGee has argued that it is wiser business policy to buy out a company rather than to engage in predatory pricing. "In the purchase case, monopoly profits could begin at once; in the predatory case, large losses would first have to be incurred." McGee, \textit{supra} note 118, at 139. For a number of questions in connection with this point of view, see Brooks, \textit{supra} note 103, at 45-46. Dewey suggests that because antitrust policy limits mergers it "provides a raison d'être for predatory price-cutting." Dewey, \textit{supra} note 158, at 80-81.

\textsuperscript{151} See J. BACKMAN, THE ECONOMICS OF THE CHEMICAL INDUSTRY ch. 10 (1970), for illustrations of low profit lines discontinued and marginal facilities which have been abandoned in that industry.

\textsuperscript{152} In the year the action is taken, profits could be adversely affected by required write-offs.

\textsuperscript{153} Whitney, Mergers, Conglomerates, and Oligopolies: A Widening of Antitrust Targets, 21 \textit{RUTGERS L. REV.} 187, 234 (1967). See also Concentration Hearings Part 2 at 560 (testimony of C. Kaysen).
companies, it was a tobacco company not a conglomerate with wide diversification. The name of the game is available resources and how they are used, not diversification.

**Profit Centers and Predatory Pricing**

There is another barrier to widespread use of price subsidization, namely the development of profit centers in many large companies including conglomerates. As was noted in connection with recipricity, each profit center seeks to maximize its returns and is not willing to make sacrifices to help other divisions. Neil Jacoby has pointed out:

> In a multi-industry company it is not feasible to force the manager of one division or subsidiary to operate unprofitably when this requires abandonment of established targets and management incentive plans.\(^{154}\)

When it is successful, a division or subsidiary rightly believes it has a stronger claim on available resources to meet its own plans for expansion. Thus, there will tend to be internal opposition to price subsidization of other divisions. Although there might appear to be less opposition if the product subsidized were in the same division, the losses incurred would mar the division's record as compared with other divisions and would result in smaller bonuses and slower promotion. When profit centers are established, that is not a very attractive prospect.\(^{155}\)

Of course, within a profit center there may be widely varying profit rates or even losses for some products. This is the typical pattern of profitability. But these variations usually reflect differences in volume, varying competitive market pressures, differences in efficiency, special costs and related factors, rather than a deliberate strategy of sales below cost in order to drive out competitors.

**Aggregate Concentration**

Although it is usually suggested that conglomerate mergers have resulted in increases in aggregate concentration, the data cited do not show the story for conglomerates alone, new or old. Rather, the available data deal with the reported trends for the relative share of total assets of manufacturing companies accounted for by the hundred and 200 largest manufacturing companies. These large companies are reported to have accounted for the following proportions of the total assets of all manufacturing companies for selected years between 1925 and 1968 (see Table II page 119).

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\(^{154}\) Jacoby, *supra* note 138, at 49.

\(^{155}\) However, Edwards offers the following view: "In the strategy of the enterprise as a whole, unprofitable business activities are sometimes desirable as supplements to others, and the ability to subsidize them from other activities contributes to flexibility and strength." *Concentration Hearings Part 1* at 44.
CONGLOMERATE MERGERS AND COMPETITION

Table II
Share of Manufacturing Assets Held by the 100 and 200 Largest Manufacturing Corporations, Selected Years, 1925-1968

<table>
<thead>
<tr>
<th>Date</th>
<th>100 Largest</th>
<th>200 Largest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1925</td>
<td>34.5%</td>
<td>N.A.\textsuperscript{a}</td>
</tr>
<tr>
<td>1929</td>
<td>38.2</td>
<td>45.8</td>
</tr>
<tr>
<td>1931</td>
<td>41.7</td>
<td>49.0</td>
</tr>
<tr>
<td>1939</td>
<td>41.9</td>
<td>48.7</td>
</tr>
<tr>
<td>1947</td>
<td>37.5</td>
<td>45.0</td>
</tr>
<tr>
<td>1960</td>
<td>45.5</td>
<td>55.2</td>
</tr>
<tr>
<td>1968</td>
<td>48.8</td>
<td>60.4</td>
</tr>
</tbody>
</table>

\textsuperscript{a} Not available.


Such data have been widely cited to prove that overall concentration has increased dramatically in the past two decades,\textsuperscript{156} and that it will continue to rise.\textsuperscript{157} These data show an increase in concentration from 1925 to 1931, followed by a decline to 1947, and then in the past two decades a rise which reflected, in part, a reversal of the preceding decline. The data do not show the uninterrupted rise in concentration which sometimes is claimed to have taken place.\textsuperscript{158}

Impact of Foreign Activities and Nonmanufacturing Acquisitions

These data are subject to such significant limitations that questions must be raised as to how adequately they portray the trends they purport to show and their meaning. The trends cited above are for companies classified as manufacturing. However, such companies often have a considerable volume of overseas investments and also often have divisions which are in non-manufacturing industries rather than in manufacturing. This is particularly true for conglomerates. Actually the only data available to measure solely the manufacturing sector of the economy is for value added by manufacture.\textsuperscript{159}

The manner in which the relative growth of nonmanufacturing and

\textsuperscript{156} See, e.g., Neal Task Force Report 5646.

\textsuperscript{157} Concentration Hearings, 89th Cong., 2d Sess., 5, at 1891 (testimony of J. Blair). It is interesting to recall that in 1932, while conceding that "it is not possible to predict," Berle and Means suggested that if overall concentration continued to rise as rapidly as in the 1909-1929 and 1924-1929 periods, the 200 largest companies would control 70 percent to 85 percent of all corporate wealth by 1949 and all corporate wealth by 1959 or 1969. A. A. Berle & G. Means, The Modern Corporation and Private Property 40-41 (1939). Needless to say, such projections proved very wide of the mark.

\textsuperscript{158} Professor Adelman concluded: "I do not see any possible escape from the conclusion that 'overall concentration' in the largest manufacturing firms has remained quite stable over a period of 30 years, from 1931 to 1960." Concentration Hearings Part I at 237.

foreign operations of manufacturing companies act to raise the aggregate concentration ratio may be indicated by a simple illustration. Assume that the largest companies account for $100 out of total assets of $250; this is a ratio of 40 percent. Now assume the assets in domestic manufacturing remain unchanged but those used overseas or in non-manufacturing industries increase by $20. Now the largest companies would have assets of $120 and total assets of all manufacturing companies would increase to $270; the ratio has risen to 44.4 percent. This illustration is designed to show tendencies only. It does illustrate how a faster growth rate in assets devoted to purposes other than domestic manufacturing will increase the ratio of aggregate concentration over time. Since manufacturing companies have been acquiring non-manufacturing companies, this development probably has resulted in some overstatement of the increase reported in concentration for manufacturing companies.160 The 200 largest companies in 1968 had acquired companies with assets of $50,177 million between 1948 and 1968; however, $14,638 million of this total was in non-manufacturing.161 In 1968, acquisitions of non-manufacturing accounted for $7.6 billion out of total acquisitions of $15.6 billion by these companies.162

The growth toward internationalization of industry in recent years also contributes to an exaggeration of the rate of increase in aggregate concentration. Many big companies have a larger proportion of their assets invested overseas now than they did in 1950. Between 1950 and 1968, total investments abroad by American manufacturing corporations increased sixfold from $7.2 billion to $45.2 billion.163 During the same period total assets of all manufacturing corporations increased about 250 percent.164 Since large companies account for most of the investment overseas, the net effect of these investments is to increase their proportion of total manufacturing assets more than would a measure confined to their American operations alone.165

160 Teledyne acquired United Insurance; ITT acquired Sheraton Hotels, Avis, and Levitt among others; Gulf and Western acquired Paramount Pictures and Chicago Thoroughbred Enterprises (owns two race tracks); Signal Companies acquired Arizona Bancorporation and Golden West Broadcasters.
161 FTC REPORT 187.
162 Id.
164 The inclusion of nonmanufacturing company assets inflates the extent of concentration by 4.5 percentage points, and of foreign operations by 4.0 percentage points. See Concentration Hearings Part 8 (testimony of Jules Backman).
165 Not many companies report their investment in foreign and domestic assets separately. Two illustrations indicate the trend: For du Pont, operating investment overseas increased from $280 million in 1960 to $1,100 million in 1968 and their share of total operating investment from 9.5 percent to 19.9 percent. Annual Report 1960 at 2, 16; Annual Report 1968 at 2, 7-8. For IBM, net investment overseas was $481.3 million or 33.9 percent of the total in 1960 and $1,202.4 million or 35.2 percent of the total in 1968. Annual Report 1961 at 5, 23; Annual Report 1968 at 45, 46, 53.
Changing Composition of Largest Group

It must also be recognized that the change in concentration over time usually does not show the record for an unchanging number of identical companies.\(^6\) Actually, the composition of this group changes markedly over time\(^6\) and even from year to year. Thus, in 1968, 7 companies moved forward into the 200 largest industrials in terms of assets and in 1967, 11 companies moved up. Since one company (Dana) that had been included in the list in 1967 lost that position in 1968, there was a net change of 16 companies in the composition of the 200 largest between 1966 and 1968. Similar changes occur every year.

A special study by the Bureau of the Census showed the ranking of the 50 largest manufacturing companies in terms of value added in 1947 and in later years. Of the 50 largest companies in 1947, by 1966 only 25 still were ranked in the top 50, 18 were ranked 51 to 100, and 7 were ranked higher than 100.\(^6\) On the other hand, of the 50 top companies in 1966, 25 were in the top 50 in 1947, 10 were in the next 50, and 15 ranked higher than 100.\(^6\)

A. D. H. Kaplan compiled lists of the hundred largest industrial companies in terms of assets as of six dates (1909, 1919, 1929, 1935, 1948 and 1960). Only 31 companies on the 1909 list were on the 1960 list and in many instances the nature of their business had changed enormously. Du Pont and General Electric provide good illustrations. Kaplan reported that “the lists for the intervening years . . . show numerous replacements and marked changes in the rank of those that remained.”\(^0\)

A study by the First National City Bank showed that of the hundred largest manufacturing companies in terms of assets in 1963, 51 were not on the list in 1919. The bank concluded:

This history of the 100 largest shows that prominence in the economy is achieved and maintained more by securing a position in growing markets than by achieving market dominance. The surviving companies are largely those that have proven adaptable to changes in the economy. They stayed in growing markets and shifted into new ones that opened up. Newcomers are those that found new needs that existing companies were unable to satisfy and those who departed were largely firms unable or unwilling to move away from slowly growing markets. Thus, a top posi-

\(^{166}\) An exception is found in value added data for the top 50 and one hundred manufacturing companies in VALUE-OF-SHIPMENT CONCENTRATION RATIOS BY INDUSTRY, supra note 159, at 2.

\(^{167}\) An FTC Study of the 1,000 largest industrial companies in 1950 and 1962 found only 637 companies on both lists. Concentration Hearings Part 1 at 158 (testimony of H. Houghton).

\(^{168}\) VALUE-OF-SHIPMENT CONCENTRATION RATIOS BY INDUSTRY, supra note 159, at 2.

\(^{169}\) Id.

tion in the economy is neither automatic nor permanent but requires
continuous attention to changing needs of the nation.\footnote{171}

Obviously, the share of total assets or total shipments accounted for in
1968 by the 100 or 200 largest companies in any earlier years would be
smaller than reported for the largest companies in 1968. And the disparity
between the two figures would grow over time.\footnote{172}

Thus, aggregate concentration data hide the dynamic changes which
have taken place in our economy. The development of new industries (e.g.,
computers), sectors with above average growth rates (e.g., chemicals, elc-
trical equipment), and the growth of conglomerates have influenced the
composition of the group and the significance of the totals.

The impact of the conglomerate, spread over a number of industries,
has a different significance than the growth of a company within a given
industry or in a single market; the entry of the conglomerate often adds
more to competitive ferment. Moreover, as technology develops many com-
panies among today's largest will be replaced by newcomers, continuing the
pattern of the past. Size gives no immunity against these developments, nor
does it give any company the power to stay at the top.

Internal Expansion Largest Factor in Growth

Moreover, the growth of large companies is due primarily to internal
expansion rather than to mergers. Thus, between 1948 and 1968, the total
assets of the 200 largest manufacturing corporations in 1968 were reported to
have increased by $242.4 billion, from $53.2 billion to $295.6 billion,\footnote{173}
acquisitions\footnote{174} accounted for $50.0 billion or 20.6 percent of this total increase.
However, for the 10 largest companies, acquired assets were only 2.8 percent
of the asset growth; for the second 10 largest it was 16.2 percent; and for the
21st to 50th largest, it was 24.3 percent.\footnote{175} Clearly, for the very largest com-
panies mergers have been a minor factor in their growth.

Despite the disappearance of 970 manufacturing and mining companies
with assets of more than $10 million through merger between 1959 and
1968, the number of large companies continued to increase as is shown
below.

\footnote{171} \textit{First Nat'l City Bank, Monthly Economic Letter}, Aug. 1964, at 92.
\footnote{172} Because of mergers it is impossible to measure the relative importance of the one
hundred or two hundred largest manufacturing companies in 1968 for many earlier years.
\footnote{173} It must be kept in mind that between 1948 and 1968, there was a major increase
in gross national product from $258 billion to $861 billion and the wholesale price index
increased from 87.9 (1957-1959 = 100) to 108.7. These developments contributed significantly
to the rise in total assets of the largest companies. \textit{Economic Report of the President} 227,
\footnote{174} The data include "all acquisitions (including partial acquisitions) made by the
acquiring company during the period 1949-1968, and are not limited to acquisitions of
mining and manufacturing companies." \textit{FTC Report} 186 n.3.
\footnote{175} \textit{Id.}
Smaller companies have grown in size and more than replaced the number absorbed in mergers. The net result has been an increase of almost 40 percent in the number of manufacturing companies with assets of $10 million or more in the past decade.

**Role of Heavy Capital Investment**

A high rate of overall concentration reflects the fact that some industries require very heavy capital investment rather than growth through merger. The hundred largest manufacturing companies accounted for 48.8 percent of the total assets of manufacturing firms in 1968. A large proportion of this total was accounted for by five industries: petroleum refining ($75.3 billion), motor vehicles and equipment ($35.9 billion), primary iron and steel ($26.8 billion), basic chemicals ($26.7 billion) and aircraft and parts ($19.3 billion). These five industries accounted for $184.0 billion out of total assets of $485.9 billion or 37.9 percent, and for 42 out of the hundred largest companies. The 42 companies accounted for 29.3 percent of total manufacturing assets. Thus, the remaining 58 largest companies accounted for 18.7 percent of total manufacturing assets. These are all capital intensive industries. After examining these data, Professor Weston concluded that “the main determinant of the high level of macroeconomic concentration is the relative size of industries, not mergers. Prohibitions on conglomerate mergers would not substantially alter future trends in macroconcentration.”

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177 The 10 largest industrials in the Fortune Directory had total assets of $87.9 billion in 1968, or 18.1 percent of the total. This group accounted for more than ½ of the assets held by the 100 largest industrials. Id. at 168.

178 J. Weston, Conglomerate Firms: Their Nature, Theory, and Performance 85 (draft manuscript 1969).
Competition Has Been Increasing

Finally, the basic question is what is happening to competition in the economy. The numbers for aggregate concentration alone do not provide evidence that competition is decreasing. On the contrary, it may easily be demonstrated that competition has been intensified. The trends tend to be obscured by the general inflation in the economy since 1965. But in the first half of the 1960's there was considerable evidence of invigorated price competition. For example, price cutting characterized such industries as chemicals, electrical machinery, aluminum fabrication, paper and paper products, and computers which between them accounted for more than 20 percent of the value added in manufacturing. During that period, increases by price leaders frequently were not followed and price shading by small companies forced large companies to cut prices.\(^{179}\)

Neil H. Jacoby has concluded that aggregate economic concentration is not a matter for concern and that conglomerate mergers add to competition.

Macro-economic concentration need not be of concern as long as the number of giant diversified corporations is large enough to preclude overt or tacit collusion among them. Because it takes more than one hundred corporate giants to account for even a half of all manufacturing assets in the nation, we are far from the possibility of non-competitive behavior because of inadequate numbers.\(^{180}\)

Professor Jacoby also concluded:

[C]onglomerate mergers are likely to invigorate competition. By strengthening the managerial and financial support available to each of its constituents, the conglomerate is able to make each a more energetic competitor in the industry in which it operates. Each entity can draw upon the conglomerate's pool of specialized managerial talent, utilize its management science, obtain financial assistance, and assume a more innovative and risk-taking posture than it could as an independent firm. Conglomeration can thus transform simple competition into multiple competition.\(^{181}\)

It seems clear that the widely cited numbers showing increasing aggregate concentration overstate the increase that has taken place in manufacturing industries, and that most of the increase that has developed has been due primarily to internal expansion rather than to external acquisitions. Moreover, the extent of concentration reflects capital requirements and technology rather than mergers. These data tell us little or nothing about the vigor of competition. Industrial giants compete vigorously both within their major industry and across industry lines. And the new conglomerates can play a significant role in this stimulus to competition.

\(^{179}\) Concentration Hearings Part 2 at 890-98 (testimony of J. Backman).

\(^{180}\) Jacoby, supra note 138.

\(^{181}\) Id.
CONGLOMERATE MERGERS AND COMPETITION

MARKET CONCENTRATION

Under the Celler-Kefauver Act, emphasis is given to the effect of mergers on the degree of competition in product markets and in geographic markets. The test usually applied by the courts in determining whether the effect of a merger "may be substantially to lessen competition, or to tend to create a monopoly" is the extent to which volume is concentrated in the merging firms or in a few firms, usually the four or eight largest participants in the market.

Concentration ratios measure the proportion of an industry's economic activity or of a product's volume accounted for by a designated number of large companies, usually the four largest (Big Four) or the eight largest (Big Eight) in a designated market. Concentration usually is measured in terms of sales or shipments, employment, value added or income originating, or assets (gross or net). The higher the proportion accounted for by the largest companies, the greater is alleged to be the control over the market and the greater the tendency to reduce competition.

Limitations of Concentration Ratios

There are several problems to be kept in mind in connection with concentration ratios. First, it is very difficult to obtain meaningful concentration data for many products. And where data are available, often they are very unsatisfactory. Problems of definition are important. How effectively do the available data delineate the market in terms of products, firms, or geographic location? Census data, which are available in considerable detail, generally

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183 Mergers are prohibited "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." The Celler-Kefauver Act, 15 U.S.C. § 18 (1964).
184 "The market share which companies may control by merging is one of the most important factors to be considered when determining the probable effects of the combination on effective competition in the relevant market." Brown Shoe Co. v. United States, 370 U.S. 343 (1962).
185 "Where concentration is gaining momentum in a market, we must be alert to carry out Congress' intent to protect competition against ever increasing concentration through mergers." United States v. Von's Grocery Co., 384 U.S. 270, 277 (1966) (emphasis added). See also Justice White's opinion in which specific reference is made to the market shares of the 4 largest firms, the top 8, and the top 12. Id. at 281 (concurring opinion).
187 Each of these bases of measurement is not available for every industry. Thus, shipments may be an unsatisfactory basis because of the large scale duplication which occurs when there are heavy shipments between plants in the same classification. See J. FREIDMAN, CONCENTRATION IN AMERICAN INDUSTRY, REPORT OF SUBCOMM. ON ANTITRUST AND MONOPOLY TO SENATE COMM. ON JUDICIARY, 85th Cong., 1st Sess., 192-93 (1957) (pursuant to S. Res. 57). For a discussion of other measures of concentration, see E. SINGER, ANTITRUST ECONOMICS chs. 13-14 (1968).
are not identical with markets. The Stigler Task Force Report concluded that concentration ratios are being determined within "a definition of the market . . . so loose and unprofessional as to be positively embarrassing. . . . [The Department of Justice] Guidelines seem to invite a substantial degree of market gerrymandering, especially in delineating regional or local markets."\(^{188}\)

The definition of an industry or product market usually may be too narrow, thus excluding products that are directly substitutable.\(^{189}\) Moreover, the available data usually do not include imports so that the relative share of a market for a domestic Big Four may be overstated for products with a significant volume of imports.\(^{190}\) When imports account for a growing share of the American market, this factor also affects comparisons over time. Professor Weston has observed:

> There is an excessive preoccupation and concern with measuring concentration in relatively narrowly defined markets when the world is undergoing a change in the scope of markets comparable to the great change of the turn of the 20th century.\(^{191}\)

Finally, the combination of companies comprising the Big Four or Big Eight may vary for the different products in an industry and for the same product at different times.\(^{192}\) Changes in the composition of the Big Four often reflect competitive pressures which are not revealed when concentration ratios are compared for the largest companies in each year.\(^{193}\)

Changes in concentration ratios tell only part of the story. Such data do not show the extent to which membership in the Big Four changed between 1947 and 1966. These data, therefore, obscure the extent to which competition has yielded new members of the Big Four. The United States Bureau of the Census made a special study of the identity of the four largest companies in 204 four-digit industries in 1947 and 1958. It found

\(^{188}\) STIGLER TASK FORCE REPORT 6476.
\(^{189}\) An exception is found in Continental Can Co. where the Court found that there is and has been a rather general confrontation between metal and glass containers and competition between them for the same end uses which is insistent, continuous, effective and quantitywise very substantial . . . . [T]he interindustry competition between glass and metal containers is sufficient to warrant treating as a relevant product market the combined glass and metal container industries and all end uses for which they compete.
\(^{190}\) In 1966, the four largest synthetic rubber producers accounted for 53 percent of total shipments. If allowance were made for consumption of natural rubber, the Big Four share drops to about 42 percent and if reclaimed rubber were included in the total, their share would have been 37.6 percent. VALUE-OF-SHIPMENT CONCENTRATION RATIOS BY INDUSTRY, supra note 159, at 14; OFFICE OF BUSINESS ECONOMICS, U.S. DEP'T OF COMMERCE, BUSINESS STATISTICS: 1967, at 180 (biannual ed. 1967).
\(^{191}\) Concentration Hearings Part 1 at 145.
\(^{192}\) For the changes in the chemical industry, see J. BACKMAN, supra note 151, at ch. 4.
\(^{193}\) In his dissent in Von's Grocery Co. Justice Stewart observed: "Because of the substantial turnover in the membership of the top 20 firms, the increase in market share of the top 20 as a group is hardly a reliable indicator of any tendency toward market concentration." 384 U.S. at 290-91.
that in 166 industries or 81.4 percent of the total "at least one of the four largest in 1947 was no longer among the four largest companies in 1958."\(^{194}\) In the remaining 38 industries, the 1947 ranks of the Big Four in 1947 were the same in 1958 in only 13 industries.\(^{195}\) Further changes undoubtedly took place between 1958 and 1966.

The interpretation of concentration ratios must be handled with great care.\(^{196}\) Even when the basic data are homogeneous and statistically accurate, their significance is subject to considerable dispute. This problem is compounded when the underlying data do not provide an accurate portrayal of the market facts. Professor Shepherd has noted that "concentration ratios themselves are not necessarily a good indicator of either market structure or market behavior or market performance."\(^{197}\)

**Concentration and Competition**

The argument that there is a relationship between the intensity of competition and the degree of concentration has been stated as follows:

Market concentration is directly related to the intensity of competition in an industry. It indicates where an industry lies in the spectrum between competition and monopoly. Economic theory suggests and empirical evidence verifies that when industry sales are concentrated in few hands, rivals behave more like monopolists than competitors. We cannot use concentration levels alone to predict precisely where competitive behavior ends and monopolistic activity begins. But there is increasing empirical evidence to support the expectation that high concentration bestows market power on an industry's leading firms.\(^{198}\) But many economists, including this writer, do not subscribe to this statement.\(^{199}\) The percentage of a market accounted for by a small number of companies is not the important point. The real test of the extent of competition and the significance of concentration ratios is found in how companies respond to various market stimuli. Big Fours in highly concentrated industries may compete among themselves with a vigor and intensity that is as great, if not greater, than the competition found in industries much less concentrated. The existence of some degree of concentration is not equivalent to the absence of competition.

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\(^{195}\) Id.

\(^{196}\) Whitney, supra note 153, at 229-30.

\(^{197}\) Concentration Hearings Part 2 at 647.

\(^{198}\) Staff of Comm. on Price Stability, Cabinet, Studies 54 (1969).

A comprehensive study for the Cabinet Committee on Price Stability found no evidence that market concentration generally increased in the post World War II period:

Average market concentration of manufacturing industries has shown no marked tendency to increase or decrease between 1947 and 1966, according to an analysis of 213 essentially comparable industries. The average level of 4-firm concentration for all industries was 41.2 percent in 1947 and 41.8 percent in 1966. In 78 industries, 4-firm concentration ratios declined by 3 percentage points or more and in 88 industries concentration increased by 3 percentage points or more.

The trend over the broad sweep of these 19 postwar years conceals changes occurring within the period. From 1947 to 1958, average concentration declined slightly, whereas between 1958 and 1966 it moved upward. Another important result obscured by these broad movements was that the numbers of highly concentrated industries (those where 4 firms held 75 percent or more of shipments) fell from 30 to 22.

Because large horizontal mergers have been relatively infrequent, the current merger movement has not had a significant direct impact on market concentration in most industries.\textsuperscript{200} Since this analysis covered the period from 1947 to 1966, some of the industries with increases in concentration undoubtedly reflected horizontal mergers (e.g., textiles and paper) which were important until recent years.

As the above study notes, there has been little change in the average market concentration ratios despite the increase in the number and size of conglomerate mergers. Of course, this is not surprising since a conglomerate which merges with a company operating in different product markets does not affect directly the extent of concentration in those markets. One ownership is substituted for another. The actual effect upon competition in each product market will depend upon the actions taken by the new owners. If the acquired company was lethargic in its competitive actions, a new management team may shake it up so that it becomes a more effective competitor. Under these conditions, the conglomerate merger may well stimulate competition rather than the reverse. The same is true if the conglomerate can make required financial resources available to the acquired companies.

On the other hand it is argued that if the conglomerate enters an industry which consists largely of small producers, it may give the acquired company so much financial muscle that its position will become much stronger and thus other companies in the industry will seek big merger partners or merge with each other. The result could be to force the weakest companies out of business and to transform the structure of the industry.\textsuperscript{201} These results may develop. But that does not mean that they are economically undesirable. Industries which have mainly small producers are

\textsuperscript{200} \textit{STUDIES}, supra note 198, at 58-59, 78 (footnotes & references omitted).

not necessarily the most efficient. In fact, it might contribute to the overall economic efficiency of some industries if many small producers were replaced by fewer larger ones. The construction industry probably provides a good illustration of an industry in which this would be a salutary development.

**Aggregate Concentration and Market Concentration**

There is no necessary relationship between the trend of aggregate concentration and the trend of market concentration. It was noted earlier that aggregate concentration has tended to increase and it was also noted that the general level of concentration was influenced significantly by a few industries which are capital intensive. An examination of the trend of market concentration in these industries indicates that with one exception the trend has been for less market concentration during the post-war years, as the following data illustrate (see Table IV).

**TABLE IV**

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>2911</td>
<td>Petroleum refining</td>
<td>37%</td>
<td>33%</td>
<td>32%</td>
<td>- 5%</td>
</tr>
<tr>
<td>3312</td>
<td>Blast furnaces &amp; steel mills</td>
<td>50</td>
<td>55</td>
<td>49</td>
<td>- 1</td>
</tr>
<tr>
<td>3722</td>
<td>Aircraft engines &amp; parts</td>
<td>72</td>
<td>62</td>
<td>58</td>
<td>-14</td>
</tr>
<tr>
<td>3717</td>
<td>Motor vehicles &amp; parts</td>
<td>56</td>
<td>75</td>
<td>79</td>
<td>+23</td>
</tr>
<tr>
<td>2812</td>
<td>Basic chemicals—alkalies &amp; chlorine</td>
<td>70</td>
<td>69</td>
<td>63</td>
<td>- 7</td>
</tr>
<tr>
<td>2813</td>
<td>Industrial gases</td>
<td>83</td>
<td>84</td>
<td>72</td>
<td>-11</td>
</tr>
<tr>
<td>2821</td>
<td>Plastics materials &amp; resins</td>
<td>44</td>
<td>47</td>
<td>32</td>
<td>-12</td>
</tr>
</tbody>
</table>


Except for motor vehicles and equipment, market concentration declined in each of the other industries whether measured from 1947 or from 1954. This is in line with the report of the Staff of the Cabinet Committee on Price Policy which found that market concentration was decreasing in producer-goods industries.  

**Concentration and New Entry**

Moreover, as Donald F. Turner has pointed out, despite the increase in overall concentration "there is little or no indication that any relative decline in the opportunities for small businesses has occurred."  

202 Studies, supra note 198, at 59.
203 Turner, supra note 78, at 1327.
204 Churchill, Age and Life Expectancy of Business Firms, Survey of Current Bus., Dec. 1955, at 15, 18. The number of tax returns filed for manufacturing and
The record varies among industries. Between 1947 and 1963, a study of 213 industries showed that the number of companies increased in 111 and declined in 98, while 4 remained unchanged.205

The proliferation of new companies in electronics, computer leasing and software, franchising, nursing homes, pollution control, and many other industries, is illustrative of the opportunities that have continued to be available. It is true that the best opportunities have been in growing sectors of the economy.

In any event, thus far conglomerate mergers have not resulted in greater market concentration. While some mergers ultimately may have that effect in some markets, it cannot be assumed that this will happen merely because such a merger has taken place. Each merger must be carefully examined within the context of the markets involved, and there should be significant evidence of the alleged effect before a merger is condemned on these grounds.

CONCLUSION

The thrust of the antitrust attack has been against conglomerate mergers rather than against existing conglomerates. This poses some interesting questions. If the conglomerate form of business organization for big companies is almost inherently anticompetitive — as seems to be implied — why is this true for developing conglomerates but not for older conglomerates? If it has not been established that older conglomerates practice anticompetitive reciprocity on a wide scale, why should it be assumed that new ones will do so? If older conglomerates have not been found to engage in predatory pricing on a wide scale, why should it be assumed that new ones will do so?

The Celler-Kefauver Act, of course, deals only with mergers. But the Clayton Act and Federal Trade Commission Act can be used to root out illegal reciprocity and predatory pricing by the older conglomerates.

Horizontal mergers were attacked largely because they increased market concentration; the accompanying changes in market structure have been interpreted as being anticompetitive. The conglomerate, which substitutes one ownership for another, does not change market concentration and hence a new approach had to be devised. This led to the search for new reasons to abort such mergers. The reciprocity and potential competition arguments were developed to provide the means to stop companies from becoming too big. The real objective, however, is to prevent an increase in overall economic concentration, that is, the proportion of the economy controlled by the hundred largest or 200 largest companies.206 Since the antitrust laws do

205 STUDIES, supra note 198, at 95.
206 See, e.g., the emphasis given to "superconcentration" by Attorney General Mitchell. Address by Attorney General Mitchell, Georgia Bar Ass'n, June 6, 1969; STUDIES, supra note 198, at 45-50, 72-81.
CONGLomerate MERGERS AND COMPETITION

not proscribe bigness\textsuperscript{207} in the absence of monopolization and hence do not control overall concentration, the arguments used to prevent conglomerate mergers have been developed to accomplish indirectly what cannot be done directly. The attainment of such a goal requires action by Congress. Such action would be necessary to make "honest men" out of our antitrust enforcers. Let me hasten to add that I do not favor such legislation.

The anticompetitive role of the three areas discussed in this paper—reciprocity, potential competition, and predatory pricing—have been exaggerated out of all relationship to their importance as anticompetitive forces. Reciprocal dealings appear to be of declining importance in the economy, partly as a result of recent court decisions. The competitive significance of such dealings cannot be evaluated without reference to price, quality, and service, which are rarely identical except for homogeneous products. If price, quality, and service are the most favorable available and there is no coercion, there is no anticompetitive effect since competition can still take place in these vital areas. Foreclosure of competition by failing to seek the lowest price for the best quality and best service is the problem, not reciprocal dealings per se. Where the most favorable buying opportunities are sought, competition is not foreclosed.

Moreover, there are many products for which reciprocal dealings make no economic sense and there are corporate policies which act as a barrier to such dealings. Two such corporate policies are a declaration that it is against company policy to engage in reciprocity, thus removing the pressure on purchasing agents to participate in such dealings, and the establishment of profit centers, the goals of which would be thwarted by reciprocal dealings.

Potential competition has been given excessive emphasis as a competitive force. The companies outside the market only act as a containing or negative force which may limit to some extent the complete freedom of actual competitors in their pricing, marketing methods, rate of new product introduction, service, and other business activities. Potential competition may prevent excessively high prices or excessive delays in introducing new products or in making other changes in business practices which could adversely affect sales. Potential competition does not make the positive contribution made by actual competition.

Moreover, too much attention has been given to the disappearance of a potential competitor, which appears to have been equated with the elimination of potential competition. These are significantly different developments. The disappearance of one or two potential competitors does not remove the restraining force of potential competition unless they are the only potential competitors available.

Size alone does not prove that a conglomerate merger partner would

\textsuperscript{207} FTC Commissioner Elman has stated: "Unless and until Congress changes the law, neither the courts nor any enforcement agency would be justified in holding that a merger, merely because of the large size of the parties, is likely to be anticompetitive, and hence unlawful, within the meaning of Section 7." FTC REPORT 211.
have been a potential competitor. Where a company manufactures the product in another part of the country (market extension) or where it manufactures a family of products (product extension), the probability that it might be a potential competitor is greatest. But its elimination as a potential competitor is not equivalent to the elimination of potential competition for the reasons noted earlier.

Many large companies which are expanding aggressively have studies made to determine the outlook for other industries which they might enter. These studies often result in the elimination of some industries as an area for future expansion. The fact that such studies remain in the files does not indicate a company was a potential entrant into that industry. Companies select among alternatives, the areas for expansion which fit into their broad strategy with emphasis upon those which will yield the highest and most sustained returns on the investment. A willingness to enter an industry through the merger route does not indicate that it would do so by building new plants.

The charge that conglomerate mergers will result in predatory pricing is highly speculative. The record is almost barren of cases involving such practices and such instances as have been uncovered are not confined to conglomerates. This record is not surprising because predatory pricing is not feasible in many market structures, or in markets which emphasize non-price competition, or where substitute products or foreign competition are readily available. Moreover, a company can use its available resources in so many other profitable ways that it would be a very rare businessman who would choose this illegal route which has been proscribed for more than half a century. This would appear to be particularly true for dynamic, expanding conglomerates which would use such resources more advantageously in their expansion programs.

Unlike horizontal mergers, a conglomerate merger has no immediate direct effect upon market concentration. Many such mergers involve the acquisition of companies which may be laggard in their competitive activity. The incentive for many of these mergers is the opportunity to build up the acquired company by shaking it out of its lethargy. Where this happens, competition will be stimulated rather than lessened. Part of the opposition to conglomerates comes from companies which have been lagging in growth and in profitability and hence become good targets for take-overs. By “shaking things up” the conglomerate can add a new dimension to competition in many markets.

208“One of the most striking contrasts between the new conglomerates and the old trusts is that the former often achieve great size without ever obtaining a dominant or even very significant share of any single market.” Davidow, supra note 34, at 1245.