Conglomerate Mergers: A Monopoly Problem?

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CONGLOMERATE MERGERS: A MONOPOLY PROBLEM?

RICHARD A. MILLER*

INTRODUCTION

The conglomerate nature of the recent merger movement has attracted much attention and caused some alarm. Without doubt merger activity is greater and conglomerate mergers are relatively more numerous than a decade or two ago. However, in expressing concern over the conglomerate trend, economists who study such industrial and market phenomena seem to lag somewhat behind other critical commentators.

There is ample academic precedent, if not justification, for such belated alarm. The American economy has seen three such movements. The first, concentrated in the years 1898-1903, as well as the second movement, occurring during the 1920's and early 1930's, apparently produced oligopolies (and sometimes single firm monopolies) by increasing substantially the share of market or industry output controlled by one or a few firms. Such mergers substantially increased monopoly power in the industries where they occurred. The current merger movement, starting in the middle 1950's, seems marked by diversification; that is, by merger the acquiring firms are moving into new markets, both product markets and geographic market areas. If the first two movements can be described as "monopoly and oligopoly by merger," then the third may be described as "diversity by merger." Unfortunately, at the time the first merger movement occurred, it was misstudied by the leading economists, who generally neglected the monopoly aspects of the mergers. And the second, "less spectacular" wave of the

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2 This neglects a weak wave of industrial mergers in 1889-1892 and another wave of railroad mergers. Stigler, Monopoly and Oligopoly by Merger, 40 AM. ECON. REV. 918 (1950), reprinted in THE ORGANIZATION OF INDUSTRY 95 (G. Stigler ed. 1968).

3 In a widely quoted passage, Stigler laments the role of economists during the early merger period:

It is sobering to reflect on the attitudes of professional economists of the period

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1920's apparently generated little interest among economists who were intent upon studying the first merger movement and the depression. For the third merger movement, Professor Reid notes that the "less than impressive" list of publications on mergers by economists seems to indicate "scant concern of economists about current merger activity."4 Their "scant concern" about conglomerate mergers, at least over the antitrust implications, probably stems from a fundamental difficulty: antitrust laws are intended to discourage the acquisition of monopoly power, and the analytical links between a conglomerate merger and an increase in monopoly power are generally unconvincing to many economists. Either the links must be more carefully forged, or the appropriate directions for policy must be more carefully indicated. This is one effort in the latter direction.5

The argument proceeds in three steps. First, some statistical information regarding the current merger movement and the state of corporate diversity in United States' industry suggest their direction and importance. Second, some comments on the developing antitrust policy on conglomerate mergers suggest that the apparent thrust of that policy rests on deficient economic analysis. And third, the circumstances surrounding conglomerate mergers and corporate diversity include financial or profit motivations toward the merger movement. Economists as wise as Taussig, as incisive as Fisher, as fond of competition as Clark and Fetter, insisted upon discussing the movement largely or exclusively in terms of industrial evolution and the economies of scale. They found no difficulty in treating the unregulated corporation as a natural phenomenon, nor were they bothered that the economies of scale should spring forth suddenly and simultaneously in an enormous variety of industries—and yet pass over the minor firms that characteristically persisted and indeed flourished in these industries. One must regretfully record that in this period Ida Tarbell and Henry Demarest Lloyd did more than the American Economic Association to foster the policy of competition.

Id. at 103. However, one must also record that substantial publications, some by economists, appear on the other side of the balance sheet; pre-1906 authors include Ernest von Halle (1895), R. T. Ely (1900), J. W. Jenks (1900), W. M. Collier (1900), Luther Conant (1901), C. J. Bullock (1901), J. E. LeRossignol (1901), E. J. Nolan (1904), John Moody (1904), W. Z. Ripley (1905), and the INDUSTRIAL COMMISSION REPORT ON TRUSTS AND INDUSTRIAL COMBINATIONS, with hearings and related documents (1901). Markham dates the first movement as 1887-1904. Markham, Survey of the Evidence and Findings on Mergers, in BUSINESS CONCENTRATION AND PRICE POLICY 154 (Nat'l Bureau Econ. Research ed. 1955). See also R. Nelson, MERGER MOVEMENTS IN AMERICAN INDUSTRY 1895-1956 (1959); Chandler, The Structure of American Industry in the Twentieth Century: An Historical Overview, 43 BUS. HISTORY REV. 255 (1969); Eis, The 1919-1930 Mergers Movement in American Industry, 12 J. LAW & ECON. 267 (1969).

4 Reid, Mergers and the Economist, 14 ANTITRUST BULL. 371, 378-79 (1969). On the other hand, the current wave has not gone entirely unnoticed. See note 1 supra.

5 Further interpretation and analyses of conglomerate mergers may require new tools of analysis. The marginal revenue curve, so helpful in describing and interpreting monopoly, was discovered and thrust into prominence only after the second merger movement had subsided, with the publication of E. Chamberlin, THE THEORY OF MONOPOLISTIC COMPETITION (1st ed. 1933), and J. Robinson, THE ECONOMICS OF IMPERFECT COMPETITION (1933). And it wasn't until 1951 that an economist published an empirical demonstration of a relationship between market structure (a concentration ratio reflecting monopoly power) and market performance (the profitability of firms) for a sample of industries. Bain, Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-1940, 65 Q.J. Econ. 293 (1951).
which are independent of increases in monopoly power. Indeed, conglomerate mergers may improve the state of competition.

I. SOME BASIC DATA ON CONGLOMERATE Mergers AND Corporate DIVERSITY

The conglomerate nature of the current merger movement, underway for a decade and a half, is well known. As Table I indicates, over $\frac{2}{3}$ of the large mergers in the 1948-1968 period, whether measured by the number of acquisitions or by the assets acquired, have been classified as conglomerate in the Federal Trade Commission merger data.\(^6\) The number of all large mergers (and assets acquired) has been increasing, but the number (and assets) of large conglomerate mergers has been increasing at a slightly faster pace; hence conglomerate large mergers, as a percentage of total large mergers, have been larger in recent years. In 1967-1968 over $\frac{3}{4}$ of the large mergers (number and assets acquired) have been conglomerate.\(^7\)

In the post war period, an increase has also occurred in the relative importance of large firms throughout both the manufacturing sector and the economy. The largest firms have, during the past two decades, accounted for an increasing share of assets, sales, value added, or any other measure of aggregate business activity. Table II presents the percentage of value

<table>
<thead>
<tr>
<th>Type</th>
<th>1967-1968(^2)</th>
<th>1948-1968(^3)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>Assets(^1)</td>
</tr>
<tr>
<td>Horizontal</td>
<td>26</td>
<td>$1,578</td>
</tr>
<tr>
<td>Vertical</td>
<td>34</td>
<td>1,407</td>
</tr>
<tr>
<td>Conglomerate</td>
<td>301</td>
<td>17,853</td>
</tr>
<tr>
<td>Product Extension</td>
<td>216</td>
<td>9,687</td>
</tr>
<tr>
<td>Market Extension</td>
<td>1</td>
<td>749</td>
</tr>
<tr>
<td>Other</td>
<td>84</td>
<td>7,417</td>
</tr>
<tr>
<td>Total</td>
<td>361</td>
<td>20,838</td>
</tr>
</tbody>
</table>

\(^{1}\) Assets in millions of dollars.

\(^{2}\) Data for 1968 are preliminary, and the entire merger series is under revision by the Federal Trade Commission.

\(^{3}\) The entire merger series was under revision and published in the BUREAU OF ECONOMICS, FTC, ECONOMIC REPORT ON CORPORATE Mergers (1969). “Large mergers” are defined as those whose assets are “$10,000,000 or more”; the emphasis on large mergers seems reasonable, since many small mergers are undetected by the FTC.

\(^{7}\) One substantial reason, of course, for the increasing relative importance (but not necessarily the growth in absolute numbers) of conglomerate mergers is the increased stringency in antitrust policy on vertical and horizontal mergers.
TABLE II

SHARE OF VALUE ADDED BY MANUFACTURE ACCOUNTED FOR BY LARGEST MANUFACTURING COMPANIES

<table>
<thead>
<tr>
<th>Company Rank Groups</th>
<th>Percent Value Added by Manufacture</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1963</td>
</tr>
<tr>
<td>Largest 50 companies</td>
<td>25</td>
</tr>
<tr>
<td>Companies ranked 51-100</td>
<td>8</td>
</tr>
<tr>
<td>Companies ranked 101-150</td>
<td>4</td>
</tr>
<tr>
<td>Companies ranked 151-200</td>
<td>4</td>
</tr>
<tr>
<td>Largest 200 companies</td>
<td>41</td>
</tr>
</tbody>
</table>


added by manufacture, accounted for by the largest manufacturing companies for the four post World War II years in which a census of manufacturers was undertaken. Between 1947 and 1963 the largest 200 companies increased their share of manufacturing value added from 30 percent to 41 percent. Generally, this relative increase occurred among the largest 50; 8 of the 11 percentage points were garnered by this group, as its share increased from 17 percent to 25 percent.8

This increase in “overall concentration” of assets, sales, or, as indicated by Table II, value added in manufacturing, contrasts with changes in concentration of sales (value of shipments) in individual industries. Of the over 400 4-digit S.I.C. industries in manufacturing, 213 provide comparable data for the same 1947-1963 period. Table III indicates that changes in the four-firm concentration ratio9 appear reasonably balanced. This measure of

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8 The share of total assets of all manufacturing corporations held by the 50 largest manufacturing corporations rose from 34.7 percent in 1948 to 37.3 percent in 1964 (a slight fall from 38.2 percent in 1962). For the 500 largest, the percentage rose from 58.4 percent to 68.0 percent (1962) and 67.2 percent (1964). Berry, Conglomerate Bigness and Diversification in Manufacturing, 28 Ohio St. L.J. 402, 413 (1967). Professor Berry discusses the differences in these two measures (assets and value added in manufacturing) of “overall concentration” and suggests that the increases may be levelling off. The latter point seems consistent with the projections in McGowan, The Effect of Alternative Anti-merger Policies on the Size Distribution of Firms, 5 Yale Econ. Essays 423 (1965). For a century long review of “overall concentration,” see J. Bain, Industrial Organization ch. 4 (2d ed. 1968), who argues that “overall concentration” has remained relatively stable since the end of the first merger movement. See also Collins & Preston, The Size Structure of the Largest Industrial Firms, 1909-1938, 51 Am. Econ. Rev. 986 (1961).

9 The share of the value of shipments was accounted for by the largest four firms. This is a widely accepted and imperfect measure of monopoly power in an industry. Of course, concentration might have fallen in this period if all mergers—including conglomerate—had been forbidden. For a discussion of problems of interpretation of this measure, see J. Bain, supra note 8, at ch. 5, and Bain, supra note 5, at 299-303; Rosenbluth, Measures of Concentration, in Business Concentration and Price Policy 57 (Nat’l Bureau Econ. Research ed. 1955). See also Hall & Tideman, Measures of Concentration, 62 J. Am. Stat. Ass’n 162 (1967). For a discussion of the stability of industry concentration in the 1947-1958 period, see Shepherd, Trends in Concentration in American Manufacturing Industries, 1947-1958, 46 Rev. Econ. & Stat. 200 (1964).
monopoly increased 3 percentage points or more in 81 industries, decreased 3 percentage points or more in 86 industries, and remained substantially unchanged in the remaining 46 industries. There are some differences between producer goods and consumer goods industries which tend to balance each other. Measured by value of shipments (a method of weighting the industries by their relative size), the increased concentration covered 35 percent, the decreased concentration covered 45 percent (using ± 3 percentage points) as shown in Table III. Again some differences between producer goods and consumer goods industries appear. These data are consistent with general overall stability in industry concentration; although some industries demonstrate change, there appears no widespread increase (or decrease) in concentration in the group of individual industries.

These two observations, that in the post war period concentration in individual industries shows no general increase, while “overall concentration” has been increasing, are consistent with an increase in corporate diversity;¹⁰ large firms are spreading their operations into an increasing number of industries by merger. One indication of this increasing corporate diversity is given in Table IV. Companies enumerated in the various economic censuses are classified into one of 179 “Enterprise Industry Cat-

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¹⁰They are also consistent with the possibility that highly concentrated industries (with large firms) are growing more rapidly (without changing the relative shares of firms in each of those industries) than the less concentrated industries. This apparently has not happened. Berry, supra note 8, and Shepherd, supra note 9. Neither does it help to explain the merger data of Table I.
TABLE IV
DISTRIBUTION OF COMPANIES, ESTABLISHMENTS, EMPLOYEES, AND SALES AND RECEIPTS
BY INDUSTRY DIVISION AND BY TYPE OF COMPANY, 1963 AND 1958

<table>
<thead>
<tr>
<th>All Industries</th>
<th>1963</th>
<th>1958</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percentage</td>
</tr>
<tr>
<td>Number of companies total</td>
<td>3,293,313</td>
<td>100.0</td>
</tr>
<tr>
<td>Single unit companies</td>
<td>3,198,384</td>
<td>97.1</td>
</tr>
<tr>
<td>Multi-unit single industry companies</td>
<td>66,165</td>
<td>2.0</td>
</tr>
<tr>
<td>Multi-unit multi-industry companies</td>
<td>28,764</td>
<td>0.9</td>
</tr>
<tr>
<td>Number of establishments total</td>
<td>3,687,556</td>
<td>100.0</td>
</tr>
<tr>
<td>Single unit companies</td>
<td>3,198,384</td>
<td>86.7</td>
</tr>
<tr>
<td>Multi-unit single industry companies</td>
<td>206,963</td>
<td>5.6</td>
</tr>
<tr>
<td>Multi-unit multi-industry companies</td>
<td>282,209</td>
<td>7.7</td>
</tr>
<tr>
<td>Number of employees total</td>
<td>33,270,321</td>
<td>100.0</td>
</tr>
<tr>
<td>Single unit companies</td>
<td>14,694,761</td>
<td>44.2</td>
</tr>
<tr>
<td>Multi-unit single industry companies</td>
<td>3,226,454</td>
<td>9.7</td>
</tr>
<tr>
<td>Multi-unit multi-industry companies</td>
<td>15,349,106</td>
<td>46.1</td>
</tr>
<tr>
<td>Sales and receipts ($1,000,000)</td>
<td>926,006</td>
<td>100.0</td>
</tr>
<tr>
<td>Single unit companies</td>
<td>432,340</td>
<td>46.2</td>
</tr>
<tr>
<td>Multi-unit single industry companies</td>
<td>96,110</td>
<td>10.3</td>
</tr>
<tr>
<td>Multi-unit multi-industry companies</td>
<td>407,557</td>
<td>43.6</td>
</tr>
</tbody>
</table>

SOURCE: Adapted from U.S. BUREAU OF THE CENSUS, ENTERPRISE STATISTICS: 1963, PART I-GENERAL REPORT ON INDUSTRIAL ORGANIZATION Table 8, at 160 (1968).

gories" covering mineral industries, manufacturing, public warehousing, wholesale trade, retail trade, and selected services. These categories are roughly at the 3-digit S.I.C. level of aggregation, hence the industries are broader (including more products) than the 4-digit industries used to compute the industry concentration ratios. Similarly each establishment (or plant) is classified into one of the same 179 categories. A company classified in one enterprise industry category may own establishments classified in different categories, hence it may be a multi-industry or diversified company. As Table IV indicates, of 3.3 million companies in 1963, 28,764 (0.9 percent) were multi-unit and multi-industry. When establishments (rather than companies) are thus classified, 282,209 establishments (7.7 percent of the 3.7 million) are owned by multi-unit, multi-industry companies. Similarly 46.1 percent of the employees in all companies are employed by, and 43.6 percent of sales and receipts are made by, multi-unit, multi-industry companies. Compared with 1958, the only other previous year for which comparable data are available, these three percentages have increased, each
by about one-tenth in the five years. Corporate diversity apparently is increasing.

Another indication of both the level of, and the increase in, diversity is contained in the Industry Specialization Ratios (ISR) reported in Table V

<table>
<thead>
<tr>
<th>TABLE V</th>
</tr>
</thead>
<tbody>
<tr>
<td>INDUSTRY SPECIALIZATION RATIOS, 1954, 1958, AND 1963</td>
</tr>
<tr>
<td>(based on employees)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>For companies classified in one of the Census Enterprise Industry Categories in the following industry divisions:</th>
<th>1963</th>
<th>1958</th>
<th>1954 (NA)</th>
<th>1958</th>
<th>1954</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Industries</td>
<td>84.8</td>
<td>87.6</td>
<td>88.3</td>
<td>89.5</td>
<td></td>
</tr>
<tr>
<td>Mineral Industries</td>
<td>88.5</td>
<td>89.3</td>
<td>93.9</td>
<td>93.9</td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>76.2</td>
<td>80.8</td>
<td>81.4</td>
<td>83.8</td>
<td></td>
</tr>
<tr>
<td>Public Warehousing</td>
<td>96.9</td>
<td>93.5</td>
<td>98.3</td>
<td>93.5</td>
<td>98.5</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>96.2</td>
<td>96.2</td>
<td>96.7</td>
<td>96.5</td>
<td></td>
</tr>
<tr>
<td>Retail Trade</td>
<td>94.2</td>
<td>95.5</td>
<td>96.8</td>
<td>96.4</td>
<td>96.8</td>
</tr>
<tr>
<td>Selected Services</td>
<td>96.9</td>
<td>97.6</td>
<td>99.0</td>
<td>98.2</td>
<td>99.0</td>
</tr>
</tbody>
</table>


for 1954, 1958, and 1963. Since each company and each establishment (plant) is classified into one of the 179 Enterprise Industry Categories, the companies classified in a particular industry may own establishments classified in another industry. Using employees as a standard for a particular industry, the ratio of: (1) employees in establishments classified in the same industry as the owning company to, (2) all employees of companies classified in that industry provides the Industry Specialization Ratio. For 1 of the 179 enterprise industry categories a value of unity (or 100 percent) indicates that companies classified in that industry category own no plants (with employees) which are classified in another industry category. If the ratio falls below unity, the companies in that industry are diversified to the extent that they own plants (with employees) classified in other industry categories. The ISR's for 1954, 1958 and 1965 indicate that companies in the manufacturing division are more marked by diversity than companies in the other five industry divisions. Indeed, companies in warehousing, wholesaling, retailing, and services are relatively undiversified. Increases in diversity, indicated by an ISR falling over time, are occurring in all six industry divisions.

However, the ISR should be interpreted as only a crude measure of
diversity. It probably understates actual diversity both by not measuring the extent of product differentiation in establishments classified in the same industry as the owning company and by taking as its market delineation the 179 Enterprise Industry Categories, most of which undoubtedly are too broadly defined, at the 3-digit level, by including several non-substitutable products in the same "industry." Moreover, "diverse" is not a synonym for "conglomerate," since the ISR may fall below one hundred if a company in that industry is vertically integrated by owning a plant from which it "buys" inputs or to which it "sells" outputs.

The contrast between diversity in manufacturing and diversity in other (non-manufacturing) enterprise industry categories is demonstrated by the classification of the 179 categories by size of their ISR's. Considerably more of the 112 manufacturing categories display smaller ISR's than do the the 67 non-manufacturing categories, as Table VI shows. Indeed in 1963, 53 of

<table>
<thead>
<tr>
<th>Table VI: Manufacturing and Non-Manufacturing Enterprise Categories, by Industry Specialization Ratios: 1963 and 1958</th>
</tr>
</thead>
<tbody>
<tr>
<td>Census Enterprise Industry Categories, by Industry Specialization Ratio</td>
</tr>
<tr>
<td>All Enterprise Industry Categories</td>
</tr>
<tr>
<td>Manufacturing Categories</td>
</tr>
<tr>
<td>With Industry Specialization Ratios of</td>
</tr>
<tr>
<td>40 to 59%</td>
</tr>
<tr>
<td>60 to 69%</td>
</tr>
<tr>
<td>70 to 79%</td>
</tr>
<tr>
<td>80 to 89%</td>
</tr>
<tr>
<td>90% or more</td>
</tr>
<tr>
<td>Non-Manufacturing Categories</td>
</tr>
<tr>
<td>With Industry Specialization Ratios of</td>
</tr>
<tr>
<td>40 to 69%</td>
</tr>
<tr>
<td>70 to 79%</td>
</tr>
<tr>
<td>80 to 89%</td>
</tr>
<tr>
<td>90% or more</td>
</tr>
</tbody>
</table>


112 manufacturing industry categories had ISR's less than 80 percent, an increase from 33 in 1958; for non-manufacturing, the number was 1 in both years.

The ISR, in a rough way, indicates the extent to which companies
classified in an industry are diversified into other activities. In a similar fashion, there is a measure of the extent to which establishments (plants) in one industry are owned by companies classified in other industries. Such a measure is the Ownership Specialization Ratio; for one of the 179 Enterprise Industry Categories, it is the ratio of: (1) employees of establishments (plants) classified in that industry if the companies owning those establishments are classified in that same industry too, (2) employees of all establishments classified in that industry, regardless of industry classification of the owning company. If this ratio is 100 percent, no establishments classified in that industry are owned by companies classified in other industry categories. If the ratio falls below 100 percent, establishments in that industry are owned by companies in other industries. Thus, the Ownership Specialization Ratio (OSR) for one of the 179 industry classification indicates the extent to which companies in other industries have diversified into that industry.

Table VII, reproducing the OSR's in 1954, 1958, and 1963, indicates considerable ownership of mineral and manufacturing plants by companies classified in a different Enterprise Industry Category; probably this ownership is by manufacturing firms seeking to improve their access to raw material supplies. Since this ratio appears generally falling over time in Enterprise Industry Categories in all six industry divisions, diversity into industries, as measured by the OSR, seems to be increasing.

Again diversity measured by the OSR (in a manner similar to the ISR)
may be understated; the enterprise industry categories, at the 3-digit level of S.I.C. detail, are too broad, and intra-plant diversity of production escapes measurement entirely. Moreover, the OSR may reflect vertical integration; hence the concept of diversity by this measure is not synonymous with conglomerate.

This brief survey of some data relevant to conglomerate mergers and corporate diversity supports several generalizations concerning the American economy. Even though industry concentration in the manufacturing sector (as measured by 4-digit, four-firm concentration ratios) has remained relatively unchanged during the post war period, the "overall concentration" within the largest firms in manufacturing has been increasing. Mergers are numerous, involve substantial assets, and are characterized by the increasing importance of conglomerate, rather than vertical and horizontal, mergers. The extent of diversity seems relatively great in manufacturing, but the trend to diversify, as the various measures change over time, extends throughout the economy.

II. SOME BASIC ECONOMICS OF THE DEVELOPING CONGLOMERATE MERGER POLICY

In its early years of enforcement, the Sherman Act seems ineffective in preventing the formation of "trusts" or monopolies. Proscription of contracts, combinations, or conspiracies in restraint of trade failed to stop or impede the first merger movement. Occasionally, corporations were dissolved after they had become full-blown monopolies. In 1914, Congress identified for special treatment a proven method for acquiring monopoly: acquisitions of shares of stock to effect "trusts," the favorite device for pooling assets, coordinating price and output decisions, and thus blunting competition. Mergers by acquisition of "stock or other share capital" were forbidden when certain economic effects could reasonably be anticipated: the substantial lessening of competition, the restraint of commerce, or the tendency to create a monopoly. By isolating mergers by stock acquisition, and proscribing them under monopoly-creating conditions, potential Sherman Act cases could be nipped in the bud.

13 Also identified in the Clayton Act, 38 Stat. 730 (1914), as amended, 15 U.S.C. §§ 12-27 (1964), were price discrimination, tying and exclusive dealing contracts, and interlocking directorates. The purpose was "to arrest the creation of trusts... in their incipiency..." S. Rep. No. 698, 63d Cong., 2d Sess. 1 (1914). More recently, "[t]he intent... is to cope with monopolistic tendencies in their incipiency and well before they have attained such effects as would justify a Sherman Act proceeding." S. Rep. No. 1775, 81st Cong., 2d Sess. 4-5 (1950). See also Brown Shoe Co. v. United States, 370 U.S. 294, 311-24 (1962); REPORT OF THE ATT'Y GEN'S NAT'L COMM. TO STUDY ANTITRUST LAWS 115, 718 (1955); W. LETWIN, LAW AND ECONOMIC POLICY IN AMERICA 275-76 (1965); Blair,
The loopholes in this initial section 7 of the Clayton Act soon became painfully evident. The purchase of assets (rather than stock) provided an obvious escape. Even stock acquisitions, if the physical assets were transferred to the acquiring firm with sufficient dispatch, were ruled immune. More important, for illegality the economic effect on competition had to occur between the acquiring and acquired companies. This was widely, and properly, interpreted to mean that only horizontal mergers, those between rival sellers, could be attacked under the original section 7; vertical mergers (those between a customer and a supplier) and conglomerate mergers (those involving firms serving separate markets) escaped prosecution.

The 1950 Celler-Kefauver amendment to section 7 plugged these "loopholes." Not only did the amendment specify asset as well as stock acquisitions, but it also extended coverage to all mergers by omitting mention of the acquiring and acquired companies. The congressional purpose, according to the Report of House Committee on the Judiciary, was
to make it clear that the bill applies to all types of mergers and acquisitions, vertical and conglomerate as well as horizontal, which have the specified [economic] effects . . . .

If, for example, one or a number of raw-material producers purchases firms in a fabricating field (i.e., a "forward vertical" acquisition), and if as a result thereof competition in that fabricating field is substantially lessened in any section of the country, the law would be violated, even though there did not exist any competition between the acquiring (raw material) and the acquired (fabricating) firms.

The same principles would, of course, apply to backward vertical and conglomerate acquisitions and mergers.

Thus, the clause specifying the economic effects — "where in any line of commerce in any section of the country the effect of such acquisition may be substantially to lessen competition or tend to create a monopoly" — was

in J. Weston & S. Peltzman, supra note 1; Bok, Section 7 of the Clayton Act and the Merging of Law and Economics, 74 HARV. L. REV. 226, 233 (1960).
16 "[W]here the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and with the corporation making the acquisition or to restrain such commerce in any section or community or tend to create a monopoly of any line of commerce . . . ." 38 Stat. 751 (1914).
17 Or between rival buyers, although the emphasis in court proceedings is generally on rivalry in selling rather than rivalry in buying because of the factual conditions of most cases.
18 H.R. Rep. No. 1191, 81st Cong., 1st Sess. 11 (1949) (emphasis added). The wording of the 1950 Celler-Kefauver amendment to section 7:
[N]o corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, 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.
intended to apply to conglomerate (as well as vertical and horizontal) mergers.

Competition in economics means rivalry: rivalry in price, in quality, and in product improvement. A company supplying a product competes with its rivals if it shades—lowers—its price or introduces a better product. Consumers face alternative suppliers who vie, in price and quality, for their custom. And in the long run the price of the product approximates the cost of production, which reflects the bidding of resources from alternative occupations.

In contrast, monopoly power in economics means the ability to raise price (or neglect product quality and improvement) and to restrict output sold in a market. Such ability to restrict supply is profitable because fewer units can be sold at a higher price. This may be possible if suppliers in a market are few enough (or a few suppliers together are large enough in relation to total market supply), so that collective (perhaps not collusive) behavior lessens rivalry in price. By recognizing their mutual interests in avoiding rivalry, the independent firms may produce monopoly-like results without explicit communication.

I have no intention of reproducing a textbook exegesis on the various "models" of market structure, such as perfect competition, pure monopoly, monopolistic competition, imperfect competition, and oligopoly. Each of these (and others) has a specific meaning, but at the present level of reality the distinctions seem unhelpful. The discussion in the text emphasizes rivalry on the selling side of the market; similar conditions should exist for competitive rivalry on the buying side otherwise monopsony power exists. For those who are familiar with the economic models of market structure, the emphasis on price rivalry should seem closer to "workable competition" than to the abstract "perfect competition" in which individual rivals fail to recognize their neighbors as rivals (e.g., farmers). This emphasis is intentional, since the oligopolistic condition of fewness usually provides the circumstances for particular mergers.

The emphasis in the text rests on markets and market structures. Some observers see undesirable effects resulting from absolute size of individual firms, regardless of their position in a market context—J. Narver, Edwards, and Blair, supra note 1, seem to approximate this view at times. The courts have, since 1920, explicitly rejected the view that "mere size is an offense." United States v. United States Steel Corp., 251 U.S. 417, 451 (1920). There may be, however, a non-economic argument against mere size: e.g., political influence becomes excessive, or economic dependence upon a few business managers is increased. See amplifications of these sociological, psychological, and political views in several of the items cited above. See also J. Bain, Industrial Organization 91 (1968); Machlup, Oligopoly and the Free Society, 1 Antitrust Law & Econ. Rev. 11 (1967).

Pre-World War II Alcoa is a prime example of a "single firm" monopoly, United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945), although some alternative producers (some foreign aluminum producers as well as suppliers of imperfectly substitutable products such as copper and steel) did exist. The economic (competition) issue is the availability of substitutes, as the Court pointed out in the Cellophane Case (United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956), a Sherman Act section 2 case, as was Alcoa): The ultimate consideration . . . is whether the defendants control the price and competition in the market for such part of trade or commerce as they are charged with monopolizing. Every manufacturer is the sole producer of the particular commodity it makes but its control of the relevant market [supply] depends upon the availability of alternative commodities for buyers: i.e., whether
In the long run, where such supply restriction is possible, prices deviate from (are above) costs of production, as the firms with monopoly power obtain monopoly profits. If competition exists, then customers face a selection of alternative suppliers, and the price (or price structure, to account for varying qualities of substitutable products, e.g., grades of wheat or beef) reflects costs of production. Should a single firm (or group of firms) attempt to raise price above cost, the availability of alternative suppliers would induce customers to shift patronage to these alternatives. Under conditions of monopoly power (a single firm or a "few" firms acting together collectively), customer alternatives are limited, and the suppliers can raise price above cost, restrict output sold in the market, and reap additional profit.  

there is a cross-elasticity of demand between [the product supplied by the defendants and the products supplied by other firms].

Id. at 380 (emphasis added).

"(A) party has monopoly power if it has, over 'any part of the trade or commerce among the several States', a power of controlling prices or unreasonably restricting competition." Id. at 389. "Monopoly power is the power to control prices or exclude competition." Id. at 391. "Price and competition are so intimately entwined that any discussion of theory must treat them as one." Id. at 392. After such superb economic pronouncements, the Court badly misapplied its correct concepts by finding a largely non-existent "reasonable interchangeability" between du Pont's cellophane and other flexible wrapping materials (waxed paper, "Saran" wrap, glassine, aluminum foil, etc.). Stocking & Mueller, The Cellophane Case and The New Competition, 45 AM. ECON. REV. 29 (1955), reprinted in A. E. A. READINGS IN INDUSTRIAL ORGANIZATION AND PUBLIC POLICY 118-50 (R. Hefleblower & G. Stocking eds. 1958).

The problem of a "few" firms ("oligopolies") acting together (collectively, but not collusively perhaps) to exercise monopoly power is illustrated by the Tobacco industry whose big four during the 1930's controlled together between 68 and 90 percent of the total United States production of "smaller cigarettes." American Tobacco Co. v. United States, 328 U.S. 781 (1946). Although the Court's analysis in this case is correct, no appropriate remedy was devised; moreover, the anticipated attack on non-collusive oligopolies has not materialized. Nichols, The Tobacco Case of 1946, 89 AM. ECON. REV. 284 (1949), reprinted in R. Heflebower & G. Stocking, supra at 105-17. Whether new "law" on the legal position of oligopolies was made seems moot. Compare C. KAYSEN & D. TURNER, ANTITRUST POLICY 108 (1959) with Rostow, The New Sherman Act: A Positive Instrument of Progress, 14 U. CHI. L. REV. 567 (1947). These cases are Sherman Act cases; however, "restraints of trade" and "monopolizing" are economic synonyms for restriction of supply (to raise price and increase profit). Perhaps the notion of "combinations" as used in section 1 can be used to attack "conglomerates who engage in restrictive trade practices." Baker, Combinations and Conspiracies — Is There a Difference?, 14 ANTITRUST BULL. 71, 89 (1969). Whether that notion should be so used, however, is another question.

21 Persistent and important deviations from competitive performance appear regularly in empirical work. These deviations produce a positive statistical relationship between fewness of suppliers (some variant of market shares for a few firms) and market performance (some variant of profit rates or price-cost relationships). For a recent example, see Miller, Market Structure and Industrial Performance, 17 J. INDUST. ECON. 104 (1969).

It should be noted that cartels and tacit collusion are inherently unstable; they may "break down" as price chiselers (price competitors) or "break away" to pursue price policies independent of the cartel or tacit agreement. Such a maverick firm recognizes that if everyone else honors the agreed price, he can benefit tremendously by independent (i.e., lower) pricing. But if every party to the agreement decides to be a maverick, . . . . The practical problems which face cartel members in maintaining their agreements are documented in e.g., H. MACROSTY, THE TRUST MOVEMENT IN BRITISH INDUSTRY (1907) (re-
If competitive and monopolistic behavior relate to price and output behavior, then changes in competition and monopoly power should relate to an increased or diminished ability (by sellers) to influence price and output in the market. An increase in monopoly power should thus mean an increased ability to restrict output (and raise price), and an increase in competition should mean a diminished power over price and output. Since lessening of competition (or increases in monopoly power) is the test under section 7, the effect on price and output should determine the outcome in merger cases.\textsuperscript{22}

Mergers between suppliers of substitutable products in the same market\textsuperscript{23} reduce the alternatives available to consumers; if the merging partners

\textsuperscript{22}The assumption is that economic concepts deserve economic interpretation; on this basis the participation of economists in discussions of antitrust policy is relevant. Probabilities (rather than certainties) and "substantially" lessened competition are understood to pertain, also.

\textsuperscript{23}The redundancy here in defining horizontal mergers involves the definition of substitutable: if products are not substitutes, they obviously are not in the same market. Any of the dimensions of a market—product ("line of commerce"), geography ("section of the country"), and time—can preclude substitutability: e.g., haircuts today in Brooklyn are not substitutes for haircuts today in Chicago; "The Guns of Navarone" (released in 1961), is now appearing to a different market in time (tonight's TV). A British observer is not so sanguine: "That Section VII says that a merger to be illegal must lessen competition in 'a line of commerce' and that the economy in general has never yet been defined in the courts as a line of commerce does not worry [the present U.S. Assistant Attorney General in charge of Antitrust]." The Economist, Oct. 11, 1969, at 45.

Perhaps this observer is correct (although he may not be unbiased, given the attempts to block the British Petroleum-Standard Oil of Ohio merger, although the merger now presumably has Justice Department approval. Dept. of Justice Press Release (Nov. 17, 1969)). In arguing for an injunction barring the acquisition of the Grinnell Corporation and The Hartford Fire Insurance Company by the International Telephone and Telegraph Corporation, government attorneys "introduced evidence that in the last two decades there has been an increasing concentration of economic power in the hands of fewer and larger corporate entities." ITT is the 11th largest industrial corporation in the United States based on sales, Grinnell, the 268th largest. A careful reading of the district court opinion denying the motions for preliminary injunctions indicates that the Department of Justice is attempting to use increases in "overall concentration" (as defined previously, supra note 8, and indicated in Table II) as an argument in section 7 cases. The court carefully and correctly distinguished increases in overall concentration (resulting from mergers of large corporations) from increases in market or industry concentration (resulting from mergers of rival sellers), basing the legal importance of the economic distinction on the congressional intent embodied in section 7. Indeed the court notes the differences ("conflict") between two Assistant Attorneys General in this regard: Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1393-95 (1965), and McLaren, Statement Before House Ways and Means Comm., March 12, 1969, as cited in United States v. International Tel. & Tel. Corp., 306 F. Supp. 766, 796 n. 92 (D. Conn. 1969). Other arguments used by the Government in this case are consistent with the text. See also Adelman, The Antimerger Act 1950-1960, 51 Am. Econ. Rev. 236 (1961).
Mergers and Monopoly

are sufficiently large, the alternatives may be reduced by a significant amount and hence competition may be lessened. Conglomerate mergers, by definition, are mergers of firms which supply products in different markets. The markets may be different geographically (hence the subcategory “market extension” merger) or different in a product sense (including the “product extension” conglomerate merger). But they are different markets. The ownership of the assets changes with the merger, but the alternatives facing the consumer do not change. The number of firms, the distribution of output among these firms, brands and brand name allegiance, the height of barriers to the entry of new firms into the market, and other aspects of market structure which bear on price and output decisions in a market seem not to change; a conglomerate merger, without more, can scarcely lessen competition or increase monopoly. Whatever logic is applied in conglomerate merger cases, to meet congressional expectation in the section 7 revision, must face this argument.

Although few conglomerate mergers have been prosecuted, an outline of the “competition lessening” aspects of those mergers is emerging. Two lines exist to this analysis linking conglomerate mergers and a lessening

24 Both these terms seem slightly misleading. “Market extension” mergers occur “when the acquiring and acquired companies manufacture the same products, but sell them in different geographic markets.” A better name might be “geographic market extension” or “market area extension” merger. “A merger is considered to be product extension in type when the acquiring and acquired companies are functionally related in production and/or distribution but sell products which do not compete directly with one another [are not substitutable in the consumers' eyes].” BUREAU OF ECONOMICS, FTC, LARGE MERGERS IN MANUFACTURING AND MINING No. 6-15-2, at 4-5 (1969). But what is “functionally related”? Does this imply economies of joint production, or perhaps some degree of imperfect substitutability either in production or in consumption? Perhaps a new classification of mergers is necessary, possibly based upon the purposes of the mergers rather than on the market relationships of the parties, to amend the trichotomy of horizontal, vertical, and conglomerate.

25 The published works listed in note 1 do not, I think, meet this argument directly. In addition, I see no inconsistency between the argument of this and the preceding four paragraphs and the “General Enforcement Policy” (paragraph 2) of the Merger Guidelines of the Dep't of Justice Press Release at 2-3 (May 30, 1968) [hereinafter cited as Merger Guidelines]:

[T]he primary role of Section 7 enforcement is to preserve and promote market structures conducive to competition. Market structure is the focus of the Department's merger policy chiefly because the conduct of the individual firms in a market tends to be controlled by the structure of that market, i.e., by those market conditions which are fairly permanent or subject to slow change (such as, principally, the number of substantial firms selling in the market, the relative sizes of their respective market shares, and the substantiality of barriers to the entry of new firms into the market).

There is a disclaimer, however:

[If] in the area of conglomerate merger activity, the incomplete state of knowledge concerning structure—conduct relationships may preclude sole reliance on the structural criteria used in these guidelines . . . .

Id. at 3-4.

26 These two lines are set out in the Mergers Guidelines ¶¶ 18, 19. In choosing cases to be prosecuted, the Department of Justice gives opportunity to the courts to "make merger policy." Insofar as the courts accept the conglomerate merger arguments of the Guidelines and of cases brought by the Justice Department, these paragraphs seem to be
of competition: (1) mergers between firms, one of which is removed as a potentially substantial entrant into the other’s market, and (2) mergers between firms which sell unrelated products to each other, thus raising the possibility of the two firms simultaneously “favoring” each other. The “potential entry” argument involves essentially the requirement that the merger removes a substantial potential entrant from entry contention, thus leaving the existing firms less in danger of alternative suppliers relieving them of their customers by price competition; the effect is equivalent to an increase in the barriers to the entry of new firms, i.e., a change in the structural characteristics of the market. This argument, however, requires a demonstration that other potential entrants (not part of the conglomerate merger) present substantially less chance of entry than the merging firm. The supply of “potential entrants” into most markets, while probably not inexhaustible, may be large enough to make such a demonstration difficult.27 The identi-

reasonably accurate predictions of the course of merger policy over the next decade or so. In addition, recent court decisions seem to argue along these lines: FTC v. Procter & Gamble Co., 386 U.S. 568 (1967), and FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965). However, the ITT-Grinnell-Hartford Insurance case (supra note 23) indicates an additional, and recently added, argument involving “increases in ‘overall concentration.’” The 1968 PRESIDENTIAL TASK FORCE REPORT ON ANTITRUST POLICY lists a third line of argument: “the addition of large resources to a firm already dominant in a market, possibly insulating its position from erosion through competition.” J. NARVER, supra note 1, at ch. 5, sees another thread developing in the conglomerate merger cases: the large size (“wealth”) of a conglomerate firm permits it to shift resources to the detriment of competition.

Narver and others emphasize the ability granted by a conglomerate’s “long purse” to subsidize localized price cutting (predatory pricing) and to undertake advertising. However, predation is questionable as a profitable tactic for any firm. McGee, Predatory Price Cutting, 1 J. LAW & ECON. 137 (1958). Advertising expenditures can raise barriers to new entry, J. BAIN, BARRIERS TO NEW COMPETITION ch. 4 (1956); J. BAIN, supra note 8, at chs. 7, 8 (1968); Comanor & Wilson, Advertising, Market Structure, and Performance, 49 REV. ECON. & STATS. 423-40 (1967); but conglomerate mergers are not prerequisites for intensive advertising. Stocking’s “Comment” on Edwards’ article, in BUSINESS CONCENTRATION AND PRICE POLICY 352-359 (Nat’l Bureau Econ. Research ed. 1955), provides a careful rebuttal to these and other issues concerning the links between conglomerate bigness and market (or monopoly) power.

27 The Merger Guidelines specify that challenges to conglomerate mergers will be made when the merger involves “one of the most likely entrants into the market” and a firm with certain specified market shares operating in an industry with specified concentration ratios. Id. at 22. Continuing,

In determining whether a firm is one of the most likely potential entrants into a market, the Department accords primary significance to the firm’s capability of entering on a competitively significant scale relative to the capability of other firms (i.e., the technological and financial resources available to it) and to the firm’s economic incentive to enter (evidenced by, for example, the general attractiveness of the market in terms of risk and profit; or any special relationship of the firm to the market; or the firm’s manifested interest in entry; or the natural expansion pattern of the firm; or the like).

Id. at 22-23. Is the entire field of large firms in United States manufacturing—the relevant population of potential entrants for a conglomerate merger—to be surveyed in each case this argument is used? Determination of “one of the most likely entrants” seems tantamount to per se prohibition of conglomerate (perhaps all) mergers by large firms—clearly not the congressional intent—or it seems to rest on a statistically random basis. See Brodley, Oligopoly Power Under The Sherman and Clayton Acts—From
fication of "the most likely potential entrant" seems fraught with uncertainty.

The "reciprocal buying" argument rests on the judgment that it is "an economically unjustified business practice which confers a competitive advantage on the favored firm unrelated to the merits of its product." These arrangements are undesirable, the argument goes, because some competitors may be foreclosed and hence competition lessened. This argument seems to disregard the purposes of reciprocal buying arrangements. Market power in sales, which is the evil of reciprocity, cannot be "created" from the leverage of market power in purchases: profit maximization in each of these independent markets requires independent pricing policies. Reciprocal buying, if made possible through conglomerate mergers, may accomplish increased profits for the merging firms not by increasing overall monopoly power but by shifting purchases and by adjusting the prices of the exchanged products. Situations in which this may occur include the evasion of a minimum or set price imposed formally by regulatory commissions; a "secret price cut" by an oligopolist (when an oligopolistic price may otherwise prevail, since open price-chiseling would be too expensive); and the opportunity to effect price discrimination, where arbitrage (without conglomerate merger and reciprocal dealing) would preclude price differences. The presumption is strong that each of these situations involves increased, rather than restricted supply of the product(s), and hence more, not less, competitive activity.

III. CIRCUMSTANCES FOR CONGLOMERATE DIVERSITY: FOUR EXAMPLES

Preceding sections have indicated that conglomerate mergers dominate the current merger movement and that corporate diversity, which is increased by conglomerate mergers, is widespread in manufacturing and is increasing throughout the economy. Emphasis in antitrust action against conglomerate mergers seems to rest on the possibility of reciprocity and the removal of a likely potential entrant. Conglomerate diversity, of course, may occur as the result of internal corporate expansion into new markets, as well as by merger. The advantages of conglomerate diversity²⁰ for a

²⁰ Merger Guidelines, supra note 25, at ¶ 19. For contrary views to the text, again, see Brodley, supra note 27, at ¶ 22-29, and Turner, supra note 23, at 1386-95.

²² Anderson, Reciprocal Dealing, 76 YALE L.J. 1020 (1967). This comment is another in a line of analyses of the "leverage" problem in several contexts (tie-in sales, exclusive dealing, and vertical mergers). But see, e.g., Hausman, Reciprocal Dealing and The Antitrust Laws, 77 HARV. L. REV. 873 (1964), and Stocking & Mueller, Business Reciprocity and the Size of Firms, 30 J. BUS. 73 (1957), as two examples of reciprocity analysis which do not recognize the role of pricing. The last sentence in the latter article is "[reciprocal dealing] is one of the several tools in the oligopolist's kit designed to increase sales without resorting to price cutting." Id. at 95. Actually reciprocal dealing may be a method by which price cutting is brought about in oligopolistic or regulated markets!
diversified firm, the circumstances under which diversity is profitable, shed light on competitive and monopolistic aspects and provide insights for merger policy. The reasons or circumstances presented here involve risk and sales variability, cost efficiency, financial gain through stock transfers, and reciprocity. Analysis of each of these indicates that conglomerate mergers and corporate diversity may improve competition or be neutral, contrary to the analysis contained in current merger policy.

1. Shifting Demands: Risk Reduction and Inverse Relationships

Often a firm can predict only imperfectly the demand for its product. Shifts in demand produce fluctuations in profits. If a firm desires to reduce risk (relative to overall net worth, or sales, or assets), it can diversify into another market where risk may exist but where the shifts in demand (which give rise to the risk) are not perfectly correlated with shifts in demand in the original market. The overall riskiness (expected variability in total profit, relative to total assets or net worth or sales) is reduced, even though risk in each market (relative to assets, net worth, or sales relative to that market) is unaffected. Without reducing the level of expected earnings (the weighted mean of the means of profit probability distribution), a firm can reduce the overall risk, i.e., the variability of expected profits (relative to total sales, or assets, or net worth). Corporations may reduce risk by placing their producing "eggs" in different market “baskets.”

In addition, the uncertain results of research and development activities may lead to diversification. A diversified firm is more likely to be able to use or exploit the uncertain outcomes of research, because research productivity assumes unpredictable dimensions. A wide spectrum of products which a firm may produce reduces the possibility that an invention need be sold in the very imperfect market for inventions, where the sales price may understate the economic value of invention.

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32 J. NEEDHAM, supra note 31, at 131-32. There is some question of the direction of cause and effect between R&D effort and diversification. Grabowski, The Determinants of Industrial Research and Development: A Study of the Chemical, Drug, and Petroleum Industries, 76 J. Pol. & Econ. 292-306 (1968), argues the opposite of my argument, to which M. GORT, DIVERSIFICATION AND INTEGRATION IN AMERICAN INDUSTRY ch. 7 (1962), provides some supporting evidence, which Needham rebuts. Even if a firm can predict fluctuations in its sales exactly, it may choose to diversify into a second activity where
2. Cost Efficiency

Despite the usual assumption that business firms minimize the cost of production for whatever rate of output they choose, some firms are "badly managed." Existing managers do not employ the most efficient production or marketing methods, fail to innovate, display negligence or indolence, or otherwise incur costs and forego profits that need not be incurred or foregone. Such a firm is ripe for "take over" and some management house-cleaning. A conglomerate merger is one device for injecting the firm with new management and hence for reducing costs of operation, or innovating, or otherwise improving the profitability of that firm.33

3. Financial Gain Through Stock Transfers

Creation of a conglomerate firm, through merger, may be related not to the market decisions in production and exchange of commodities but instead to the price movements of shares of stock. The price of a stock on the market depends, to some substantial extent, on its price-earnings ratio. The price-earnings ratios differ among stocks because investors value their future earnings prospects differently. Consider the following example of Marvin May:

Company A stock is selling at a price-earnings ratio of 30 because of expected growth of 33% per year in its earnings per share. Company B is

sales fluctuations are negatively correlated with sales fluctuations on the first market. Seasonal examples abound: coal and ice merchants; egg producers (winter) who cater to vacationers (summer); resort operators and employees who travel between Maine and Florida. These are examples (of a temporal kind) of diversifying to utilize "spare [underemployed] resources." See Gort, in W. Alberts & J. Segall, supra note 31, at 35-39; Alberts, in W. Alberts & J. Segall, supra note 31, at 262.

Seasonal (and other negatively correlated) demand fluctuations may be considered as one form of technological interdependence, where outputs are related in a temporal manner. Another form of technological interdependence is joint production. Some firms are diversified simply because their production processes involve products sold in different product (rather than temporal) markets; Slaughter houses sell meat and hides because animals grow both products. Oil refineries produce gasoline, kerosene, fuel oil, lubricating oil, and petrochemical raw materials because crude oil cannot be transformed into only one of these products without excessive cost. The most widely cited example is wool and mutton. Where the production processes of different products are intimately related, however, mergers are not the vehicle for achieving diversity; i.e., the marginal costs of these joint products may be considered low. This, too, is an example of "spare [underemployed] resources."

33 If a firm desires conglomerate growth, then its managers must weigh the relative merits of internal expansion and external mergers. Mergers for growth are more attractive than internal expansion if the stock of the acquired firm is sufficiently undervalued prior to the merger; if the value of the stock completely discounts the anticipated cost savings, then the acquiring firm obtains no benefit from merger via internal expansion. In such a comparison, the managers must also consider the effect on price of the product which might occur as the result of internal expansion: new capacity in the entered market may reduce price by a substantial amount.

For some examples of cost reduction effected by conglomerate mergers, see Phelan, Business Considerations in Merging, 12 ANTITRUST BULL. 147 (1967); Turner, supra note 23, at 1323-39.
not expected to have any growth and its stock is selling at a price-earnings ratio of 10. Both firms are earning $1.00 per share and both have 1,000,000 shares outstanding. The price of Company A stock is $30.00 per share and the price of Company B stock is $10.00 per share. Company A offers to acquire all of the stock of Company B by exchanging stock on the basis of one-half share ($15.00's worth) of Company A stock for each share of Company B stock. This is 50% over market for Company B stock and the offer is accepted.

The transaction is completed. No change in operating earnings occur during the next period, and the combined earnings remain at $2,000,000. At this point Company A has 1,500,000 shares outstanding, the 1,000,000 which were out before the acquisition plus 500,000 new shares issued to acquire Company B. Earnings per share of Company A stock thus rise to $1.33, a growth of 33% as expected. The price-earnings ratio remains at 30 and the stock price rises to $40.00 per share. Company A stockholders are, of course, very pleased. The entire $1.33 in earnings is available for dividends, and the price of their stock has risen 33% in addition. Former Company B stockholders are equally pleased. Not only did they receive 50% more for their stock than the market price, but that one-half share of Company A stock they received has already gone up in value from $15.00 to $20.00. They have doubled their net worth, at market prices, in less than one year.9

The resulting growth in the price of A's stock, benefiting the stockholders, some of whom engineered the merger, is independent of internal growth of both A and B. Instead, the growth in the price of A's shares — the objective of the merger — evolves because the stock market values shares on the basis of a stock's p/e and because A purchased a company with a lower p/e (at a price intermediate to the two pre-merger p/e's). Like a chain letter, this process will eventually produce a market fall for A's stock "when the conglomerate runs out of acquisitions" and internal growth is largely absent. But if those who bring the merger about sell their own shares soon enough, the day of reckoning comes to others.

Present accounting methods aid in playing the price-earnings game of mergers. Under the "pooling-of-interest" method of accounting in merger cases, the assets and liabilities of the two firms are merely added — as if they married rather than as if one acquired the other. If a price higher than the book value of assets was "paid" for the acquired firm through the issuance of stock or other securities, the difference (the higher "cost") does not appear on the books after the merger.8 And through appropriate use of war-

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84 May, The Earnings Per Share Trap, 24 FINAN. ANAL. J. 113-114 (1968). His discussion continues by pointing to the readjustment problems which accompany the decline in the rate of acquisition (here, an annual doubling of size of profits); when earnings no longer increase at 33 percent per year, the 30:1 price-earnings ratio is starkly revealed as an optimistic estimate by shareholders of future earnings. The point, of course, is that such "growth" may come entirely by merger, with zero increases in total sales and profits. May warns of the dangers and concludes: "[T]he rate of growth of earnings per share is not an appropriate benchmark of growth for valuation purposes when mergers or acquisitions are involved." Id. at 115.


36 See, e.g., Briloff, Distortions Arising from Pooling-of-Interests Accounting, 24
rants, convertible debentures, as well as common stock, the acquiring firm may "profit" even if the merger falls through.\textsuperscript{37} And an exchange of stock, unlike the dollar purchase of a firm, delays the capital-gains tax liability for stockholders of the acquired firm.

Financial entrepreneurs may produce conglomerate firms by merger through use of the tax laws, security regulations, and accounting practices; the financial rewards (incentives) for merging may come from changes in stock prices (aided, of course, by those tax laws, security regulations and accounting practices), not from any increase in monopoly power in the product markets.\textsuperscript{38} The real question raised here for antitrust policy is whether or not the antitrust laws are appropriate to support the Securities and Exchange Commission, to police the stock exchange, to plug tax loopholes, or to reform accounting practices.\textsuperscript{39}

\textit{FINAN. ANAL. J.} 71 (1968): The 'Funny-Money' Game, 25 \textit{FINAN. ANAL. J.} 73 (1969). The former analyzes the marriage of Gulf and Western Industries, Inc., with Paramount Pictures Corporation; the latter analyzes the swallowing of Wilson & Company by Ling-Temco-Vought. Both involved pooling of interests accounting which disguised, to the benefit, presumably, of the managers, the actual financial effects of the mergers; Briloff is able to unravel many of the threads in the public accounting records in a manner which only CPA's—certainly not most investors in common stock—can do. The alternative method of accounting, involving outright purchase, does require a new basis of accountability (which pooling of interest does not), namely the market price paid rather than the book value of assets. In the ITT-Grinnell merger, the premium paid (over book value) was $53 per share; for the ITT-Hartford Insurance merger, the premium, was $28 per share. United States v. International Tel. & Tel. Corp., 306 F. Supp. 766 (D. Conn. 1969).

\textsuperscript{37} Burck, \textit{supra} note 35, at 158. If the unsuccessful acquiring firm can quietly pick up a substantial block of the target firm's stock it may additionally profit by a rise in the price of that stock when another firm acquires its intended target. Burck's examples: Loew's Theaters Inc.'s unsuccessful bid for Commercial Credit (acquired by Control Data); Gulf and Western's unsuccessful bid for Sinclair Oil (merged with Atlantic-Richfield). Incidentally, corporate mergers may provide opportunities for financial arbitrage, when there exists a "spread between two or more securities that are equivalent in value but are trading at different prices due to some temporary market imbalance." See Robertson, \textit{Personal Investing}, \textit{FORTUNE}, Feb. 1969, at 165-66.

\textsuperscript{38} Any study of the conglomerate merger movement would thus seem incomplete without some attention to the financial aspects. These comments are designed only to indicate that accounting practices, tax laws, and security regulations provide strong motives for some mergers, not to exhaustively list and analyze all the financial possibilities. The concern of (some) accountants is reflected in Wyatt, \textit{A Critical Study of Accounting for Business Combinations}, \textit{Accounting Research Study} No. 5 (1963), a study sponsored, but not endorsed by the Institute. Chapter 6 points out, among other problems, that pooling-of-interest now describes accounting procedures rather than a type of business combination.

\textsuperscript{39} The merger movement at the turn of the century involved financial gain for its entrepreneurs. The men who effected the mergers, whose names include Rockefeller, Carnegie, Mellon, Moore, and Duke, produced firms with monopoly power in particular markets by merging small, competitive firms. Inducing the owners of these competitive firms to merge required that the anticipated monopoly profits be shared with those owners, by attractive offers to purchase their stock. All the discounted prospective gain, however, was not shared in this manner. These monopoly entrepreneurs (who were in the industry of making monopolies) were more than handsomely rewarded by their share of the discounted monopoly profits of the monopolies they formed. "Watered stock" did, after all, have some basis in an increase in expected earnings if not in the original cost of physical assets.
4. Reciprocity for Competitive Behavior

Reciprocity, the practice of "buying from one's customers," may be profitable for conglomerate firms under certain market conditions. If firm $A$ sells its product to firm $B$ (and others), the conglomerate nature of $A$ may permit it to purchase $B$'s product. The courts seem to have accepted the following argument: the fact that $A$ purchases from $B$ permits $A$ to increase its sales to $B$, hence increase its monopoly power. However, the additional restriction ("buy from me or I won't buy from you") is equivalent to an additional cost imposed on the other party, and under competitive conditions the abundance of alternative suppliers and customers renders the restriction meaningless. If firm $A$ possesses monopsony power (ability to affect the market price of purchased commodities) it will establish a profit maximizing price by appropriate marginal considerations. An additional restriction (reciprocity to increase sales of the other product) is the equivalent of a lower, non-profit maximizing price for firm $A$ in its monopsonized purchases. Firm $A$ cannot both retain its entire monopsony power in its purchases and expand its monopoly power in its sales; it must balance its gains in sales with its foregone profits in purchases. If the establishment of market prices can be done without outside interference, and if the products are economically independent, reciprocity even under monopoly conditions does not seem worthwhile.

On the other hand, if a firm does not possess freedom to price its product as it wishes, and if it would (without this obstruction) establish a different price, then reciprocity may become a profitable practice. Assume that firm $B$ is a regulated monopoly, i.e., the price for its product or service is established by a regulatory commission. Incentives exist for both firm $A$ and firm $B$ to evade the rate regulation, and reciprocity provides a mechanism. By purchasing increased output from $A$ (at an inflated or monopoly price), firm $B$ can produce the effect of a price cut in its sales to $A$ without seeming to violate the price established by regulation. Reciprocity is substituted for an otherwise blatantly illegal price cut.

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41 This section draws on the argument in Anderson, supra note 29, at 1027.
42 This argument evidently explains the circumstances in Waugh Equipment Company, 15 F.T.C. 232 (1931). Several officers of both Armour & Company and Swift and Company, substantial users of railroad services, owned a controlling interest in Waugh, a manufacturer of draft-gears and other equipment used on railroads. By playing alternative rail lines against each other, these officers used the meat packers' purchase of transportation service to influence the railroads' purchase of railroad equipment; Waugh sales of draft-gears rose dramatically from 1 percent of the total in 1924 (prior to the meat company officers' acquiring Waugh stock) to 35 percent in 1930 (after their acquisition). The equivalent of a lower price on railroad service was effected by increased purchases of Waugh gears (to the benefit not of Swift and Armour but of their officers!). A similar arrangement involved Mechanical Manufacturing Company, also producer of draft-gears (and bumping posts and centering devices) and Swift and Company; Mechanical Manufacturing Co., 16 F.T.C. 67 (1932). See other citations in Anderson, supra note 29 passim. The same interpretation may be involved in whatever reciprocal dealings exist
necessary; firm B, a member of an oligopoly or perhaps cartel, may desire to cut its price but not irritate his fellow oligopolists or cartel members, who may retaliate by meeting his price cut. The appearance of upholding the oligopoly or cartel price can be maintained, and at the same time the price may be secretly cut, if B engages in reciprocity.

**CONCLUSIONS**

The data of Section I indicate that conglomerate mergers are becoming relatively (numerically and by value added) more important in the current wave of corporate merger activity. In addition, the diversity of corporations in particular industries seems to be increasing in this postwar period. Despite the increased share of corporate assets held by the largest 50 (or 200) manufacturing firms, and despite the conglomerate merger activity, concentration ratios reflecting an important dimension of market structure seem not to have changed substantially.

Antitrust policy may be headed toward a strong stance against conglomerate mergers, at least if one firm is large, where large is measured against other firms either in an industry or in the economy as a whole. The arguments of reciprocity and entry barriers seem weak in linking conglomerate mergers, even among large firms, to the condition that, for illegality, competition must probably be lessened or monopoly increased by such a merger. Section II thus suggests that the acquisition of increased

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or existed between the railroads and General Motors Corporation, the largest commercial shippers in the country and also the largest manufacturer (GM's Electro-Motive Division) of diesel railroad locomotives. United States v. General Motors Corp., 5 TRADE REG. REP. ¶ 45,063, at 52,513 (N.D. Ill. June 2, 1967).

The evasion of rate regulation may be present in two other contexts: tying agreements, Bowman, Tying Arrangements and The Leverage Problem, 67 YALE L.J. 19-36 (1957) (e.g., Northern Pacific Ry. Co. v. United States, 356 U.S. 1 (1958)) and vertical integration (e.g., United States v. Yellow Cab Co., 332 U.S. 218 (1947)). Whether the antitrust laws should be employed to enforce governmentally regulated prices is open to some question. See also Ferguson, Tying Arrangements and Reciprocity: An Economic Analysis, 30 LAW & CONTEMP. PROB. 552 (1965). A defendant might attempt to escape an antitrust charge of “lessening competition” by demonstrating increased competition by the evasion of rate regulation. Even if unsuccessful, he thereby opens himself to generally greater penalties for violating regulation of rates.

43 Gentry was an oligopolist in both the dehydrated onion and garlic markets. Conceivably Consolidated's purchases from food processors, who also purchased onion and garlic, were the equivalent of a price cut in those markets. Gentry's share of dehydrated onion sales rose from 28 to 35 percent of the industry sales from 1950 to 1958; however, its shares of dehydrated garlic sales fell from 51 percent to 39 percent. Factual evidence on the existence of reciprocal dealing in this case was weak, however. Consolidated Food Corp. v. FTC, 329 F.2d 626, 626-27 (7th Cir. 1964).

44 We generally do not know the extent to which conglomerate mergers have contributed to the increase in corporate diversity. Professor Willard Mueller, former Director of the Bureau of Economics of the Federal Trade Commission, apparently believes that mergers are almost the entire cause of the relative growth of assets of the largest 200 corporations. Wall Street Journal, Nov. 5, 1969, at 84, col. 1-2, reporting his testimony before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, after delivering the FTC Staff Study on conglomerate mergers.
monopoly power is a doubtful motive which cannot be relied upon to explain conglomerate mergers.

If the increase in monopoly power is a doubtful motive, then conglomerate mergers need interpretation by resort to other circumstances. Section III indicates four circumstances which may lead to conglomerate mergers: (1) shifting demands which are either inversely related to each other (perhaps in a predictable manner) or imperfectly correlated (and somewhat unpredictable); (2) reduction in cost; (3) financial gain through stock transfers; and (4) reciprocity for competitive behavior. These circumstances seem conducive to the conglomerate merger.

Cost reduction leads not to higher prices and reduced output but to lower prices and increased output through a more efficient use of resources. Reduction of risk and utilization of spare resources seem both neutral on monopoly augmentation grounds and socially desirable. Financial gain through stock transfer likewise seems neutral in its price and output effects in any product market; here the purpose is gain through changes in the prices of shares of stock. And reciprocity may lead not to monopoly creation (despite the analysis of current policy) but to increases in competitive rivalry either through the evasion of rate regulation or through indirect but effective price cutting in oligopolistic markets. The White House Task Force on Antitrust Policy has proposed new legislation to control conglomerate mergers: a large firm (assets exceeding $250 million or annual sales exceeding $500 million) would be prohibited from acquiring a leading firm in an industry (a firm among the largest four, with 10 percent or more of sales, where the industry sales exceed $100 million and the four firm concentration ratio is 50 percent or more). A member of that Task Force warns that this proposed anti-conglomerate merger act is not supported by a "set of research materials showing a relationship between concentration of general economic activity in conglomerates and anticompetitive behavior." Indeed, none exists, a lack which is in sharp contrast with the empirical support for the Task Force recommendation to reduce concentration in particular industries. More importantly, prohibition of conglomerate mergers might just negate those competitive economic goals which antitrust laws presumably embody.

45 But other measures, e.g., a revision of accounting procedures for mergers, may be required. See notes 34-38 supra.
47 Id. at 5658 (Professor Paul W. MacAvoy in an appended Separate Statement).
48 See note 21 supra. Moreover, as Section III attempts to indicate, and as Berry's (supra note 8) statistical analysis seems tentatively to show, the relationships between conglomerate mergers (or corporate diversity) and monopoly creation may be just the reverse of those relationships necessary to support the Task Force merger proposal.