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STATEMENT

by

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COMMISSIONER

FEDERAL TRADE COMMISSION

on

CONGLOMERATE MERGERS

THE QUEST FOR GUIDELINES

"VANISHING SIGN POSTS LEGAL AND ECONOMIC"

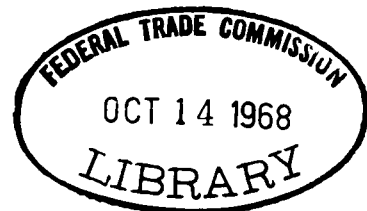
before

FALL MARKETING CONFERENCE

NATIONAL ASSOCIATION OF MANUFACTURERS

NEW YORK, N. Y.

OCTOBER 10, 1968



## CONGLOMERATE MERGERS

### THE QUEST FOR GUIDELINES

#### "VANISHING SIGN POSTS LEGAL AND ECONOMIC"

The want ads on occasion afford considerable insight into current economic developments. Certainly, the classified section in recent issues of the Wall Street Journal has a great deal to tell us about the direction of the merger movement. Perhaps the most striking notice of this nature to come to my attention is an ad with the arresting caption "Let's Conglomerate Together". There, a "Successful, Imaginative Profit-and-Growth Oriented" electronics manufacturer publicized its desire to meet with top management of other firms for an evaluation of combined growth potential with "Synergistic Growth" as the announced goal. 1/ Other ads proclaim "Available for Acquisition" or "\$1,000,000 Available [for Merger] Type of Business Not Important". 2/ Clearly, business is bent on diversifying with a vengeance and firms interested in acquisitions are not deterred if the business of the prospective partner is not closely related to their own.

This is confirmed by recent Federal Trade Commission statistics which throw considerable light on the depth and

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1/ Wall Street Journal, August 2, 1968.

2/ Ibid.

direction of the trend in mergers. Conglomerate acquisitions are by far the most significant category of corporate amalgamation according to these figures. For example, in 1967, of large mergers 3/ conglomerate acquisitions accounted for 83% of the number of mergers and 80% of the acquired assets. 4/ Further, the figures as a whole show that in the period 1963 to 1967, the importance of conglomerate combinations measured either in terms of assets or number of mergers has increased substantially. The preliminary figures for the first half of 1968, are also of considerable interest. In that six month period, conglomerate mergers accounted for 79.3% of the number of acquisitions and 89.8% of the merged assets with a dollar value of \$4,879,900,000. The critical nature of this phenomenon is underscored by the fact that the dollar value of the merged assets in the case of conglomerate mergers for the first half of this year constitutes approximately 29.4% of the comparable 16 billion dollars plus figure for the entire preceding five year period.

Moreover, the type of conglomerate mergers and their frequency disclosed by the Commission's figures, broken down by product extension, market extension and

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3/ Those involving acquisitions of firms with assets of \$10,000,000 or more.

4/ "Merger Activity Set New Record Last Year, FTC Reports" F.T.C. Press Release March 18, 1968.

other mergers where there is no discernible relationship between the combined firms are significant. For the period 1963-1967, product extension mergers considerably outnumbered mergers between wholly unrelated companies and both categories were far more significant than market extension mergers. 5/ The applicable economic and legal considerations may, of course, dictate different approaches to the various categories of conglomerate acquisitions.

The increasing importance of the conglomerate merger movement of necessity has radically changed the contours of the economy and created difficult problems of economic and legal analysis. Overall concentration in the economy as a whole as opposed to concentration in single product markets appears to be a function of business's drive for

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<u>5/</u> <u>Type of Merger</u>	<u>1963</u> No.	-	<u>1967</u> Assets (millions)
Conglomerate:	382		\$16,577
Product extension	281		10,589
Market extension	16		1,821
Other	85		4,167

Source, F.T.C. Press Release, March 18, 1968, supra note 4.

diversification. 6/ The antitrust significance of that development lies in the fact that by virtue of such diversification certain firms have become more significant than the industries in which they operate. 7/ As a result, the danger arises that some companies may no longer be subject to the normal competitive discipline of the markets wherein they do business.

The threatened breakdown of traditional industry boundaries as a result of conglomerate mergers 8/ has a profound effect on antitrust policy. For, as the American firm diversifies and broadens its lines of commerce, the important antitrust issues are less concerned with monopolization of a given product market. The single product analysis of monopoly and oligopoly theory on which antitrust enforcement has to a large extent hitherto rested does not adequately explain the behavior of the conglomerate firms with the power to shift resources from one market to another. It is necessary, therefore, to reorient the

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6/ Cf. testimony of Dr. Joel Dirlam, Hearings on Economic Concentration before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 88th Cong. 2d Sess. pt. 2, 748 (1965) [hereinafter cited as Concentration Hearings].

7/ Id at 770.

8/ See Houghton, Mergers, Super Concentration and the Public Interest, "Administered Prices: A Compendium on Public Policy", Subcommittee on Antitrust and Monopoly of the Committee of the Judiciary, U. S. Senate, 88th Cong. 1st Sess. 152, 165 (1963).

antitrust focus to the issues arising from multiple product forms of competition. 9/

However, important as it is, in this area economic analysis can only operate within the statutory framework provided by Congress. The direction of enforcement is of necessity governed by the text of the merger law and the underlying Congressional intent. The difficulty in dealing with aggregate concentration as opposed to concentration within a well defined product market stems from the fact that the expression of legislative concern prior to passage of the statute is not entirely consistent with the remedy actually provided. Evidently, the Congressional fear of accelerating overall concentration was a significant factor giving rise to the 1950 amendment of Section 7 of the Clayton Act. Alarm was expressed that the economy would become dominated by a few holding companies on the way to becoming "collectivist" corporations and that the "huge enterprises" built up by conglomerate acquisitions would enable these firms to drive out competition. 10/ Insofar as conglomerate mergers were

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9/ Singer, Antitrust Economics, Prentice-Hall Inc. (1968); Concentration Hearings supra note 6 at 770.

10/ For example, one Congressman in 1949, posed the following question:

[Footnote continued]

concerned those Congressman pressing for the 1950 revision of the merger law were, apparently, motivated by a fear of the social and political consequences of rising overall

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[Footnote 10 continued]

"How far should government, the people, allow that kind of concentration, which for want of a better name we call conglomerate concentration, to proceed? . . . If no brakes are placed on it, we are going to have, are we not, a few dominating companies like General Motors, which in effect is a holding company, purely an investment holding company? . . . Is not the consumer, which is part of the public, affected by the fact that the General Motors Corporation becomes a sort of collectivist corporation? . . . You get to a point where it is so large that it affects the lives and happiness of so many people, that as a matter of fact, you could not let it fail." (Hearings on Study of Monopoly Power, House Subcommittee on the Judiciary, 81st Cong. 1st Sess. 1949, at 636).

Another condemned conglomerate mergers on the following grounds:

"A third avenue of expansion -- and this is one of the most detrimental movements to a free enterprise economy -- is the conglomerate acquisition. This is the type which carries the activities of the giant corporations to all sorts of fields, often completely unrelated to their normal operations. In times such as these, when big corporations have such huge quantities of funds, they are constantly looking around for new kinds of businesses to enter. By this process they build up huge business enterprises which enable them to play one type of business against another in order to drive out competition." (U. S. Congressional Record, 81st Cong. 1st Sess. 1949, 11,496).

Quoted in Narver, Conglomerate Mergers and Market Competition, 47, 51 University of California Press (1967).

concentration, the growing influence on the part of large multi-product and market corporations, and possibly, if you will, a fear of bigness as such.

These socio-political considerations, however, are not clearly reflected in the text of Section 7 whose prohibition is written solely in terms of economic effect prohibiting those mergers:

" . . . 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."

This test presupposes that analysis of the effects of corporate amalgamation will focus on well defined product and geographic markets. The antitrust laws were not designed to cope with aggregate concentration in the economy as a whole and there is merit to the suggestion that if the government is to concern itself with that phenomenon such action should be undertaken pursuant to a statute specifically designed to deal with that problem. This appears also to be the position of the Department of Justice. 11/ In any event, the practical

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11/ Donald Turner, former Assistant Attorney General in charge of the Antitrust Division, it was reported:

" . . . believes that the concentration of assets into fewer and fewer hands is not a good thing from a 'political or social point of view,' but he does not think that this problem should or can be solved by antitrust action unless probable

[Footnote continued]



problems arising from an attempt to utilize the antitrust laws as a vehicle for a wholesale restructuring of all markets in the direction of pure competition are equally obvious, for the possible gains would be far outweighed by the "general disruption of the intermarket fabric of our dynamic business life". Such a campaign, moreover, would "so far out-run proven knowledge of the real nature of the problem" and "the availability of competent regulatory personnel that numerous and costly blunders would be inevitable -- many of them irreversible". 12/

Clearly, if antitrust is to deal effectively with conglomerate mergers, the enforcement agencies and the courts must devise realistic tests applicable to a particular product or geographic market which take into consideration whatever advantages the diversified firm

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[Footnote 11 continued]

antitrust consequences can be proved. What would be required to stop concentration, he asserted, is a direct attack: 'For example, \* \* \* Congress could pass a statute that would say to the top 50 or 100 companies "any time you make an acquisition in excess of a certain size you must peel off assets of comparable magnitude."' 300 BNA ATRR A-11 (1967).

12/ Nourse, Government Discipline of Private Economic Power, "Administrated Prices: A Compendium on Public Policy", supra note 8 at 245, 247. See also Dirlam & Kahn, Fair Competition, The Law and Economics of Antitrust Policy, 284 (1954).

derives outside the relevant market. A body of economic theory and legal precedent focusing on the structural characteristics of a market governing its economic performance such as barriers to new competition is gradually developing which should achieve that objective. However, before developing that theme it may be pertinent to note that it is no accident that product extension mergers account for such a significant number of conglomerate acquisitions. 13/ Where product lines are related, it is easier than in the case of the pure conglomerate to bring to bear the resources of the diversified concern in the market of the acquired company. And it is, of course, the ability to shift resources from one market to another which is one of the keys to analyzing the competitive impact of the diversification acquisition.

Basic to current enforcement of the merger statute is the general consensus among economists -- gaining increasing acceptance in the courts -- that it is the

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13/ "Conglomerate acquisitions involving no significant economic relationships have been relatively infrequent as compared to those that 'fit' the operations of the acquirer in some tangible respect. Companies looking for new lines of business tend to buy into those fields with which they have at least some degree of familiarity, and where economies and efficiencies from assimilation are at least possible . . . ." Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1315 (1965).

structure of a market which governs its economic performance. This is of particular importance in the case of a statute such as Section 7 which requires the enforcement agencies to engage in a kind of economic forecasting of the probable consequences of a merger. For example, two crucial market structure characteristics of particular importance in evaluating an acquisition are concentration in the industry and the barriers to entry of new competition. In the case of highly concentrated industries, the Supreme Court has held that the largest firms in such markets are more likely to engage in policies of "mutual advantage" than in vigorous competition. (United States v. Aluminum Co. of America, 377 U.S. 271 (1964). 14/ Economists have termed this condition "oligopolistic interdependence", to describe the recognition on the part of dominant firms in highly concentrated industries that whatever the competitive strategies employed they can be matched by their rivals of equal or larger size. In that climate,

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14/ See also United States v. Wilson Sporting Goods Co., 365 ATRR X-1, X-12 (N.D. Ill. 1968) a product extension merger proceeding in the sporting equipment field where the court held "[in the case of] tight knit oligopoly, [a] small group of large diversified firms competing against one another over a large range of products . . . would tend to reach somewhat different competitive decisions than those which small firms would reach particularly where the threat of new entry had been considerably diminished."

firms tend to veer away from price competition and depend to a greater extent on various forms of non-price competition such as advertising or other types of promotions. 15/

Barriers to entry of new competition measure the obstacles to entry of potential competitors into particular industries and markets. Taking them into consideration it should be possible to determine the cost or selling price advantages held by established firms in an industry relative to new or potential competition, that is, the condition of entry. Such barriers can be categorized roughly under three headings: economies of scale, absolute costs 16/ and product differentiation. 17/ The last

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15/ See Food from farmer to consumer, the Report of the National Committee on Food Marketing, 94 (1966).

16/ Barriers in the form of economies of scale arise from the fact that a firm may not secure the lowest possible production costs until it has achieved a certain share of the market which it is about to enter. Since in many instances a firm entering a new market may have to start with less than an optimum market share, this factor may impede entry and put entrants at a disadvantage with firms already in the industry enjoying the advantages of economies of scale. Absolute cost barriers on the other hand indicate that the potential entrants will never be able to overcome the cost advantage of the established firm, at any rate of output. For example, the established firm may have patents which prospective entrants can secure only by paying a royalty or spending funds necessary to invent substitutes for them. See generally, Caves, American Industry: Structure Conduct Performance, Prentice-Hall (1964).

17/ When established firms have a reservoir of customer goodwill, resulting from advertising or sales promotion, [Footnote continued]

category has been considered of particular relevance in the case of product extension mergers in the consumer area as evidenced by the Supreme Court decision in Clorox and the Third Circuit opinion in the General Foods - S. O. S. case. 18/ Obviously, it is easier to integrate the promotional efforts of the combined firms when related goods are involved than in the case of the pure diversification merger.

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[Footnote 17 continued]

they need only to maintain it. A new firm entering the industry, however, would have to sell at prices below those of the more preferred brands of the established sellers or invest heavily in advertising or other types of promotional activities in order to achieve a preferred status for its own brands and a sales volume capable of generating low unit processing and distributing costs. (F.T.C., The Structure of Food Manufacturing, 62 (1966), Technical Study Number 8). This may have a direct bearing on the cost disadvantages to a firm which is a potential entrant to a particular market. See also Caves, supra 16.

18/ Federal Trade Commission v. The Procter & Gamble Company, 386 U.S. 568 (1967), 1967 Trade Cases ¶ 72,061 at 83,801; General Foods Corp. v. Federal Trade Commission, 386 F.2d 936 (3d Cir 1967), 1967 Trade Cases ¶ 72,269 at 84,637. E.g. in Clorox, the court affirmed the Commission's determination that "the substitution of Procter with its huge assets and advertising advantages for the already dominant Clorox would dissuade new entrants and discourage active competition from the firms already in the industry"; similarly, the court in General Foods held that the merger raised entry barriers in the market of S. O. S. since consumer preference for the dominant brands had been generated by extensive advertising and "the smaller companies producing less well-known brands and potential producers of new brands could not make significant market penetrations without engaging in heavy expenditures for advertising and promotions.

(Footnote continued)

The concept of barriers to entry is a significant one in view of the fact that if entry is easy and it appears that rivals on the outside are ready to join the competitive race in the particular market, then even in concentrated industries this may have a restraining influence on the temptation to dominant firms in such markets to take advantage of their preeminent position. In short, entry by potential competitors may influence entrenched firms to price their products below levels which their dominant market position might otherwise command.

The concepts of ease of entry or the condition of entry, as a result, are crucial. Barriers to the entry of new firms in effect permit entrenched firms in concentrated industries to exercise their market power unchecked by competition. The preservation of potential competitors and fostering the conditions permitting their entry into concentrated markets therefore is vital. The more concentrated the market, the greater the need for preserving potential competitors. An evaluation of conglomerate mergers taking into consideration the concepts of barriers to entry and potential competition will I believe permit the Commission and other enforcement agencies to embark upon an active and flexible enforcement program

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[Footnote 18 continued]

After the merger . . . the existing competitors and such potential competitors as existed faced an even more formidable opponent . . . ."

under Section 7 as it is now written by focusing on a merger's impact on a well defined product line or market. Such analysis seems to have particular application in the case of the product extension merger. For after all, firms engaged in manufacturing and/or distributing related products are the most likely entrants into each others markets. Such acquisitions "remove from the scene those firms whose normal pattern of internal growth might most likely eventually bring them into direct competition with their acquirer; and vice-versa, they terminate the possibility that a likely entrant by internal expansion, the acquiring company, will add to the number of competitors in the market of the acquired firm. Thus 'potential' competition is frustrated." 19/ A brief rundown of the Commission's statement of enforcement policy for product extension mergers in grocery manufacturing indicates the importance of these concepts which are central to the criteria announced by the F.T.C. for assessing such acquisitions under the Merger Act. 20/

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19/ Blake and Blum, Network Television Rate Practices: A Case Study in the Failure of Social Control of Price Discrimination, 74 Yale L.J. 1339, 1367 (1965).

20/ Enforcement Policy with Respect to Product Extension Mergers in Grocery Products Manufacturing (F.T.C. Press Release, May 15, 1968)[hereinafter referred to as Policy Statement].

The Commission's survey of grocery products manufacturing notes that the industry has changed substantially in recent years. Small companies have had a tendency to disappear, conglomeration is becoming extensive and market concentration has concurrently increased in many grocery products markets. 21/ According to this analysis, large scale promotional activity and heavy advertising expenses have both resulted from and contributed to these changes. 22/ Overall concentration in the food manufacturing sector of industry in terms of profits was impressive in 1963. In that year, the 50 largest firms received 61%, and the 100 largest, 71% of total profits for all food manufacturing companies; the balance of 29% was divided among the remaining 30,000 firms in the industry. 23/ Significantly, this trend toward aggregate concentration was accompanied by high and rising concentration in individual food industries. 24/

The statement notes a correlation between rising concentration and the extent of effort devoted to product

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21/ Id at 1.

22/ Ibid.

23/ Id at 4.

24/ Over 20% of individual food industries are characterized by concentration levels where 8 firms control 90% or more of production or where the top 4 control 75% or more. (Id at 4).



differentiation. 25/ It appears that relatively few food manufacturers have the financial capability to effectively utilize television and certain other advertising media. For example, in 1964, the 50 largest food manufacturers accounted for 88% of network television advertising and 78% of such advertising in general magazines by such manufacturers. 26/ The fact that advertising is concentrated to such an extent among the largest companies appears to be no accident, but due to the high cost of television and other preferred methods of advertising. 27/ In the past, discriminatory advertising rates magnified the expense factor of advertising as a stimulus to mergers and the comparative disadvantage of smaller companies in this area of the economy. 28/ On the basis of this industry background, the Commission has identified the ranking and market share of the acquired firm in its line of commerce, the strength of the acquiring firm in its markets, and the nature and extent of the promotional efforts of the acquiring firm as among the major criteria for selecting those product extension mergers in grocery products

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25/ Id at 5.

26/ Ibid.

27/ Id at 9.

28/ Ibid.

manufacturing which raise significant questions of law or policy. 28/

The emphasis on advertising and resultant product differentiation as a critical factor in evaluating product extension mergers does not mean that the Commission is hostile to advertising as such or that it intends to use the antitrust statutes to regulate its

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28/ " . . . On the basis of its current knowledge, the Commission can identify at least four major criteria for selection of grocery product extension type mergers which raise significant question of law or policy. Acquisitions with these factors are those in which:

(1) Both the acquiring and acquired companies engage in the manufacture of grocery products. Grocery products include food and other consumer products customarily sold in food and grocery stores.

(2) The combined company has assets in excess of \$250 million.

(3) The acquiring company engages in extensive promotional efforts, sells highly differentiated consumer products, and produces a number of products, in some of which it holds a strong market position. A strong market position is defined as being one of the top four producers of a product in which the top four companies hold 40 percent or more of the value of shipments.

(4) The acquired company is either among the top eight producers of any one important grocery product, or has more than a 5 percent share of a relevant market."

Policy Statement, supra note 20 at 13, 14.

extent. After all "[it] is a major tool which must be used vigorously if we are to quicken the pulse and expand the scope of the economy." 30/ It does mean that the Commission cannot overlook the impact of advertising on competition and the competitive effects of acquisitions by the leading conglomerate firms in a setting where product differentiation may make entry into markets difficult.

The Commission's Policy Statement on product extension mergers recognizes the importance of advertising as a competitive tool. The problem seems rooted in the fact that it is too expensive for many of the smaller and medium sized companies which it would be desirable to preserve as competitive entities. Assuming that advertising and promotion is as vital to marketing in the consumer products field as the evidence before the Commission seems to indicate merely preventing mergers of independent competitors with the larger conglomerate firms will not in and of itself preserve a competitive market structure, vital as such enforcement activity is. Cognizant of this, the Commission indicated in its Policy Statement that although acquisitions by the largest firms under the criteria announced would be suspect, amalgamations of smaller

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30/ Statement of Luther M. Hodges, former Secretary of Commerce, reported in 34 Advertising Age, 4 (Weekly ed. Jan. 15, 1963).

firms to achieve advertising efficiency would not necessarily be opposed. 31/

Equally important, government, the advertising industry and the communications media might consider devising ways to make national and regional advertising available at lower cost to the smaller independent firms in the consumer products fields. The Commission in studying the root causes of product extension mergers should therefore look into the question of whether advertising is available on non-discriminatory terms to all competitors seeking the benefits of that promotional medium. 32/ Furthermore, with the advent of UHF, the

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31/ "The structure of food retailing and the imperatives of modern advertising and promotion provide a tremendous stimulus for large scale operations in food manufacturing

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" . . . it follows that many small and medium sized companies will continue to have a strong incentive to sell out or merge. It does not follow, however, that they must inevitably merge with the largest companies. Public policy may affect the direction, as well as the extent, of the merger movement . . . channeling the direction of the merger activity away from those acquiring companies which may adversely affect competition may create an environment conducive to growth and vitality among small and medium size grocery products manufacturing companies." Policy Statement, supra note 20 at 12.

32/ The Commission reported to Congress that investigations were underway in fiscal year 1968, exploring alleged discriminatory advertising rates in both newspaper and television advertising. Hearings, Subcommittee of the Committee on Appropriations, House of Representatives on Independent Offices and Department of Housing and Urban Development Appropriations for 1969, 90th Cong. Second Sess. (1968) at 98, 99.

technical barriers to additional television channels seem to have been broken and the competition of additional stations and possibly new networks might well bring down costs to the prospective advertiser. 33/ Answers of this nature, of course, cannot be found solely within the scope of antitrust enforcement. However, the preservation of competition in a dynamically changing economy requires a broader gauged approach than we have been accustomed to in the past.

This indicates that if the free enterprise system is to flourish, governmental policy as a whole must be integrated in order to encourage the economic conditions permitting its survival, and antitrust, if it is to achieve its objectives, must rest on a wider base than the anti-trust laws and enforcement agencies alone. It is not enough merely to prevent anticompetitive mergers, although I strongly advocate that course. A viable national policy

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33/ " . . . Combined use of UHF and VHF would greatly increase the number of television stations which could be licensed in an individual community and would bring about a commensurate increase in interstation competition. It would also encourage the formation of additional television networks. Increasing the number of independent stations would make it easier for advertisers to put together an independent 'network' of stations in each important market willing to accept the program. The quality and amount of independent programming would be likely to increase because the cost could be distributed over a greater number of stations." Blake and Blum, supra note 19 at 1342.

devoted to preserving competition must also rely on a preventive approach designed to ameliorate those conditions such as discriminatory pricing and the difficulty of adequately promoting their products which force smaller firms to seek amalgamation with their largest rivals.

This, the Commission is ready to do. Its announcement last July of an "In-Depth Investigation of [the] Conglomerate Merger Movement" 34/ indicates that it is prepared to go beyond a nuts and bolts assessment of what it may take to bring a successful merger case and promises to focus on broader long range issues. Significantly, included among these are the preservation of the competitive opportunities of medium and small businesses, measures to encourage internal growth to promote competition, and the issue of whether new legislation is required to bring the conglomerate merger movement under control. Recognizing that merger litigation under existing statutes alone may not keep abreast with an economy undergoing rapid transformation, the Commission realizes that antitrust too must progress to keep pace with events.

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34/ F.T.C. Press Release, July 9, 1968.