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# MERGER PROBLEMS CONFRONTING FTC

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## MERGER PROBLEMS CONFRONTING FTC

The Federal Trade Commission, as most of you know, has undertaken an economic investigation of recent corporate mergers and acquisitions. The purpose of the study is to provide facts on mergers for the information and guidance of the Commission, the Department of Justice, the Congress, and the public.

It is hoped that the report, when it is completed, will furnish answers to important questions concerning the dimensions and significance of the present merger movement. Among other things, it will attempt to

1. Determine the relative and absolute economic importance of mergers and acquisitions both generally and in specific lines of commerce.

2. Ascertain the extent to which mergers fall into the classification of horizontal, vertical or conglomerate.

3. Analyze the motives and causes underlying recent mergers, such as (a) the desire for product diversification; (b) the desire to lessen competition; (c) the desire for prestige and power; (d) the desire on the part of small and medium size firms to grow rapidly through external expansion so that they might more effectively compete with the larger firms already established in the industry; (e) the extent to which acquisitions were caused by the financial distress of the acquired firms; (f) the use of acquired firms for tax losses; and (g) the desire on the part of firms to integrate "forward" to a higher stage of fabrication or marketing or "backward" toward raw material sources.

Until a careful study of this kind is made, evaluation of the post-Korean merger pattern must be largely speculative. My own personal speculation is that, taken by itself, and in terms of the relative share of the economy involved, the recent merger wave may not be quite as significant as the wave of the 1920's, and does not compare with the trust-forming era of 1887-1904. This comparison in no way serves as a basis for looking upon the current wave with equanimity. On the contrary the cumulative effect of the three merger movements, beginning before the turn of the century and continuing to date, is of grave concern to the Commission. Both of the two earlier waves were regarded with considerable alarm by the public, and in turn by Congress. The present wave has stimulated nearly as much activity in the press. This interest and concern is, of course, all the more important in light of the recent amendment to section 7 of the Clayton Act, known as the Anti-Merger Act of 1950.

It has been suggested that most of today's mergers were initiated by management rather than bankers or financiers. If so, this

distinguishes the present movement from the former where the so-called trusts were usually put together by bankers who offered securities to the public "so thoroughly watered" that it took a generation of industrial growth, the inflation of a world war, and a nationwide depression to dry them out. In the speculation-mad 1920's the bankers used to say, "Now, we'll put Worthington Pump and International Nickel together and get Pumpernickel."1/

At the time the Commission announced its survey of mergers it released a table compiled by the Bureau of Economics listing or estimating, by years, the number of mergers and acquisitions from 1919 to 1954.2/ At the same time I issued a statement stressing the fact that "These figures throw no light on the magnitude or significance of the mergers involved or the extent to which they may affect competition in specific market areas."

As our investigation progressed the accuracy of this qualifying statement became more and more apparent. We discovered, for example, that many of the listed acquisitions did not come within the jurisdiction of either the Commission or the Department of Justice. Furthermore, the table is of doubtful value, even as a comparative numerical listing, inasmuch as different types of industries were included in different years and changes in classifications occurred during the period. One commentator, in discussing the table, said that in any event "a head-count of mergers is an utterly fatuous measurement of the public interest." I am inclined to agree, at least in part, and have therefore asked the Bureau of Economics to withdraw the preliminary table pending issuance of the final report.

Recent merger activity has been particularly strong in the baking, paper, textile, dairy, chemical, automotive and primary metals industries. Let us briefly examine each of these industries and pose some of the problems facing the Commission.

In discussing these problems it is important to bear in mind that new section 7 prohibits not only horizontal mergers, but also vertical and conglomerate acquisitions which may substantially lessen competition or tend toward monopoly. A conglomerate merger is a combination of companies engaged in dissimilar businesses. Many acquisitions appear to have been of the conglomerate type. This suggests that the desire for product diversification may have been an important motive behind the merger movement.

A horizontal merger of two substantial competitors engaged in the same line of commerce in the same market presents a relatively simple problem for the law enforcement agency. But how about

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1/See Harris, The Urge to Merge, Fortune Magazine, November, 1954, pp. 102-103.

2/It was stated at that time that the number of mergers shown for more recent years was based on a preliminary survey of the files of the Bureau of Economics.

small successive acquisitions? How about horizontal combinations of companies presently operating in different market areas? How about the company which buys a source of supply or a retail outlet, or one which buys up an entirely different type of business in order to "spread the risk" - in order not to have "all its eggs in one basket"? Here the effects on competition may be problematical, difficult to foresee, and even more difficult to demonstrate.

## Baking

Originally, because of the perishability of the product, the market area for a bakery plant was limited. But as the years passed improvements were made in rapid transportation and in the use of refrigeration, thus broadening the area which could be served from an individual plant.

Because of these improvements large companies can now profitably serve areas which hitherto they could not reach. This, of course, initially increased competition in these markets. However, as they encountered the competition of local bakeries in the new areas which they entered, large bakeries often found it advantageous to buy up the small ones. And this presents us with one of our problems. At what point in the successive acquisition of a number of local bakers can the Commission say that further purchases may well result in a substantial lessening of competition? The problem is compounded by the fact that most of the acquired bakeries are relatively small. Then there is the difficulty of obtaining statistical data on market shares for the relevant market areas. Reliable information on economic concentration for the nation as a whole is meager enough; for individual market areas it is often non-existent.

There is a second type of merger occurring in the bakery industry which illustrates another of our problems. As large bakers widen their market areas they often come into competition with each other in limited overlap areas. For one reason or another they decide to merge. Since most of the sales by each company are in areas not served by the other, does this type of situation represent a violation of amended section 7?

## Paper and Paper Products

In the paper industry we find both horizontal and vertical mergers. As an example of the former may I cite the purchase of one large paper company by a competitive large paper company, specifically, the acquisition of the St. Helens Pulp & Paper Company by the Crown Zellerbach Corporation. These two companies appear to produce parallel lines of coarse papers and serve the same geographic area. In this particular case the Commission has issued a complaint (Docket 1680) looking toward divestiture.

The vertical acquisitions in the paper industry have been largely those in which manufacturers have purchased pulp mills in order to secure their own supply of raw material. Such acquisitions tend to set off a sort of chain reaction, because with each acquisition the supply of pulp available in the free market becomes less, which in turn impels other paper companies to obtain their own source of supply. Here is the dilemma. If the larger companies are permitted to make these acquisitions, their ability to compete with each other and with the rest of the industry may be enhanced. At the same time, however, the smaller companies, which do not have, nor are likely to get their own pulp mills, suffer a reduction in the supply of the raw materials available to them, thus lessening their ability to compete.

The Commission presently is investigating the possible injurious effects upon competition of one of the vertical acquisitions in this industry, namely, the purchase by a large paper company of a large pulp producer, which in the past had been an important source of supply for smaller paper companies that are in direct competition with the acquiring company.

## Textiles

In textiles, all three classes of mergers and acquisitions have occurred: horizontal, vertical and conglomerate. There have been horizontal mergers to obtain additional plant and equipment in order to expand the production of existing lines. There have been "backward" vertical mergers in which the acquiring firms have obtained suppliers, such as yarn mills and spinning companies. And there have been "forward" vertical mergers both within manufacturing, such as the purchase of bleachers, dyers, finishers and converters, and beyond manufacturing, such as the acquisition of sales agencies.

However, as I have indicated, it is not the number of mergers which is significant; it is their probable impact on competition. It is contended, for example, that the textile industry is highly competitive, that competition is so vigorous that even a sizable number of mergers and acquisitions cannot be expected to diminish it appreciably.

Where competition is not particularly vigorous just one acquisition may violate the law; where it is vigorous, it may take many to endanger competition. The task of the Commission in obtaining a fair judgment of the vigor of competition in any given industry or in any market is not a simple one, particularly when the tools of analysis in the form of available statistical information are so inadequate.

## Dairy Industry

In the dairy industry, as in baking, most mergers have been horizontal from the point of view of product classification, but in

many instances the acquired and acquiring firms were not in close competition with each other because of geographical considerations. Like the bread industry the market area for a given plant is restricted by the perishability of the product. But with technological improvements, such as local pasteurizing, refrigeration and improved transportation, large dairy companies have found it possible to widen the areas which their individual plants can serve. Certain of the large dairv companies have long used mergers and acquisitions as a means of business expansion.

But now some of the smaller companies apparently want "to catch up" with the industry's giants, using mergers and acquisitions to do so. A case in point is the "X" company which has greatly extended its operations by buying up no less than 45 firms since 1951. Here we have a difficult problem. Should the attempt by a smaller company to approach, through mergers and acquisitions, the standing of the industry's leaders be stopped by the application of the new law? Would an action against such a company have the effect of immunizing the large companies from the competition of an aggressive rapidly-expanding competitor and thus further entrench their dominant position?

## Chemicals

Aside from such mergers as Mathieson Chemical Corporation with Olin Industries to form Olin-Mathieson Chemical Corporation and the recent acquisitions of W. R. Grace and Company - which by the way are big mergers - most of the important mergers in the chemical industry have taken place in one of its branches, namely, drugs and medicines.

In appraising mergers in this field several considerations must be borne in mind. For one thing the industry since the war has been revolutionized by the introduction of new products, such as antibiotics, vitamin $B_{12}$, cortisone, and others. The development of these products constitutes further proof of what has long been recognized as an established fact - success in the drug industry is due in no small measure to research.

Another consideration is that manufacturers of ethical pharmaceuticals require salesmen of sufficient scientific and technical background to be able to promote drug products to physicians. This sort of sales staff cannot be recruited on short notice, and must be trained. Furthermore, since profit margins tend to be higher on finished products than on raw materials, the general disposition is to try to market products in finished form. Some of the mergers in the chemical industry seem to be due to efforts by larger companies to strengthen themselves in one or the other of these respects. This is not to suggest, of course, that they may or may not lessen competition in violation of section 7.

One manufacturer of medicinal chemicals which has a good research organization and ample plant capacity, but was relatively unsuccessful in its marketing efforts, merged with a pharmaceutical manufacturer who is not outstanding in research but does have an experienced sales staff as well as a respected name. Or, as another illustration, there is the firm which discovered a new antibiotic, but lacked other pharmaceutical preparations, acquiring a company which was a successful seller of several preparations.

The Commission's problem in this industry, and in other fields as well, is whether we should attempt to prevent mergers of this type which are designed to round out a company's general business structure.

## Automobiles and Primary Metals

In the automotive industry, all important mergers except the Chrysler-Briggs merger have been horizontal. As has been pointed out on other occasions the smaller automobile companies were permitted to merge in order to enable them to compete more effectively against the giants in the industry. No one can deny, or at least the Commission did not deny, that there was already an undesirable concentration of production in the automotive field, and that further concentration was unfortunate. However, on balance, and because of the diminishing volume of the smaller companies, it seemed wise to permit them to try to achieve, via the merger route, national coverage in distribution and assembly plants, better access to supplies, and fuller product lines which may enable them to compete more vigorously with the so-called "Big Three." As the following table shows, the merged companies still have a hard row to hoe:

Automobile Passenger Car Production
12 Months 1954 3/

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| General Motors | 52.2% |
| Ford | 30.6% |
| Chrysler | 13.1% |
| Studebaker-Packard | 2.1% |
| Hudson-Nash | 1.7% |
| Kaiser-Willys | 0.3% |

In the steel industry the Department of Justice refused to approve the merger of Bethlehem and Youngstown, which ranked second and sixth among the fully-integrated steel companies. Here, unlike the automobile mergers, one of the big companies sought to acquire the facilities of a smaller but substantial (1/2 billion dollar) competitor. The Department considered, among other things, the historical importance of merger and acquisitions in the long-term growth of the

3/Ward's Automotive Reports for January 10, 1955, Vol. 30, No. 2, p. 16.

large steel companies. It also pointed out that the economic and competitive problems in that industry differed substantially from those encountered in the automobile industry.

But the Commission and presumably the Department are still confronted with merger problems in the metals industry. Aside from the proposed Bethlehem-Youngstown merger, the principal acquisitions have been by what might be regarded as "medium-sized" or even "small" companies which have been buying up still smaller firms. Again we have the problem of the merger of companies, which though of appreciable size, are still far smaller than the industry's leaders.

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In this brief sketch of the nature of the current merger movement I have endeavored to outline some of the difficult problems which face us at the Commission. Everyone will agree, I think, that they call for a careful and discriminating application of general principles of law to economic realities. The "urge to merge" is neither bad nor good per se. Competition may be injured by some mergers and revitalized by others. Each case must be examined on its individual merits. Each acquisition must be tested in the light of the relevant economic and marketing factors existing in the particular industry in the light of its history and setting.

It is important to remember, on the other hand, that the new anti-merger law is an important and vital part of national antitrust policy. The process of getting big by buying out smaller firms was one of the causes of the Sherman Act in 1890 - yet the following fifteen years, the turn-of-the-century as it is called, comprised the greatest merger movement and trust-forming era in history. The Clayton Act of 1914 attempted to put further brakes on combinations, but this proved ineffective largely because of the courts' persistence in judging mergers by Sherman Act tests. The new Anti-Merger Act of 1950, which established tests of its own, shows a strong and continuing purpose to curb the concentration process.

That the task confronting the Commission is complex shall neither deter nor discourage a maximum effort to accomplish this Congressional purpose. I have pointed out the complexities simply to underline the thoroughness with which the Commission has tackled its investigation. Were we to plunge into this study with the blunt judgments and despotic determinations of a Russian court, we could achieve speed but at the cost of justice. We could analyze and classify mergers with simple disregard for their effect, but in so doing we would fail our responsibility as an expert body. The Congress, the business community and the people are united in wanting fair and vigorous competition, whether it be accomplished by mergers or by their dissolution.

I can assure you the Commission will be able at the conclusion of its study to turn the light of fair and considered judgment on those current mergers which threaten free competition.

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