

1956

Markets, Competition, and Monopolistic Tendencies in Merger Cases - An Economic Problem in a Legal Setting

Irston R. Barnes

Follow this and additional works at: <https://scholarship.law.marquette.edu/mulr>



Part of the [Law Commons](#)

Repository Citation

Irston R. Barnes, *Markets, Competition, and Monopolistic Tendencies in Merger Cases - An Economic Problem in a Legal Setting*, 40 Marq. L. Rev. 141 (1956).

Available at: <https://scholarship.law.marquette.edu/mulr/vol40/iss2/2>

This Article is brought to you for free and open access by the Journals at Marquette Law Scholarly Commons. It has been accepted for inclusion in Marquette Law Review by an authorized editor of Marquette Law Scholarly Commons. For more information, please contact megan.obrien@marquette.edu.

MARKETS, COMPETITION, AND MONOPOLISTIC TENDENCIES IN MERGER CASES*

AN ECONOMIC PROBLEM IN A LEGAL SETTING

IRSTON R. BARNES ** †

Section 7 of the Clayton Act, as amended, seeks a legal solution to what is essentially an economic problem—the maintenance of vigorous and healthy competition. What markets are relevant in judging the competitive consequences of mergers? What is a lessening of competition? What are monopolistic tendencies?

The present discussion investigates only the economic, not the legal, consequences of various industry and market developments arising from mergers and acquisitions.

Discussions of the Clayton Act's anti-merger provisions sometimes encounter confusion by reason of the use of such bivalent terms as monopoly and competition. These terms have belonged to the language of economics for generations. They have also been a part of the language of the law, including the English common law as well as our own Sherman Act and other antitrust legislation. Basically the terms are economic, and the economist can discuss market changes only by using these basic economic concepts. The economist should, however, remember that when he has reached an economic conclusion

* Speech delivered at Marquette University Management Center — Law School Conference on May 27, 1956.

** Mr. Barnes is a graduate of Yale College, Class of 1926, and received his Ph.D. in economics from Yale University in 1928. He taught at Yale, first as an instructor and then as an assistant professor from 1928 to 1941, the field of his special interest being public utility regulation and trade regulation. He came to Washington in 1941 as a consulting economist in the Antitrust Division of the Department of Justice. In 1944 he went to the Civil Aeronautics Board as Director of the Economic Bureau and became Economic Advisor to the Board in the following year. He transferred to the Federal Trade Commission in 1948, where he has served as economist, Chief of the Division of Economic Evidence, Acting Chief of the Division of Economic Evidence and Reports, and more recently as business economist. His books include PUBLIC UTILITY CONTROL IN MASSACHUSETTS (Yale U. Press), CASES ON PUBLIC UTILITY REGULATION (Crofts), and THE ECONOMICS OF PUBLIC UTILITY REGULATION (Crofts). He has also had a number of articles in various law journals and economic periodicals.

† The views herein expressed are those of the author and do not necessarily reflect those of the Federal Trade Commission.

with respect to competition and monopolistic tendencies, he has not thereby arrived at a legal conclusion regarding a violation of the Clayton Act or of other antitrust acts. And the lawyer should also remember that the economist, using terms which the antitrust laws have borrowed from economics, is not usurping the function of the court or Commission by deciding the ultimate legal questions presented by mergers and acquisitions.

Section 7, as amended, provides that

“. . . no corporation engaged in commerce shall require . . . the whole or any part of the stock . . .” or “. . . 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 . . . may be substantially to lessen competition, or to tend to create a monopoly.”

Section 7 has been amended in two essentials: first, the statutory prohibition is extended to acquisitions of assets as well as to acquisitions of securities; and, secondly, the test of illegality is no longer the lessening of competition between the acquiring and acquired corporations, but a substantial lessening of competition or a tendency toward monopoly generally.

This revision in the test of illegality indicates quite clearly that the Congress was interested in economic realities, in testing mergers and acquisitions by their probable economic consequences, rather than by accepting merely formal, although more concretely definable, legal tests. This wise approach to the merger and acquisition problem needs to be recalled in view of the present impatience with enforcement results under Section 7, an impatience which could lead to the adoption of more rigid, more easily enforceable, but less economically effective, standards.

Although mergers and acquisitions have been a prominent feature of our antitrust problem from pre-Sherman Act days, we all recognize that mergers and acquisitions are a part of the accepted folkways of American business. During the last five or six years of prosperity, the financial press has noted from 40 to 70 or more individual acquisitions per month. More are reported in the various trade journals. Probably fewer than 30 per cent of those reported in the financial press require economic investigation, and probably fewer than 10 per cent, perhaps fewer than 5 per cent, would be considered for any legal action. Mergers as such are not taboo; they are inhibited only where they produce a probable substantial lessening of competition or a tendency toward monopoly.

A Prospective Statute and Its Economic Tests

The anti-merger law provides that mergers shall be illegal where the effect *may be* substantially to lessen competition or to tend to

create a monopoly. The legislative history of the amended Section 7 indicates that "may be" should be interpreted to mean a reasonable probability, not a mere possibility.¹

The courts and the Commission need not await the ultimate consequences of a merger in terms of lessened competition and created monopoly before passing upon its illegality. The law makes illegal, not only those acquisitions and mergers which *will* produce a substantial lessening of competition or a tendency toward monopoly, but all of those which have the reasonable probability of producing the forbidden result. The statutory standard is essentially a judgment standard, and the law is not, from the economist's point of view, improperly administered if it forestalls mergers, which in all the circumstances of the case, have the reasonable probability of producing the forbidden results, even if a subsequent appearance of new competition thereafter indicates that the objectionable consequences of the merger might not, in fact, have been realized.

Since the statutory tests are prospective, judgment must rest essentially upon an examination of what changes in market structures will result from the acquisition, and what probable changes in competitive behavior will follow from the changes which are foreseen in market structure. Market structure tests have validity because corporate managements will in general be responsive to market logic, pursuing policies which are calculated to be profitable for their company in the particular market setting. Competitive behavior in a particular industry, and in other competitively similar industries, is also significant. A consideration of competitive behavior may be expected to yield important insights into the importance of structural market changes.

The Relevant Markets

Markets are normally central to any judgment of the prospective competitive consequences of mergers. This is not to say, however, that acquisitions may not produce competitive consequences which are not reflected in market changes. For example, a change in industry

¹ "The use of these words ["may be"] means that the bill, if enacted, would not apply to the mere possibility but only to the reasonable probability of the prescribed effect, as determined by the Commission in accord with the Administrative Procedure Act.

"The words 'may be' have been in Section 7 of the Clayton Act since 1914. The concept of reasonable probability conveyed by these words is a necessary element in any statute which seeks to arrest restraints of trade in their incipiency and before they develop into full-fledged restraints violative of the Sherman Act. A requirement of certainty and actuality of injury to competition is incompatible with any effort to supplement the Sherman Act by reaching incipient restraints." (U.S. Senate Committee on the Judiciary, amending an Act entitled "An Act to supplement existing laws against unlawful restraints and monopoly and for other purposes," to accompany H.R. 2734, S. REPT. No. 1775, 81st Cong., 2d Sess. (1950), p. 6.)

structure which tended to retard technological advances might leave market conditions unchanged.

Any discussion of markets in relation to mergers encounters the ancient problem of which comes first, the hen or the egg. On one hand, it may be argued that markets,—in the words of the statute, “any line of commerce in any section of the country”—must be identified before competitive consequences may be investigated. On the other hand, it may be said that only after prospective competitive consequences have been identified and examined does it become possible to indicate in what markets significant changes may be expected to occur.

The identification of the markets which may be affected by a merger is not always a simple and obvious matter. Markets must be examined in terms of the products or the product lines concerned, the appropriate geographic areas, and the market level or levels which will feel the impact of the merger. These markets will normally be identified by the way in which the acquiring and acquired companies and their principal competitors conduct their purchases and sales.

A market is not adequately described for the purpose of analyzing the effects of a merger until the principal firms on the demand and supply sides of the market have been identified and their positions with respect to competition in the market have been understood.

In analyzing the product markets affected by mergers, consideration must be given to possible substitutes. Is a product a substitute simply because it is technically available at a reasonable price, or must there be evidence that users of the product do actually buy the substitute and use it more or less interchangeably with the primary product?²

What are the hazards in defining the relevant product market? If the product market be defined too narrowly, the amount of competition discovered may be less than is actually at work in the market. If the

² In the recent Supreme Court decision in the Cellophane case, *U.S. v. duPont*, June 11, 1956, the majority of the Court stated that “despite cellophane’s advantages it has to meet competition from other materials in every one of its uses.” The majority, therefore, concluded that “cellophane’s interchangeability with the other materials mentioned [glassine, greaseproof and vegetable parchment papers, waxing papers, sulphite bag and wrapping papers, aluminum foil, cellulose acetate, pliofilm, polyethylene, saran, and cry-o-rap] suffices to make it a part of this flexible packaging material market.”

On the other hand, the minority opinion argued that the relevant market was not flexible wrapping materials generally, but cellophane alone, and asserted that the majority opinion virtually emasculated section 2 of the Sherman Act:

“... They admit that ‘cellophane’ combines the desirable elements of transparency, strength and cheapness more definitely than any of a host of other packaging materials. Yet they hold that all of those materials are so indistinguishable from cellophane as to warrant their inclusion in the market. We cannot agree that cellophane, in the language of *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 613, is ‘the self-same product’ as glassine, greaseproof and vegetable parchment papers, waxed papers, sulphite papers, aluminum foil, cellulose acetate, and pliofilm and other films.”

market is too broadly defined, the true competitive effects of the merger may be concealed and minimized in an appearance of competition that is unreal. Is the market too narrowly defined if the product market is described as rubber-base interior paints? Oil-base paints and rubber-base paints are for most users substitute products on the demand side of the market, and if consumers do readily choose between them on the basis of price and other similar considerations, perhaps the appropriate product market is interior paints, not simply rubber-base interior paints. Interior paints and exterior paints may be substitute products on the supply side of the market. If paint manufacturers can and do readily vary the proportion of their output which goes into interior and exterior paints according to shifting consumer demand, then perhaps the appropriate market, on the supply side, should include both interior and exterior paints. On the other hand, if a shoe manufacturer who has been producing men's shoes merges with a manufacturer of women's shoes, should the appropriate product market on the supply side include both men's and women's shoes? Do shoe manufacturers readily shift from producing women's shoes to producing men's shoes and vice versa? Would a shift in product require changes in equipment, in the training required of their workers, and a change in marketing channels?

If a steel company integrates forward by acquiring a fabricator of structural shapes, is the product market confined to structural shapes or does it include other fabricated steel products whose production might be affected by an inadequacy in the supply of steel to non-integrated fabricators?

Defining the geographic markets also involves some judgment. The areas in which the acquiring and acquired companies concentrate their principal sales efforts, and in which their immediate competitors concentrate their efforts, will normally identify the geographic markets which require attention. Is it necessary, however, to examine every market in which the acquiring and acquired companies and their principal competitors sell, or may the peripheral markets in which they sell limited quantities or on an irregular basis be ignored?

The market levels that require study can only be determined from an examination of competitive relations within concrete markets. If a frozen food packer sells only to chain stores, it might appear that the chain store market constituted the proper market level, but since the chain store is in competition with super markets and independent retailers, it may be more appropriate to regard the market levels as comprehending the frozen food packers on the supply side, and all those chain stores, super markets and conventional wholesalers and retailers who handle frozen food products on the demand side.

A Substantial Lessening of Competition

What is the competition whose substantial lessening is the essence of a violation of Section 7? Competition is no simple standardized set of business practices. As every businessman knows, competition is a highly individual problem for each corporate management. No two companies, even within the same industry or within the same market, conduct their search for patronage in precisely the same way.

Patterns of competition change as industries grow and develop. They change especially as the number and size of the companies composing the industry change. The competitive tactics which are effective for a local business serving an essentially local market are quite inadequate for a larger company selling in a regional or a national market. What then is the competition which the anti-merger law seeks to preserve? Obviously, there is no simple, unambiguous answer.

What are some of the ways in which businesses compete? Offering a lower price for comparable quantity and quality is the classical form of competition, and much competition is still on a price basis. Notices of special sales and of special offerings are a conspicuous part of the advertising copy in newspapers and in much of the local radio advertising. But the kind of price competition engaged in by retailers is as a rule relatively inconspicuous in the competitive arsenal of manufacturers. An examination of 162 advertisements appearing in two current magazines showed only 8 companies which appealed for patronage primarily on a price basis. Seventy stressed the superior quality of the product; 17, convenience; 13, economy; 4, safety or security; 10, service; 10, comfort; 8, prestige; and 22 were of an institutional character designed to enhance the prestige of the advertising company.

In many industries and markets, price competition is largely sporadic in character, with price leadership a normal pattern of behavior. In these situations, any residual competition commonly takes the form of special concessions, coupon deals, and similar arrangements which are promptly matched by other large sellers, but which can often not be matched by the small local competitors. Therefore, it is not surprising that such limited and sporadic price competition normally increases the sales of the larger well-known firms at the expense of the small local competitors.

Is it a matter of any concern to consumers or to the public generally whether competition assumes one or another form? Is price competition more important than improvements in quality, service, greater safety and convenience in use, and the like? Is competition the same from the public point of view whether the product incorporates more service units, costs fewer dollars, imparts more prestige, or indirectly subsidizes more free entertainment on radio or television?

No judgment can be reached respecting the significance of an

acquisition without an understanding of the competitive mores of the industries and markets involved. An understanding of the textile industry is of little help in appraising the competitive effects of an acquisition in steel.

Competition is a complex of behavior patterns. What is effective competition depends upon the nature of the particular product and the organization of particular industries and markets. The technology of an industry determines whether a small company or a large company can compete effectively. Only a relatively large company can produce steel by the open-hearth process, but if the new turbo-hearth, developed by U.S. Steel, comes into common use, steel may be economically produced in much smaller establishments. Flour is apparently produced most economically in mills having a daily capacity of some 5,000 or more hundredweight, but a large majority of the flour mills are very much smaller; many are survivals of an earlier period and will not be replaced as they fall into disuse. The present technology in the paper industry appears to favor integrated pulp and paper mills with a capacity of 300 or more tons per day; however, a considerable number of the older and smaller mills, principally in the North and East, compete successfully, particularly in the production of specialty papers.

Sterling silver, china, textiles, radios, shoes, prepared foods, and a vast array of other products can be, and are, produced in plants of moderate size. Yet, a considerable proportion of the production of all of these products is in the hands of a few large companies operating several plants. Here it may be that the economies of large-scale marketing, the establishment of brand names by mass advertising, is more significant than production techniques in determining the profitable scale of business organization.

An examination of the competitive mores of an industry requires an analysis which will reveal how companies secure raw materials, how they organize their production operations, and how they compete in the sales of their products. It requires an examination of the presence or absence of price competition, the practice of price leadership, the use of product differentiation, mass advertising, and other substitutes for improvements in quality and reductions in price. It requires a consideration of changes in the quality of the product, the costs of production, the technologies of production, the availability of substitutes, the population of business firms, and the demand for the product.

Once the competitive characteristics of an industry and its markets are understood, it becomes possible to evaluate whatever quantitative information may be available respecting the significance of a merger or acquisition.

In short, a substantial lessening of competition arises either from

a reduction in competitive opportunities or a reduction in the incentives to compete. And since the anti-merger law is intended to be applied prospectively to those acquisitions which may have the effect of substantially lessening competition, the economic analysis of mergers must turn principally on changes in the competitive structure of industries and markets, evaluated in the light of the competitive behavior of the relevant industries and markets, and of other competitively similar industries and markets.

A Tendency Toward Monopoly

The Clayton Act does not test a merger by asking whether it has achieved monopoly; instead, it prohibits mergers which "tend to create a monopoly." Monopoly seems like a clear and unambiguous term; it signifies one seller who is free to price his products according to what the traffic will bear.³

The economist looking at this statutory test will recognize that the substantive evils of monopoly may appear long before monopoly in the formal sense is reached. It is possible to have the prices charged by competing sellers approximate monopoly prices, *if* the sellers are so few that each seller recognizes that any attempt to win patronage by price competition will be unprofitable, and if a convention of price leadership creates a spirit of mutual confidence so that a price leader is free to set noncompetitive or monopolistic prices. An industry of few sellers, operating under a price leadership convention, may charge the equivalent of monopoly prices without realizing monopoly profits: high prices may so limit the volume of sales that production costs are high, or sellers may spend so much on advertising, salesmen, and other costly promotions that high costs of distribution limit profits.

Balancing the Economic Tests

The amended Section 7 provides two economic tests by which an illegal merger or acquisition may be recognized: a substantial lessening of competition or a tendency toward monopoly. It is commonly thought that the first—a substantial lessening of competition—represents the lesser test, and that a substantial lessening of competition will normally be encountered before the tendency toward monopoly sets in.

For the economist, the first test, a substantial lessening of competition, represents the broader, rather than the lesser, test. There are many different circumstances out of which a substantial lessening of competition may arise.

³ Monopsony, a monopolistic condition on the buying side of the market, appears to be equally simple in concept; it refers to a situation where there is only one purchaser of a product or service, and his noncompetitive position presumably enables him to play competing sellers off one against the other and thereby to win important price concessions.

The tendency toward monopoly may be an evil that appears early in the development of concentration in an industry, or it may appear late. Possibly it might appear that a tendency toward monopoly, not involving a substantial lessening of competition, would be associated with an industry where concentration is already so far advanced that only small companies remain to be acquired, each so insignificant that no very convincing showing of a lessening of competition may be made, although each small acquisition would bring nearer a state of monopoly. Or a tendency toward monopoly might be anticipated where a limited number of competitors no longer find it advantageous to compete, and where the acquisition of one by another brings hardly a perceptible change in competitive behavior. But it is also possible to have a tendency toward monopoly, or at least toward monopolistic behavior, set in rather early in the concentration history of an industry, while scores, or perhaps even hundreds, of competitors still wage lively rivalry.

A tendency toward monopoly exists whenever one competitor, or a few competitors, become so disproportionately large that new competitive tactics are adopted which give the beginnings of that competitive immunity that is the essence of that partial monopoly which has marked the demise of price competition in many industries.

This monopolistic-trend test cannot be applied mechanically without a regard for the history and character of the industry. In many products where engineering design and technical improvements are the essence of competition, where the product is typically improved rather than cheapened as a means of meeting competition, each progressive change involves an element of product differentiation and confers upon the innovator a temporary monopolistic advantage. The evil is not to be found in such product differentiations, which represent genuine changes in the utility or service afforded by the product, but in those artificial, pseudo differentiations which supply the basis for sales puffing without real differences which are significant to the user or consumer.

Economic Evidence in Merger Cases

What kinds of economic facts will normally be examined in the course of appraising the economic effects of a merger? The products manufactured or services performed by the acquiring and acquired companies will always be the starting point. The markets to which each of the products moves—the geographic markets, the functional markets in which the products are sold, and the price or quality lines in which they fall—must be identified. Other companies producing the same products for the same markets must be known, and the positions of each in the competitive hierarchy must be appraised. Buyers composing the demand side of the market must also be listed,

and some estimate must be made of their relative bargaining strength as it will be affected by the merger. Similarly the markets in which the acquiring and acquired companies buy must be examined, even though some of the companies which compete for the same raw materials are not necessarily competitive in manufacturing the same products. The history of the industry will reveal whether any practical importance attaches to potential competitors who might enter these markets from other industries or from other geographic areas. Similarly, consideration must be given to the closeness of substitutes which may broaden the product market, at least for some uses.

The development and evaluation of economic evidence presents the most complicated aspects of merger litigation, an area where significant experience may be slow in accumulating. It is not possible to foresee what types of evidence will be developed by the government or by respondents, or what kinds and quantities of evidence will ultimately satisfy the Commission and the courts. This phase of the problem is beyond the scope of the present inquiry.

ECONOMIC CONSEQUENCES OF MERGERS

A consideration of a series of mergers, real and fancied, is perhaps the easiest way to focus on some of the questions which economists ask about mergers. Only a representative sample of leading questions can be noted, but they point the way of investigation and decision. Of course, mergers cannot safely be typed and judged by categories; each merger presents problems as specific as those of the individual corporation in its own market and industry setting.

A Merger of Direct Competitors

The merger of two competitors always, of course, eliminates competition between them. This was the sin against which the original Section 7 was directed. But the elimination of competition between competitors who merge is not now the critical test of a violation of the amended Section 7. Only if the elimination of competition between the two merging competitors may be so substantial as to adversely affect competitive conditions in the relevant markets will the merger be regarded as a violation of the Clayton Act.

Many acquisitions by competitors have taken place since Section 7 was amended. There have been mergers of shoe manufacturers, dress manufacturers, men's clothing firms, food processors, and many others, where no adverse competitive effects were anticipated and where no formal action was started.

Every complaint thus far issued in the enforcement of Section 7, as amended, has presented some elimination of competition between the acquiring and acquired companies. It was so in Pillsbury Mills' acquisition of Ballard & Ballard Co. and Duff's Baking Mix Division

of American Home Products,⁴ and in the acquisition by Luria Bros., Inc.,⁵ by Crown Zellerbach Corp. of St. Helens Pulp & Paper Co.,⁶ by A. G. Spalding & Bros. of Rawlings Manufacturing Co.,⁷ by Farm Journal of *Better Farming* from Curtis Publishing Co.,⁸ by Foremost Dairies, Inc., in several acquisitions,⁹ by Scovill Manufacturing Co. of DeLong Hook & Eye Co.,¹⁰ by Brillo Manufacturing Co. of Williams Co.,¹¹ by Scott Paper Co.,¹² by Schenley Industries of Park & Tilford,¹³ by General Shoe Corp.,¹⁴ by Hilton Hotels,¹⁵ by Minute Maid Corp. of Snow Crop,¹⁶ by Brown Shoe Co.,¹⁷ and by American Radiator & Standard Sanitary Corp. of Mullins Manufacturing Co.¹⁸ Indeed, in each instance the acquiring and acquired companies have not only been competitors but each has been a significant factor in its own market.

If the elimination of competition between the acquiring and acquired companies is not enough in itself to be determinative of a Section 7 violation, what criteria will determine the legality of such acquisitions? The economic question can best be answered on the basis of a consideration of specific market and industry situations. The answer will necessarily depend more upon the competitive structure of the industry and competitive behavior in the relevant markets than it will upon the size, either absolute or relative, or other characteristics of the parties to the merger.

A Reduction in the Number of Competitors

An acquisition which results in a critical reduction in the number of competing firms may be expected to effect a substantial lessening of competition. Conceptually, this category of case appears simple;

⁴ FTC: Pillsbury Mills, Inc., Docket No. 6000, Complaint June 16, 1952.

⁵ FTC: Luria Bros. & Co., Inc. et al., Docket No. 6156, Complaint January 19, 1954.

⁶ FTC: Crown Zellerbach Corp., Docket No. 6180, Complaint February 15, 1954.

⁷ FTC: A. G. Spalding & Bros., Inc., Docket No. 6478, Complaint December 8, 1955.

⁸ FTC: Farm Journal, Inc., Docket No. 6388, Complaint April 30, 1955.

⁹ FTC: Foremost Dairies, Inc., Docket No. 6495, Complaint January 17, 1956.

¹⁰ FTC: Scovill Manufacturing Co., Inc., Docket No. 6527, Complaint March 12, 1956.

¹¹ FTC: Brillo Manufacturing Co., Inc., Docket No. 6557, Complaint May 22, 1956.

¹² FTC: Scott Paper Co., Docket No. 6559, Complaint June 1, 1956.

¹³ U.S. v. Schenley Industries, Inc., Civil No. 1686, Complaint February 14, 1955 (D.C. Del.).

¹⁴ U.S. v. General Shoe Corp., Civil No. 2001, Complaint March 29, 1955 (D.C., M.D. Tenn.).

¹⁵ U.S. v. Hilton Hotels Corp., et al., Civil No. 1889-55, Complaint April 27, 1955 (D.C., D.C.).

¹⁶ U.S. v. Minute Maid Corp., Civil No. 6429-M, Complaint September 7, 1955 (D.C., S.D. Fla.).

¹⁷ U.S. v. Brown Shoe Co., Civil No. 10,527, Complaint November 28, 1955 (D.C., E.D. Mo.).

¹⁸ U.S. v. American Radiator & Standard Sanitary Corp., Civil No. 14,469, Complaint March 30, 1956 (D.C., W.D. Pa.)

practically, a determination of when a reduction in the number of competitors becomes critical may be exceedingly perplexing. What reduction in the number of efficient and effective competitors, what changes in the balance of competitive potentialities, or what increase in the size of large companies, will lead to crucial changes in competitive behavior? An economist may find a critical change in competitive behavior in the disappearance of price competition, a growing emphasis on product differentiation, and similar trends that mitigate direct rivalry between sellers of essentially similar goods and services.

In most markets where the number of competitors is considerable, a single acquisition may produce no measurable lessening of competition, but a series of acquisitions, whether by one or by many companies, may produce a progressive decline in competitive incentives.

Since the enactment of Section 7, this problem has been presented in a number of industries; shoe, textiles, local dairies, local breweries, animal feed manufacturers, and others. In one or two of these situations, complaints have issued, but most of these fields have appeared to offer less promising opportunities for an initial testing of a new statute. Take, for example, the many acquisitions of local breweries. Each acquisition has involved a relatively small capacity, and no one, standing alone, would appear to make a critical change in competition in the local market. In this situation, how firm a legal action against an acquisition could be based upon the probability that this trend will produce an unwanted and significant lessening of competition?

Can there be a critical reduction in the number of competitors when the number is already reduced to the point where price leadership is the prevailing practice? This is the situation, as the economist sees it, in Crown Zellerbach Corp.'s acquisition of St. Helens Pulp & Paper Co. Crown Zellerbach was the largest, and St. Helens was the third largest, of the full-line producers of coarse papers in the western states. If the western states constitute a relevant market, is the acquisition objectionable if the continued independence of St. Helens would not guarantee active price competition? Although price competition is largely quiescent, may a decision be based on the possibility that an expanding market will call forth additional competitors who, if the existing number be preserved, may restore a measure of price competition?

Increasing Concentration in Production and Sales

Growing concentration in production was one evil stressed by the Congressional committees in reporting the bill to amend Section 7.¹⁹

¹⁹ "The importance of mergers and acquisitions as a cause of economic concentration has increased rapidly during recent years with the acceleration of the merger movement. During the period, 1940-47 some 2,500 formerly independent manufacturing and mining companies disappeared as a result of mergers and acquisitions. This is a minimum estimate, since it is based upon a sample drawn

Concentration in production may occur while the total number of competitors is quite large. In many industries the four largest producers control from 40 to 90 percent of the industry's output, with the remainder divided among scores, or even hundreds, of small and relatively ineffectual competitors. Where the bulk of the industry's output, or where the bulk of the sales in any market, comes to be concentrated in a small number of competitors, the economist would expect that the stage has been set for significant changes in competitive behavior. This does not always and inevitably happen. In the history of American industry, there have been Henry Fords and Harvey Firestones, who have thought that it was good business to be vigorously competitive even when the number of their competitors had been sharply curtailed, but there are also numerous examples of price leadership, delivered price systems, and fair trading conventions whereby market price behavior has been made amenable to managerial policies.

This issue of undue concentration was one aspect of the first complaint which the Federal Trade Commission issued under Section 7, directed against the acquisition by Pillsbury Mills of Ballard and of Duff's. In the field of flour base mixes, Pillsbury was estimated to have 22.7 percent of the southeastern market in 1949-1950, with Ballard having 12.0 percent, and Duff's, 10.2 percent; these two acquisitions gave Pillsbury an estimated 44.9 percent of that mix market. On a national basis, Pillsbury estimated that General Mills had 21.29 percent in 1949-1950, whereas it had 15.97 percent; Duff had 5.93

principally from reports of acquisitions of the larger corporations as published in the leading financial manuals.

"Apart from this general effect, the current movement has had the result of raising the level of economic concentration in a number of very specific ways. In the first place, recent merger activity has been of outstanding importance in several of the traditionally small business industries. More acquisitions and mergers have taken place in textiles and apparel and food and kindred products—predominantly 'small business' fields—than in any other industries. Furthermore, in certain other industries which have traditionally been considered as 'small business' fields (such as steel drums, tight cooperage, and wines) nearly all of the industry has been taken over by very large corporations. Finally, the outstanding characteristic of the merger movement has been that of large corporations buying out small companies, rather than smaller companies combining together in order to compete more effectively with their larger rivals. More than 70 percent of the total number of firms acquired during 1940-47 have been absorbed by larger corporations with assets of over \$5 million. In contrast, fully 93 percent of all the firms bought out held assets of less than \$1 million. Some 33 of the nation's 200 largest industrial corporations have brought out an average of 5 companies each, and 13 have purchased more than 10 concerns each.

"Such in general outline is the broad economic problem of high and increasing concentration with which this legislation is concerned." U.S. Senate Committee on the Judiciary, amending an Act entitled "An Act to supplement existing laws against unlawful restraints and monopoly and for other purposes," to accompany H.R. 2734, H. R. REPT. 1191, 81st Cong., 1st Sess. (1949), pp. 2-3. See also: S. REPT. No. 1775, 81st Cong., 2d Sess. (1950), p. 3.

percent, and Ballard, 1.13 percent.²⁰ Is the increase in concentration any less serious because the acquisitions only raised Pillsbury to approximate equality with General Mills? The economist can give no definitive answer without exploring the markets for prepared mixes, but these percentages are probably indicative of a change in both the opportunities and the incentives for competition. In this situation the economist's judgment must be based less upon the avowed managerial policies of the acquiring company, or even on its past competitive behavior, than upon an appraisal of what kinds of competitive policies this market situation would favor, assuming that the acquiring company and its competitors are primarily interested in maximizing their profits.

A similar problem was presented to the Justice Department by a proposed merger between Bethlehem Steel Corporation and Youngstown Sheet & Tube Company. The two companies were actively competitive only in Detroit and a few other local markets, and the new company would have been smaller than U.S. Steel. What significance would attach to the possibility that the new company could compete more effectively with U.S. Steel? Is it necessary for all competitors to be of equal size in order to maintain effective competition? Would the existence of two giants in the steel industry have made it more difficult for smaller companies to remain competitive?

Is it important to attempt to preserve a substantial number of competitors in an industry where production is already concentrated and where the smaller firms seem ineffectual? Where the technology has advanced to the point where only larger firms are efficient, no public purpose would appear to be served by preserving small and inefficient firms. No useful purpose would be served in objecting to the acquisition of many of the small obsolete flour mills having a capacity of only a few hundredweight a day. Yet in another industry, the paper industry, a number of older and smaller mills appear to be successful competitors in the production of specialty papers which are required in small volume.

Disproportionate Size

May the development of disproportionate size, without undue concentration, produce changes in industry and market practices which will be detrimental to competition? In most industries disproportionate size on the part of one competitor is matched by some growth in other large companies, which often results in a quite concentrated industry. However, there is an intermediate period when the pace-setting company achieves disproportionate size, and the problem is whether the

²⁰ FTC: Pillsbury Mills, Inc., Docket No. 6000, Opinion of the Commission, December 28, 1953.

achievement of this disproportionate size may become a critical factor transmuting vigorous and healthy competition into competition which is less beneficial to the public.

An increase in relative size is unlikely to be challenged where the increase is related to a change in technology. Disproportionate size, in the sense in which the term is here used, is seldom achieved by a company that is concentrating more production in a single large-scale plant, but commonly applies only to companies whose growth is keyed to the acquisition of a number of plants.

One of the historical antitrust cases presented essentially this situation. International Harvester Co. was found by the courts to have achieved a virtual monopoly by its acquisitions. International Harvester continued to manufacture the several lines of farm machinery which it had acquired and to maintain separate dealers in each community to handle its different lines, virtually foreclosing any new manufacturer from obtaining adequate distribution for its line. The consent decree required International Harvester to divest itself not only of some of its subsidiary lines but also to limit the number of dealers which it might have under franchise in any community.²¹

The automobile industry presents this problem in view of the dominant positions of General Motors Corp. and Ford Motor Co. Although the number of automobile manufacturers, even including the small ones, could be counted on the fingers of two hands, several mergers have taken place without being challenged under Section 7. Nash and Hudson have merged into American Motors Corporation; Studebaker and Packard into Studebaker-Packard Corp.; and Kaiser-Frazier and Willys into Willys Motors, Inc. These acquisitions were unchallenged, even though there has been a widespread public impression that healthy competition does not prevail in the automobile industry. There has, of course, been intense rivalry among automobile manufacturers, and there has been much concern as to whether the smaller manufacturers can survive.

The problem of maintaining healthy competition in the automobile industry seems to be the direct result of the disproportionate size of the largest companies. An almost insuperable handicap to competition by the smaller companies lies in the costs of retooling and in annual model changes. If new tooling costs be assumed to be \$25 million, the tooling cost per car would, on the basis of 1954 estimates of production, vary from \$18 for a Chevrolet or a Ford, to \$41 for a Buick, \$58 for an Oldsmobile, \$62 for a Plymouth, \$67 for a Pontiac, \$94 for a Mercury, \$165 for a Dodge, \$294 for a Studebaker, and \$400 for a Nash. This is only one example of how the development of dispro-

²¹ U.S. v. International Harvester Co., 214 F. 987 (D.C. Minn., 1914).

portionate size may favor a change in competitive tactics which will be prejudicial to the preservation of healthy and effective competition. Any competitive problems which the automobile industry has are not soluble in terms of Section 7, but the experience of the automobile industry should provide a lesson that will inform and direct the enforcement of Section 7: competition may be substantially lessened in ways which are prejudicial to the public interest even though the intensities of business rivalries are unimpaired.

Acquisition of a Strategic Competitor

The removal of a strategic competitor may constitute the essence of the injury to competition arising out of an acquisition.

When Pillsbury Mills acquired Ballard, it removed a strategic competitor from the family flour market in the southeastern states. In 1949-1950, Ballard and Pillsbury Mills each accounted for approximately 4.3 percent of the sales of family and bakery flour in the Southeast; General Mills accounted for 8.3 percent.²² By the acquisition, Pillsbury became the largest supplier, but this fact would appear to have less significance than the elimination from the southeastern market of one of the largest and most successful regional competitors.

By reason of the general characteristics of the Southeastern market, Ballard was more important to the preservation of competition than its sales would suggest. It was one of a handful of regional mills that could and did compete successfully with General Mills and Pillsbury and other national companies. It sold premium flour under its own brand; it advertised regionally; its flour enjoyed a marked consumer preference, so that in some markets it was the largest selling brand, and in virtually all markets it was able to win and keep a place on the display shelves of the chains and other large distributors. Despite its ability to compete with national companies, Ballard could not, being dependent upon a regional market, ignore the competition of the small mills which made up the remainder of the southeastern milling industry. Ballard and a handful of other regional mills were in fact connecting links in the transmission of competitive pressures between the small local companies and the national companies. Without the connecting link of the regional firms, a market having an hour-glass structure would be divided into two separate and distinct markets; in the premium flour market the national companies would compete only with other national companies, principally on a non-price basis; in the nonpremium market, a multitude of small local companies would be without competitive influence; for neither singly nor in combination could their production and sales make headway against nationally advertised brands.

²² FTC: Pillsbury Mills, Inc., Docket No. 6000, Opinion of the Commission, December 28, 1953.

How is it possible to identify whether an acquired company is, or is not, strategic in the preservation of competition in particular markets? Is it not necessary to understand how competition is carried on in the particular markets, what factors make a firm an effective competitor, and what, if any, changes in the balance of competitive pressures and in competitive practices may be expected to result from the acquisition?

Competing and Noncompeting Price Lines

Many markets appear to be divided among different price lines. This is conspicuously true of automobiles, men's and women's clothing, radios, and a number of other items. Perhaps the convention of different price lines is as firmly established with respect to the manufacture and sales of shoes as in any other area.

When will the merger of companies manufacturing different price lines adversely affect competition? No categorical general answer can be given. Most consumers would prefer a somewhat better product if their income permits the luxury. Considering the volume of consumer credit, can it be said that consumers do not weigh the choice between buying a pair of shoes that costs \$8.95 and a pair that costs \$11.95, between buying a radio for \$39 and one for \$49, or between buying a car that costs \$2400 or one that costs \$3100? And if consumers weigh such alternatives, is it not unrealistic to ignore such consumer behavior?

Do not sellers consider their offerings to be competitive both with more expensive and with less expensive products that serve the same purpose? Is it not a typical competitive device to improve a product's sales appeal by adding features that have been popularized in a higher price line? How many of the lower priced cars make their strongest appeal on the basis of high price car features?

Competition Among Substitute Products

Under what circumstances may an acquisition of a company producing products which are substitutes for its products result in a substantial lessening of competition? Would a merger between copper and aluminum companies be expected to affect competition in the use of copper and aluminum electric and telephone cables?

The newest in hard-surface floor coverings is a plastic product; plastic tiles have also made substantial headway in competition with ceramic tiles for bathroom finishes. A large manufacturer of linoleum and asphalt tiles acquired a manufacturer of plastic floor coverings. Would it be expected that plastic floor coverings would make faster headway in the market if it were promoted by companies not manufacturing linoleum or rubber tile floor coverings? As a general proposition, will competition be more vigorous if new competitors enter

the field with new technologies and with new products rather than leaving such developments wholly to established companies that may have an investment interest in avoiding the unduly rapid absolescence of existing plant and equipment?

Acquisition of Capacity and Conversion to Other Products

The acquisition of capacity for conversion to other product lines may present perplexing problems with respect to competitive effects.²³ Where the acquired company was operating in a shrinking market, the conversion of its capacity to another product line in stronger demand presumably represents a more efficient use of economic resources. On the other hand, a successful and growing company may seek to meet expanding market opportunities, not by constructing its new capacity, but by buying capacity and converting it to its own requirements.

Prior to its acquisition by Crown Zellerbach Corp., St. Helens Pulp & Paper Co. had other prospective buyers examining its mill. If the St. Helens mill had been acquired by one of these other buyers, the mill would presumably have been converted from the manufacture of wrapping papers and other course papers to the production of a different series of products. How would the competitive consequences in the market for coarse papers have been different if the St. Helens mill had been acquired and converted to a different product line?

Regional and National Companies Absorbing Local Companies

In a considerable number of industries where production has been preponderantly for local or regional markets, there have been acquisitions that have created multi-unit companies operating in many regions. This happened some years ago in the cement industry. It has been happening more recently in the manufacture of animal feeds. And still more recently, there have been a series of acquisitions of companies manufacturing cartons and containers.

As an industry becomes regional rather than local, or national rather than regional, what changes occur in the patterns of competition? Does competition become more vigorous and healthy, or does it become more cautious and restrained? Is a company which operates in a series of regional markets under the same necessity to compete vigorously in any one of those markets? If the management of a

²³ FTC: Scott Paper Co., Docket No. 6559, Complaint June 1, 1956. The complaint stated—

"As a result of the acquisition of Soundview, Detroit, and Hollingsworth, individually and collectively, Scott adapted, modernized, increased the capacity, and converted the facilities of these acquired companies so that its production, distribution and sale of sanitary paper products and household waxed paper was substantially increased. As the result of these acquisitions, individually and collectively, and the improvements related thereto, Scott has increased its dominant position in the sale of sanitary paper products and household waxed paper. . . ."

single-unit local company has no choice but to compete in order to survive, and if the management of a multi-unit multi-market firm has a choice as to whether it will compete vigorously in a particular market, is the mere fact that management has this choice an indication of a change in competitive conditions and evidence of a lessening of competition?

A more extreme example is presented when a national company moves into a local market and becomes the dominant factor in that market. This has happened most conspicuously in recent years in the dairy industry. On January 17, 1956, the Federal Trade Commission issued a complaint, charging *Foremost Dairies* with violation of Section 7. *Foremost Dairies*, following the example of the earlier growth of *National Dairy Corporation* and the *Borden Company*, had acquired some 30 dairy companies, 3 of which had an aggregate of 23 subsidiaries. It had also acquired a number of unincorporated dairy enterprises.

What happens when a national company invades a local market? Will the national company, in meeting local competition, choose to expend sales effort and take shorter profits in one or a few markets while maintaining prices and normal profit margins in other markets? Is the capacity of the national chain to sustain competitive losses in a limited number of local markets an indication that the national chain is a more efficient producer and a more capable competitor? Is the loss of local markets by local companies that are unable to meet the competition of the national chain an injury to competition, or is it only an injury to competitors?

What happens to competition if two or more national chains become the dominant sellers in the same series of local markets? Will two national chains that compete with one another in 20 different metropolitan areas be disposed to engage in price cutting directed against one another in any one market, or will that kind of price competition appear to be too dangerous and costly if it can spread from one to many markets? Will the dominant chains have opportunities to use competitive strategies which will enable them to absorb progressively a larger share of successive local markets through the use of tactics which cannot be successfully countered by the local competitors?

A Reduction In Open Market Supplies

A characteristic growth among large-scale enterprises has been a reaching back to acquire control over sources of supply, either to assure adequate quantities, to guarantee appropriate quality, or to avoid uncertainties arising out of fluctuating costs. Thus steel companies own iron and coal mines and limestone quarries. Lumber and

paper companies own forests, and some canneries even own producing farms.

Is there a probability that such mergers between companies which stand in a supplier-customer relation will result in a significant reduction in competition? The answer would appear to depend upon the technology of the industry. If there are large and important economies to be achieved by the physical integration of successive stages between raw material production and the final product, the integrated company may be a more efficient and economical, and thereby a more effective, competitor. On the other hand, there may be no real and substantial economies to be achieved through mergers between suppliers and customers.

In any event, will the integrated firms possess strategic advantages which may force competitors to adopt a program of acquiring sources of supply? Will these mergers result in a curtailment in open market supply, shutting off competitors from access to a vital raw material in periods of shortage? What proportion of the market supply of the raw material can be brought under control of integrated companies without giving rise to market changes which will be prejudicial to the nonintegrated manufacturers?

This problem has been presented by a number of acquisitions in different industries: acquisitions by pulp companies of lumber companies to serve as a source of wood supply, acquisitions by paper companies of pulp companies that have been producing a substantial quantity of market pulp, acquisitions by fertilizer companies of producers of phosphate rock and other fertilizer materials, acquisitions by rubber manufacturers of chemical companies producing the raw materials from which synthetic rubber is made.

Acquisitions or mergers which make other firms dependent upon a competitor for their supplies of raw materials or partially fabricated products offer subtle and dangerous possibilities of a substantial lessening of competition. In times of short supply the needs of the integrated firm will be taken care of first, and its competitors may be compelled to curtail production. Will the integrated firm be able, under the guise of legitimate competition, to direct a price squeeze against unintegrated competitors, increasing their costs by price increases at one stage, and curtailing their margins by holding prices down at a later stage?

Forestalling Competition

Competition may be forestalled by acquiring raw material sources, patent rights to equipment and processes, market outlets, or potential competitors that show signs of prosperity and growth. There are famous antimonopoly cases in the past that illustrate each of these possibilities. Leading companies in metals industries owe a part of

their position of leadership to control of the more economical sources of raw materials. The acquisition of patent rights permitted Hartford-Empire Company to forestall the development of serious competition in the manufacture of glass containers.²⁴ The acquisition of competitors built up the original Standard Oil and American Tobacco trusts.²⁵ Indeed, the Aluminum Company of America was judged to have forestalled competition merely by constantly providing new capacity in anticipation of the growth in market demand.²⁶

Acquisition of Manufacturing Capacity

The maintenance of competition may be threatened where a large consumer or distributor acquires manufacturing capacity to supply a part of its requirements. Some chain stores have manufacturing subsidiaries which supply them with private brand merchandise. Some automobile manufacturers have subsidiaries which manufacture a portion of the parts and assemblies which they require. When a large buyer makes an acquisition of this character, how will it affect that buyer's dealings with other suppliers? Will the large buyer be able to obtain unfair or discriminatory price concessions from unaffiliated suppliers? Is the fact that some of these concessions fall within the prohibitions of other antitrust laws an adequate reason for disregarding such competitive effects when appraising mergers?

The Acquisition of Outlets

Wherever there is a merger between supplier and customer, there is forward integration for the supplier as well as backward integration for the customer. In recent years there have been many mergers which have given manufacturers ownership of the outlets through which their products are sold. Acquisitions by shoe manufacturers of retail chains were cited in two complaints issued by the Antitrust Division.²⁷ Petroleum companies have made it a practice to own or control

²⁴ *Hartford-Empire Co. v. U.S.*, 323 U.S. 386 (1945).

²⁵ *Standard Oil Co. (N.J.) v. U.S.*, 221 U.S. 1 (1911); *American Tobacco Co. v. U.S.*, 221 U.S. 106 (1911).

²⁶ *U.S. v. Aluminum Co. of America*, 148 F.2d 416, 430-431 (1945).

²⁷ *U.S. v. General Shoe Corp.*, Civil No. 2001 (D.C., M.D. Tenn.), complaint, March 29, 1955. A consent decree filed February 17, 1956, terminated the General Shoe Corp. case. The company was directed to divest itself of all capital stock owned or controlled by it in any shoe manufacturer or retailer other than a subsidiary of the company; for five years it was ordered to purchase shoes manufactured by others to an amount at least 20 percent of the total volume of shoes sold by General's affiliated retail outlets; it was enjoined from operating any retail outlet on a low profit margin for the purpose of injuring an independent retailer or from receiving quantity discounts not available to other manufacturers under like conditions and from requiring any independent retailer to buy any specified proportion of its requirements from General; it was directed to grant licenses under its patents to any shoe manufacturer "not a large shoe manufacturer," to charge only a reasonable royalty, and to furnish a written manual describing any special methods of manufacture used in connection with the patents; and it was restrained from any further acquisitions

many of the stations through which their gasoline and oil reaches the consumer. The steel companies have historically integrated forward into the fabrication of selected steel products. The Aluminum Company did the same.

Under what circumstances are forward acquisitions, giving a control of market outlets, likely to be productive of a significant curtailment of competition? Is the situation changed by high birth and death rates among the business population in which the outlets are located? Is it a matter of indifference whether the acquisition of outlets occurs as a discreet series of transactions or whether it involves an organized chain of outlets with well-established trade names?

The acquisition of a minority stock interest by Union Bag & Paper Corporation in Hankins Container Company, supplemented by two contracts, presented questions involving both the anti-merger provisions of Section 7 and the interlocking directorate provisions of Section 8 of the Clayton Act, and the unfair competition provisions of Section 5 of the Federal Trade Commission Act. Union purchased approximately a 9 percent stock interest in Hankins, and entered into a stockholder's agreement and a container board contract which provided that Union directors be elected to the board of Hankins, that Hankins would not purchase more of its requirements from others than was specified in its contracts with its prior suppliers, that it would not manufacture more than a specified amount in its own paper mill, and that it would purchase the remainder of its requirements from Union. The agreement assured Hankins a source of supply, and provided that additional capital would be contributed if Hankins' purchases from Union passed a stipulated annual figure; it also largely preempted the Hankins' market for Union. May a limited acquisition of stock, combined with purchase contracts, be a violation of Section 7 of the Clayton Act as well as of Section 5 of the Federal Trade Commission Act? Could a series of minority stock interests, following this pattern, foreclose a larger aggregate of markets than could be foreclosed by outright acquisitions of competitors?

A consent order dated May 10, 1956, terminated the *Union Bag & Paper Corp.-Hankins Container Co. case*. Union was required to divest itself of stock held in Hankins within 90 days but it was not prevented from acquiring up to 9 percent of the outstanding capital stock (the amount held) provided the acquisition was solely for investment.

of shoe manufacturers, retailers or wholesalers without a showing that the acquisition will not substantially lessen competition.

U.S. v. Brown Shoe Co., Civil No. 10,527, E.D. Mo., complaint November 28, 1955. On January 13, 1956, the court dissolved a temporary restraining order prohibiting the consummation of the merger, but issued a temporary injunction which would permit the merger on terms which would permit an adequate remedial order, if on final judgment, the merger was found to violate the Clayton Act. (C.C.H. par. 68,244).

The restrictive contracts relating to purchase and sale of securities to the manufacturer and supplier of container board, corrugating medium, and other products were set aside.

Abrogating the Market Tests of Efficiency

In a wholly unintegrated industry, competition exists at each stage in production from the raw material to the final finished product. Each producer is compelled to sell to the next fabricator at competitive prices, and thus the inefficiencies of intermediate producers cannot be shifted as costs to fabricators at later stages. As integrated companies are built up, often by acquisition and merger, raw materials and semi-finished products are transferred from one department to another on the basis of bookkeeping costs rather than competitive market prices, but as long as active competitive markets exist at each stage, the integrated company has a yardstick to judge whether it is equaling or exceeding the competitive standards. However, if integrated companies come to dominate the industry, will not competitive conditions have changed? How large a proportion of an industry can become integrated before the nonintegrated segment of the industry becomes so handicapped with respect to volume, technology and other determinants of costs that it can no longer serve as a standard of competitive efficiency? How can any one acquisition, or even a series of acquisitions, coming at a later stage in the history of an industry, be judged to be in violation of the anti-merger provisions when similar, earlier acquisitions were unchallenged? At what stage in the integration history of an industry, should the economist erect a "Stop-Look-and-Consider" sign? Is the economist being an ivory-tower theorist if he suspects that some of the links in the integrated chain of production may, in the absence of market tests, become and remain relatively inefficient so long as the overall profit position of the integrated company is not thereby prejudiced?

Lengthening of the Product Line

A full product line is often a marked competitive advantage. A company may become a full-line producer either by developing new departments and entering new areas of production, or it may acquire companies already experienced in new product lines. A considerable number of acquisitions have added to the acquiring company's product lines. Are such acquisitions restrictive of competition?

If the leading producers in the industry are full-line producers, is there any likelihood that the achievement of full-line status by other producers will have an adverse effect upon competition? If both the acquiring and acquired companies are prominent and successful producers, are they not potential competitors, for will not each seek to expand its production so that it becomes a full-line producer? Is the

forestalling of potential competition the kind of substantial lessening of competition of which the amended Section 7 takes cognizance? Since many acquisitions directed at the lengthening of product lines involve companies which are competitive with respect to a limited proportion of their production, is there justification for making the elimination of what is admittedly a limited amount of direct competition the occasion for ruling out a merger which may otherwise affect only an elimination of potential competition?

Diversification

Diversification has been a conspicuous feature of the recent merger movement. Large and successful companies have acquired other companies that are engaged in product lines or in markets which are remote from those in which the acquiring company has been occupied.

The problem of diversification has been presented in metals, chemicals, textiles, consumers' durable goods, building supplies, and elsewhere. Generalized conclusions with respect to competitive effects are no more valid in the case of diversifying, conglomerate acquisitions than in other acquisitions, but it should be recognized that adverse competitive effects can arise from such acquisitions, and that it will not normally be possible to point with the same precision to the same high probability of a substantial lessening of competition that can be identified in other types of mergers.

The acquired company, having become a subsidiary of a larger and presumably financially more powerful parent corporation, is no longer the urgent, necessitous competitor that it was when it stood alone. Is it to be expected that the incentives to competition may be dulled for the acquired company when a diversifying company adds that firm to its corporate family?

The Disappearance of an Independent Industry

The ultimate in diversification occurs when companies in a number of unrelated industries diversify into the same industry. This happened to the earth-moving industry during the past five years. *BUSINESS WEEK*, commented on April 15, 1954, that the "earth-moving industry is getting more and more fiercely competitive every day" and "the industry is regarded as prosperous, expanding and well hedged against business recessions." The article noted that the industry had been "pretty much a specialist's field, with many small companies and a few big ones." But all of that has been changed by a series of acquisitions, principally by companies not otherwise in the earth-moving industry. In a series of maneuvers that reportedly threw the industry into a "ferment," General Motors acquired Euclid Road Machinery Co.; Westinghouse Air Brake Co. acquired R. C. LeTourneau, Inc., and Le Roi Co.; Allis-Chalmers acquired LaPlant-

Choate Co., Inc., and Buda Company; Caterpillar Tractor acquired Trackson Co.; Pettibone Mulliken Corp. acquired Universal Engineering Corp., Rome Grader and George Haiss Manufacturing Co.; and Pullman Standard Car Manufacturing Co. acquired the scraper division of Isaacson Iron Works. Baldwin Locomotive, in acquiring Lima-Hamilton, also acquired Austin Western Co.; and Clark Equipment Co., in acquiring Ross-Carrier, obtained its subsidiary, Morgan Power Shovel Co.

Is it not likely that the character and vigor of competition was changed by such a series of acquisitions? Yet can it be said that any one of the acquisitions constituted a violation of the Clayton Act? Was it not to be expected that, so long as earth-moving equipment manufacturers were independent, they were compelled to be efficient and aggressive competitors in their own field? Is it to be expected that each of the new owners of an earth-moving equipment subsidiary will be as generous as an independent management would be in appropriating funds for expansion, for new equipment, for new research, and for more aggressive sales? So long as most of the earth-moving equipment industry was largely in the hands of successful independent single-purpose competitors, could it be demonstrated that the acquisition of one or two members of the industry by interests outside the industry would be detrimental to competition? Was there ever a point in this series of acquisitions of independent earth-moving equipment manufacturers by alien parents when a complaint could have successfully charged a substantial lessening of competition?

Quantifying the Statutory Tests

Is it possible to quantify the statutory tests of a substantial lessening of competition or a tendency toward monopoly? Is there a yardstick which will indicate when a lessening of competition has become a substantial lessening, or when a tendency toward monopoly, which theoretically might be said to set in whenever one competitor acquires another, has reached a point of public concern?

The nature of competition and monopoly precludes any standardized quantitative tests being applied from market to market or industry to industry. Each industry and each market bears the marks of its competitive experience, and what may be a substantial lessening of competition in one market may be of little significance in another. No one fact, commonly no simple set of facts, will suffice to determine whether an acquisition or merger will curtail competition seriously or advance monopolistic conditions significantly.

Price, quantity, quality, credit terms, protection of inventories against price changes, prestige advertising, special services keyed to the customer's requirements, products and services tailored to indi-

vidual needs, all of these make up the warp and woof of competition in the real life of business. Few acquisitions and mergers can take place that will not affect competitive strategy and competitive tactics for the acquiring company, and perhaps also for its competitors, or its suppliers. Where the balance lies will always call for judgment informed by experience, whether the analyst is an economist seeking an answer to an economic problem or an attorney attempting to advise a client or to conduct a litigation. No one industry is a law unto itself in competitive conduct; the experience of competitively similar industries will always be relevant in formulating the basis for analytical study and in testing the probable validity of any conclusions reached.

With the passage of time, decisions in litigation arising under Section 7 may establish precedents which will tempt the attorney to conclude that he has a simple yardstick by which he may advise his clients that a particular acquisition falls within, or falls without, the prohibitions of the antimerger law, but the economist will always need to examine the characteristics of competition in the particular trade or industry before he will be willing to express an economic judgment that there may be a significant lessening of competition or a tendency toward monopoly.