The Effects of the Beatrice-Conagra Merger on Brand-level Marketing Strategies

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Table of Contents

Figures

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Abstract

This paper uses graphical and statistical techniques to examine the effects of the acquisition of the Beatrice Foods Company by ConAgra, Inc. on brand-level marketing strategies. While some instances of postmerger brand harvesting were found, we did not find evidence that there was any systematic or widespread practice of a harvesting strategy.

The Effects of the Beatrice - ConAgra Merger on Brand-level Marketing Strategies

1. Introduction

During the 1960s and '70s, firms wishing to expand via merger could expect the close scrutiny of the Department of Justice and the Federal Trade Commission. Mergers by direct competitors and by firms in closely allied lines of business were generally deemed anticompetitive and subject to challenge in the courts. The 1980s, however, brought a sea change in the opinion of these antitrust enforcement agencies. Mergers previously considered insupportable under the law went unchallenged. Increasingly large mergers were proposed and consummated; mergers such as the union in 1988 of Kraft Foods and General Foods under the Philip Morris banner went unchallenged.

Some economists have hailed such mergers as leading to an increase in market and managerial efficiency (Demsetz 1973, 1974; Peltzman 1977), resulting in net gains by consumers. Other economists fear that whatever efficiency gains might arise would be more than offset by consumer losses due to the increased market power held by the combined firms (Greer 1992, Ch 8; Baker and Bresnahan 1985). How the relaxation of enforcement of antitrust policy actually affects business conduct is an empirical question.

This paper examines the effects of the acquisition of the Beatrice Foods Company by ConAgra, Inc. in August of 1990. The following section describes the Beatrice-ConAgra merger in greater detail, the third section discusses the literature related to the performance of firms involved in mergers and acquisitions, the fourth section examines data on prices, market shares, and advertising for several food products owned by the merging firms, and the last section discusses the findings and draws conclusions.

2. The Beatrice - ConAgra Merger

In August, 1990, ConAgra Inc. completed the acquisition of the Beatrice Foods Company. Prior to the merger, ConAgra was the nation's second largest food manufacturer, with sales of $16 billion, primarily in meat products and frozen foods. Beatrice, then owned by the leveraged buyout firm of Kohlberg, Kravis, Roberts & Co. (KKR), had annual sales of $4 billion in a broad range of food product categories, including the prepared meats business.

When ConAgra agreed to purchase Beatrice Foods from KKR, it was no newcomer to the arena of corporate acquisitions. Prior to the 1980s, ConAgra dealt primarily in milling, commodities, and farm supply. ConAgra made its entry into the packaged foods business with the 1980 acquisition of Banquet Foods from RCA. Under chairman Charles M. Harper, ConAgra was known for driving a hard bargain when negotiating acquisitions (Therrien 1991). For example, RCA originally wanted $200 million for Banquet, but the final cost to ConAgra was $55 million in cash and stock (Bailey 1990). In 1983, ConAgra purchased the Armour processed meats line from the Greyhound Corp. for $166 million, and in 1986 it acquired RJR Nabisco's frozen food line, which included the Morton, Patio, and Chun King brands, for $64 million. Along the way it also purchased several smaller independent food processors (Mergers and Acquisitions 1990). ConAgra consummated all these acquisitions without violating its stated financial performance goals[1]. ConAgra next attempted to take over the poultry processor Holly Farms in 1989, but poultry giant Tyson paid $1.29 billion to outbid them.

ConAgra's acquisition of Beatrice for $1.34 billion, however, was, for it, in a completely different league than the previous takeovers. Acknowledging that "we stretched our balance sheet standard [of 35% long-term debt] on this," Mr. Harper said the acquisition would put ConAgra at nearly 50% debt (Gibson, Johnson, and Anders 1990). After the transaction was complete, Standard and Poor's downgraded ConAgra's bond rating from A to BBB (Mergers and Acquisitions 1991).

Not all analysts shared S&P's concern. After the takeover announcement, ConAgra's stock price rose in a down market, unlike the usual case, when the acquiring company declines on the news (Bailey 1990). By the end of fiscal year 1991, ConAgra had achieved two of its three above-stated performance goals: return on common stock was 20.2% and earnings per share were 16.3% (ConAgra Annual Report 1991). Part of the reason for the low impact of the acquisition

[1] As stated in ConAgra's 1990 Annual Report, these included: more than a 20% after-tax return on year-beginning common stockholders' equity; to increase earnings per share, on average, more than 14% per year; and to maintain long term debt at less than 35% of total capitalization.

on corporate performance was the structure of ConAgra's payment to KKR. Of the $1.34 billion purchase price, less than half, $626 million, was in cash; the remainder was in common and preferred ConAgra stock (Gibson *et al.* 1990). The relatively low percentage of the purchase price paid in cash meant that ConAgra was not forced to substantially increase its cash flow.

KKR's original asking price was substantially higher than the $1.34 billion paid, but there were several incentives for KKR to sell. When KKR purchased Beatrice in a leveraged buyout for $8.1 billion in 1986, the transaction was the largest LBO at the time (Baker 1992). To generate cash to pay down debt, KKR immediately began selling off components of Beatrice, a conglomerate with interests in car rental, undergarments, and luggage, as well as in food. KKR's management of the Beatrice takeover and dismemberment was considered a model LBO. At the same time, its acquisition of RJR Nabisco was considered a model of how not to manage an LBO. At the time KKR sold Beatrice for $1.34 billion, it was raising more than $1.7 billion to bolster its investment in RJR (Wall St. Journal 6/8/90). In addition, ConAgra's use of stock to pay for Beatrice was particularly attractive to investors in KKR; payments in stock were tax-deferred for KKR, while cash was immediately taxable.

3. Mergers and Acquisitions in the Literature

Much of the literature on mergers and acquisition focuses on the creation of value in terms of the financial market valuation of the merging entities (Slusky and Caves 1991; Lubatkin 1983, 1987). Chatterjee (1986) hypothesizes that mergers create value in any of three ways: financial synergies, giving the combined firm access to sources of capital that were previously denied it; operational synergies, where production or administrative efficiencies allow the firm to enjoy reduced costs; and collusive synergies, anything that allows the firm to exert market power to charge higher prices. Singh and Montgomery (1987) also list three sources for value creation in mergers between two related companies. They ignore Chatterjee's first category, financial synergy, and expand his second into economies of size, those efficiencies which arise in the production of a single product; and economies of scope, those efficiencies which arise in the joint production of two or more products, including reductions in distribution costs. They retain market power as their third source of value creation.

Economies of scope and market power were seen as driving forces behind ConAgra's acquisition of Beatrice. At the time of the takeover much was made in the popular and financial press that, beyond the acquisition of many leading or number two brands, the most important assets that ConAgra obtained were a major distribution system for dry groceries and a sales force experienced in marketing those products (Mergers and Acquisitions 1990, Bailey 1990). The addition of so many strong brands was also seen as giving ConAgra additional clout in dealing with retailers. One securities analyst was quoted as saying that the takeover means "more shelf space for ConAgra... and higher profitability" (Potts 1990).

In a study of market power gains due to merger, Lubatkin, Cotterill, and Da (1994) attempt to address the question of how such acquisitions affect consumers. They examined four large mergers in food manufacturing industries during the 1980s[2] to determine the relationships between changes in price, market share, and the degree of relatedness of those firms' products. Using Selling Area Markets, Inc. (SAMI) data on warehouse withdrawals, they were able to identify 415 products marketed by the merging companies and to group them item by item into either horizontal, related, or unrelated classifications. They found that horizontal combinations (e.g., between competing brands of potato chips) were associated with positive one-year product price changes in the pooled data and in two of the four individual mergers. Related combinations (e.g., between a brand of potato chips and a brand of tortilla chips) and unrelated combinations showed no such association.

Cotterill (1993a) and Chevalier (1994) identify another potential impact on the acquiring firm in a large merger – that of shouldering large amounts of debt to pay for the target. Large debt loads require large cash flows to service the debt, and, if normal operations prove inadequate, the acquiring firm must increase its cash flow by raising prices, cutting costs, or selling assets. For example, after KKR purchased the Beatrice company for $8.1 billion in a leveraged buyout in 1986, it sold off several major pieces of the firm in the first year for more than $3.5 billion and raised an additional $3 billion in asset sales the following year (Baker 1992). In analyzing the impact on the stock value of rivals of merging firms, Chatterjee (1986), in a study of mergers over the period 1969 to 1972, found that rivals' stock gained

[2] The mergers they studied were the acquisition of Nabisco Brands by R. J. Reynolds in 1984, the acquisition of the Carnation Company by Nestle in 1984, the acquisitions of Anderson Clayton and Golden Grain by Quaker Oats in 1986, and the acquisition of Kraft by the General Foods division of Philip Morris in 1988.

value. He attributed this to an "information effect," that a merger signals that there is a technological or process innovation available which makes cost reductions possible. However, Cotterill (1993), in a study of mergers and leveraged buyouts in food retailing, reasons that the competitiveness of the merged firm is constrained by the increased debt, and it is from this that its rivals benefit. In an interview, Erivan Haub, who owns a controlling interest in the A&P supermarket chain, noted "through leveraged buyouts and takeovers, A&P's competitors are becoming loaded with debt... They will pass along the cost of serving this debt by raising prices" (Fuhrmann 1988).

4. Examination of Performance

To gain a better understanding of the impact of the Beatrice acquisition on conduct, we will look at the market performance of several brands directly involved in the takeover. It is not possible to examine all brands involved; while the premerger ConAgra dominated "the middle of the plate" (meat and prepared entrees) (Gibson *et al.* 1990), Beatrice was present in almost every line of the processed foods industry[3]. We will take as examples several brands and product categories of prepared foods, and examine the changes in their prices, market shares, and advertising levels during the five year period from the first quarter of 1988 to the fourth quarter of 1992. The data sources for this analysis are the Information Resources, Inc. InfoScan database (IRI), and the Leading National Advertisers *Class Brand Report*, (LNA). IRI provides quarterly information derived from checkout scanner data on the quantities sold, prices, market shares, and local promotions for a wide variety of processed foods sold in supermarkets across the U.S. While IRI provides data at the local as well as the national level, we will exclusively use the national data for this analysis. LNA provides quarterly estimates of national expenditures at the brand level for up to ten types of advertising covering both print and broadcast media. In this analysis we will use the total advertising spending in all categories as our measure of advertising support.

[3] Even if the time necessary to complete an exhaustive analysis of all product categories were available, the data is not. The IRI dataset used here covers only products with UPC (scanner) codes and does not include all such product categories. Data on products without scanner codes, such as fresh meats and poultry, is not available to us.

There are several things we wish to investigate here. In cases where there were horizontal combinations, we will see if joint management of previously competing brands leads to an increase in prices. Product categories where brands contain similar but not identical characteristics are spatially differentiated; that is, each brand is positioned differently in product space[4]. Such differentiation is termed Hotelling differentiation (Hotelling 1929). A given brand competes primarily with its nearest neighbors; if a brand were to unilaterally increase its price, some customers would switch to competing brands, and its nearest neighbors would gain most of the switching customers. Brands more distantly positioned in product space are less important and sometimes not considered at all in marketing decisions (Bresnahan 1981, Levy and Reitzes 1993). When there is a merger between two firms marketing similarly positioned competing brands, this lessens the potential losses a firm will experience when one of its brands raises its price. Some of the customers who switch away from the now higher priced brand will buy another of the firm's products, allowing the firm to retain those customers' patronage (Baker and Bresnahan 1985; Carlton and Perloff 1994, Ch. 8).

Even in categories where the merger does not bring two previously competing brands under common management, the need to increase cash flow to pay the costs associated with the takeover may lead to changes in conduct. Two different avenues of analysis will be explored. The first is, as above, to compare pre- and postmerger price trends to determine whether there appears to be an attempt to harvest a brand's franchise capital. Such conduct has been observed in ready-to-eat breakfast cereals following the LBO of RJR Nabisco (Cotterill 1993b). The second is to examine whether advertising is curtailed in order to reduce spending and increase available cash. Simultaneous increases in price and decreases in marketing costs will increase short run profits at the expense of the brand's long run market position.

The first product category we shall examine is sausage. Prepared meat products is one of the areas where Beatrice and ConAgra most closely overlapped. After the merger announcement, the FTC requested additional information about the proposed sale, and it was believed that the information request was for this area of their business (Wall Street Journal, 7/10/90). The work by Lubatkin *et al.* (1994) indicates that it is in horizontal product line mergers such as this that

[4] The "dimensions" of product space are the relevant attributes of a given product. For example, in the sausage product category, product dimensions might include taste, fat content, ingredients (all beef, all meat, etc.), and shape (patty or link).

we would most likely see price elevation. Beatrice brought with it two major brands of sausage, Swift and Eckrich, while ConAgra's primary brand was Armour, with Webber and Decker among its less prominent brands. Figure 1 contains the price trends for the Beatrice brands Swift and Eckrich (light lines), the ConAgra brands Armour and Webber (medium lines), and for all sausage (heavy line)[5]. The mean price of all brands of sausage peaks in the third quarter of 1990 and falls thereafter. The mean prices of Swift and Eckrich consistently maintain a price premium above all sausage's mean price, with a run up in their price beginning one or two quarters prior to the merger. After the merger, Swift maintains its elevated price while Eckrich's price gradually returns to its premerger level. Armour's price rises from below the mean price to about the price level of Eckrich in the third quarter of 1989 and then levels off, again falling below the mean price of all sausage in the second quarter of 1990 and staying below it for the rest of the period. Webber consistently remains below the mean price.

Figure 2 contains the prices of sausage indexed so that the second quarter of 1990 equals 100. This will allow us to look more easily at the relative changes in the brands' prices following the merger. For the first year following the merger, all prices (except Webbers, the lowest priced brand) declined more or were raised less than the mean price of all sausage, clearly showing that in this case there is no attempt to harvest these brands or exert market power. Figure 3 shows that advertising support for each of the three major brands was also maintained throughout the postmerger period.

ConAgra and Beatrice were also major players in the frankfurter market prior to the merger, each marketing several brands. ConAgra was ranked third and Beatrice fifth at the manufacturer level at the end of 1989. Figure 4 displays the price and advertising trends for Armour, ConAgra's primary brand, and for Eckrich, Beatrice's top brand, as well as the mean price for all hot dogs. Prior to the merger, Armour's price deviated little from the mean hot dog price. Armour's price shows a steep rise in the second quarter of 1990, beginning just prior to the merger announcement, which peaks at the end of 1990. Subsequently, its price falls gradually relative the mean price, which it reaches in the fourth quarter of 1992. Eckrich's price, on the other hand, begins to climb a year before the merger, reaching its peak at the end of 1990. It then drops sharply to its pre-increase level. While

[5] The vertical line in this and subsequent figures is drawn at the second quarter of 1990, the last full quarter that Beatrice operated as an independent company. This quarter will be used as the benchmark against which later prices, indices, and shares will be compared.

there is great variation in advertising levels for both brands, Armour's ad levels fall to almost nothing from the fourth quarter of 1990 until 1992.

Figure 5 shows hot dog prices indexed so that the second quarter of 1990 equals 100. Here we again see that Armour's price rises sharply at the time of the merger and maintains its increase above the all-brands index until the third quarter of 1992. Eckrich's price index is only above the all-brands index for the last quarter of 1990, the final quarter of its price spike in Figure 4. For all other post-merger quarters its index is below the all-brands index. The graphical evidence on price and advertising suggests that there may have been a post-merger attempt to harvest the Armour frankfurter brand. Armour's market share trend (not shown) lends weight to this hypothesis. Following the merger, Armour's market share[6] fell by almost half, from 4.3% in the first quarter of 1990 to 2.2% in the fourth quarter of 1992.

We turn now to products where only one of the merging firms controlled a major brand. In this case, the merged firm cannot expect to reap Hotelling-type gains from price increases (where some consumers shifting from one of a firm's brands due to an increase in price purchase other brands owned by the same firm). Under these circumstances, attempts to exercise market power or to harvest a brand by increasing price lead to demand shifts to rivals' brands, and a price increase is only rational if demand is inelastic or the firm wishes to maximize short run profit at the expense of market share.

Hunts is the nation's second leading brand of catsup. Prior to the merger, Beatrice positioned Hunts as a cost leader, pricing 5 to 8 cents below the mean price of all catsup (Figure 6), and about 12 to 15 cents below the market leader, Heinz (Haller 1994). Beginning in the fourth quarter of 1990, Hunts began to raise its price dramatically, so that by the second quarter 1991 its price was equal to or slightly above the mean catsup price. During the same period, Hunts' market share plummeted; in just two quarters, from the third quarter of 1990 to the first quarter of 1991, it fell from a high of nearly 24% to about 16%, a 30% drop in market share. Figure 7 continues the story, showing Hunts' price index increasing more than 20% in the year and a half following the merger, while the mean price of catsup rose by less than 10%. National advertising, which had been cyclical in nature, was virtually stopped after the merger. LNA reports only $600.00 in total

[6] The market shares used here and throughout this paper are volume market shares. A brand's volume market share is calculated on a quantity basis, rather than on a dollar basis.

ad expenditures for Hunts catsup from the second quarter of 1990 through the end of 1992. This strongly suggests that the Hunts brand was being harvested in catsup, by both increasing prices and reducing, or eliminating, advertising expenditures.

Hunts also holds a strong position in canned and processed tomatoes. At the end of 1989, Hunts was the leading firm in tomato paste and sauce and the number two firm in whole canned tomatoes. Hunts tomato products command a price premium over the mean price of other brands (Figure 8), but consumers are apparently sensitive to changes in Hunts price relative to other brands' prices. Following the second quarter of 1990, Hunts clearly loses or gains market share as its relative price departs from or approaches the all-brands index (Figure 9). In contrast to catsup, Hunts maintains its advertising spending on tomato products, at least until 1992 (Figure 8). In the case of processed tomatoes, there is little evidence of a concerted effort to harvest the Hunts brand name.

One product category in which a harvesting strategy is clearly being executed is in popcorn. Orville Redenbacher is the leading brand in both regular and microwave popcorn. Microwave popcorn is far and away the growth segment of this category: from the first quarter of 1988 until the fourth quarter of 1992, dollar sales of microwave popcorn grew by 27%, while sales of regular popcorn fell by more than 37%. As the following charts show, ConAgra has chosen to harvest the Orville Redenbacher brand (OR) in regular popcorn while pricing aggressively in the microwave segment. In the first quarter of 1988, the mean price of regular popcorn was about 74 cents per pound and OR enjoyed a 61 cent premium (Figure 10). By the end of 1992, regular popcorn's price was virtually unchanged at 78 cents, while OR's premium increased to 78 cents. Looking at the regular popcorn price index (Figure 11) shows this clearly. While the all-brands index is generally below 100, the OR index continues to rise. During this period, OR's volume market share fell by about 4.5%, from a high of 22.6% the first quarter of 1989 to 18.1% at the end of 1992. While it is cyclical in nature, advertising support for OR appears to be constant overall[7]. It must be noted that, while there is clearly a harvesting strategy being practiced with OR regular popcorn, it was instituted prior to the merger. This appears to be a classic example of harvesting a strong brand in a maturing market. The OR price trend

[7] The advertising trend presented in Figure 10 is for both regular and microwave popcorn. Limitations in the available advertising data as well as the nature of the advertising itself (ads frequently do not distinguish between regular and microwave) preclude separating the two types.

shows a slow, steady increase from the start of our data at the beginning of 1988, while the OR market share trend shows a steady decline, at least from the first quarter of 1989. Over this period, OR lost about 20% of its share of the regular popcorn market. There does not appear to be any evidence of an alteration of strategy around or after the time of the merger.

The story for microwave popcorn is quite different. OR's microwave popcorn price is initially above the all-brands level, but approaches it gradually, finally falling below it after the third quarter of 1991 (Figure 12). Market share appears to be sensitive to these price changes, registering increases corresponding to most price drops. We again get a clear picture of the brand's conduct when we examine the price index trend (Figure 13). Prior to the benchmark second quarter of 1990 OR's price index is higher than the all-brands index. Following the second quarter 1990, OR's microwave price index is at or below the all-brands index. This indicates that its price is falling more quickly than all brands' prices, both before and after the merger. OR is attempting to maintain its dominant market share in a growing market as it faces competition from an increasing number of competitors.

The last product category we will examine is peanut butter. Although before the merger ConAgra owned and marketed several small brands, we focus here exclusively on the Beatrice brand Peter Pan, the number three brand nationally throughout the period of study. Prior to the merger, Peter Pan was priced slightly higher than the mean price of all brands of peanut butter. See Figure 14. After the merger, beginning with the sharp rise in peanut butter prices due to the peanut shortage at the end of 1990, the price of Peter Pan matched the all-brands peanut butter price, staying within a penny or two of the mean. In this case, there appears to have been an attempt to position Peter Pan more competitively against its rivals. It is interesting to note that this had little effect on its share; Figure 15 displays the trends of market share and advertising as a percent of sales over time. One can easily see that Peter Pan's market share responds much more sharply to changes in its advertising expenditure than it does to changes in its price.

5. Conclusions

Based on the evidence presented above, there is no indication that ConAgra practiced any systematic or widespread postmerger brand harvesting. Of the products examined, there were three instances of

what might be deemed a harvesting strategy. For both Armour hot dogs and Hunts catsup, postmerger prices increased at rates above the levels of their competitors and their postmerger advertising spending fell to almost nothing. During the same period, Armour's market share declined dramatically, while Hunts' share, after an initial steep decline, continued to fluctuate. The third instance of apparent harvesting, Orville Redenbacher regular popcorn, appears to have been in place long before the merger occurred. Additionally, ConAgra does not appear to be attempting to use its enlarged stable of brands in the sausage category to reap Hotelling-type gains. There is no evidence to suggest that a concerted multi-brand price increase was attempted after the merger. On the whole, based on the sample of the brands which we have examined, it appears that ConAgra continued with business as usual following the acquisition of Beatrice.

This is not surprising. When KKR purchased Beatrice in 1986, it was a classic LBO - buy a large company, sell off as many of its subsidiaries as possible as quickly as possible, and get out. Beatrice contributed nothing to KKR but the opportunity for short-term profit. ConAgra's purchase of Beatrice Foods, on the other hand, was made with the intent of using Beatrice's established brands, distribution network, and experienced sales force to position itself more firmly "across the food chain." Beatrice's assets complemented ConAgra's strengths. This appears to be one case where synergy, the elusive driving force behind much of the recent merger wave, actually exists.

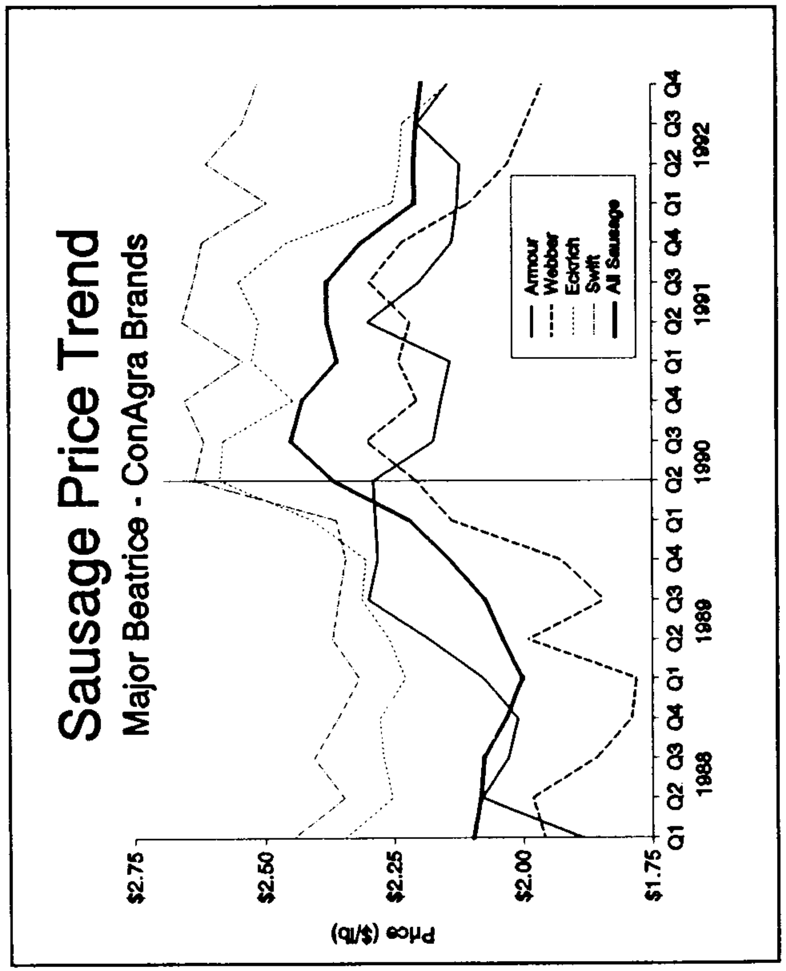
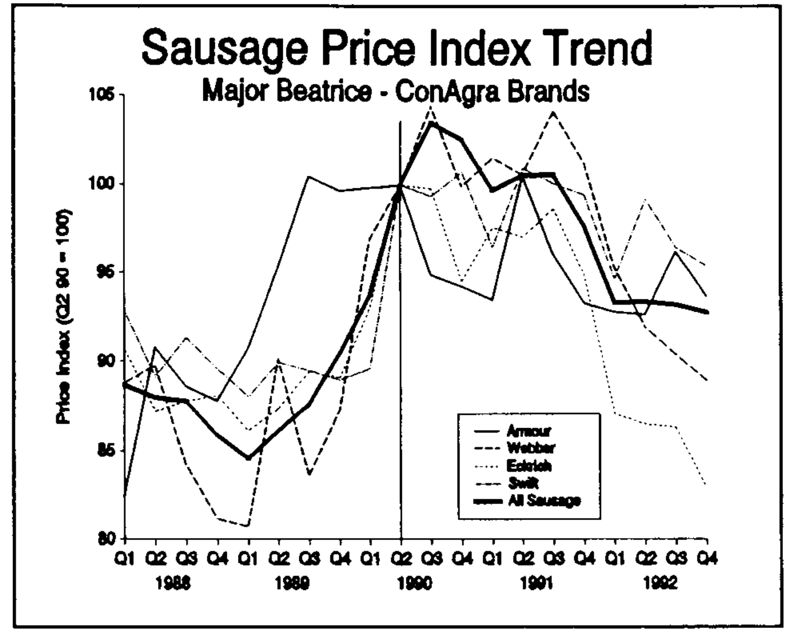


Figure 1



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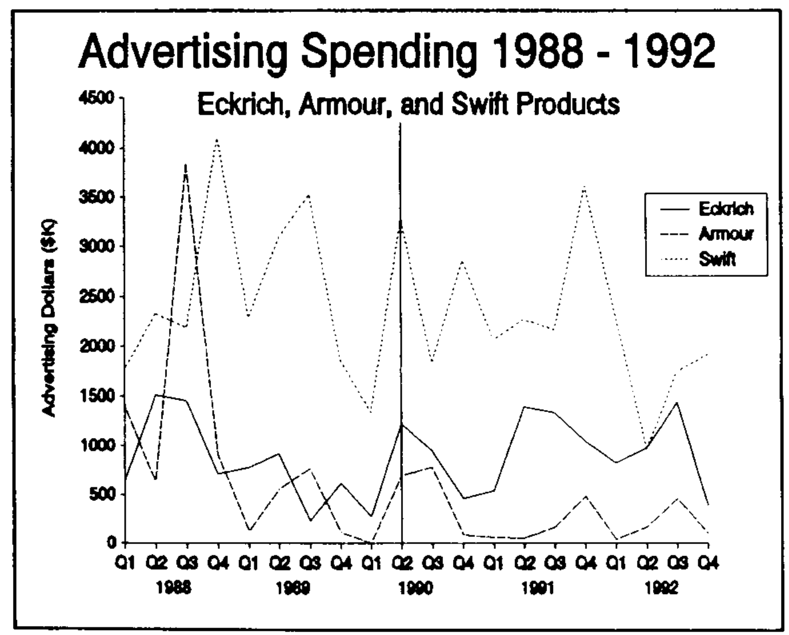

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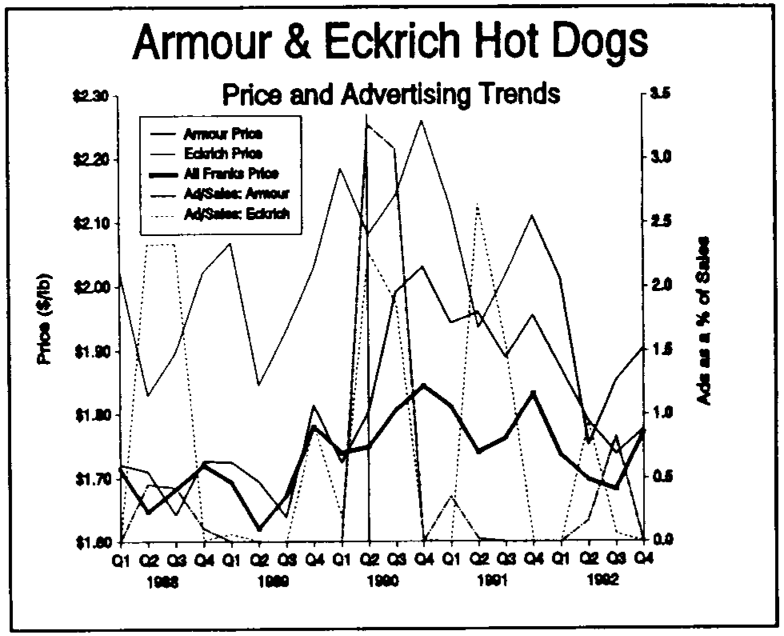

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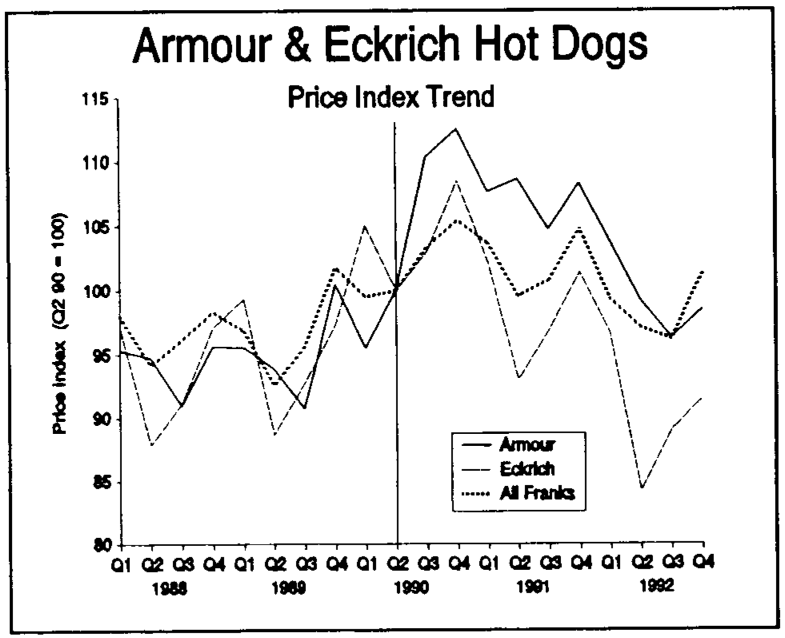

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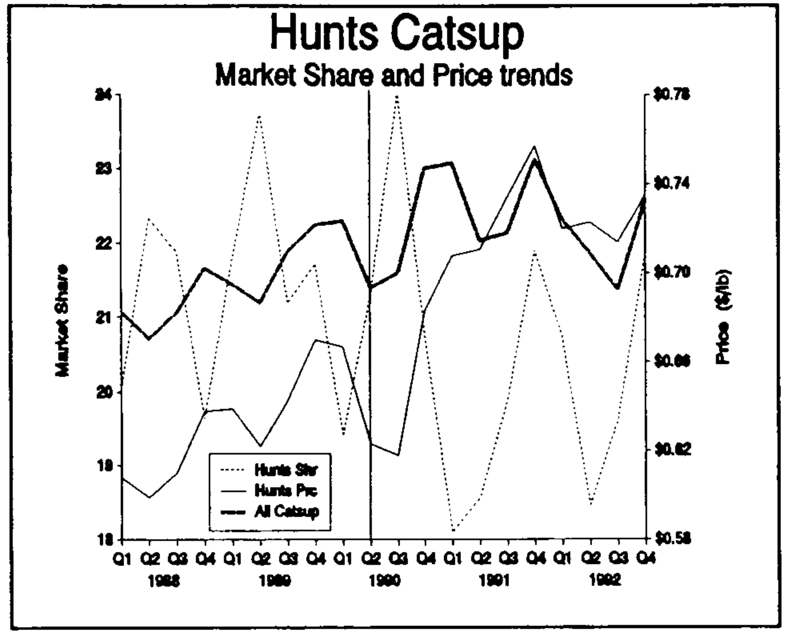

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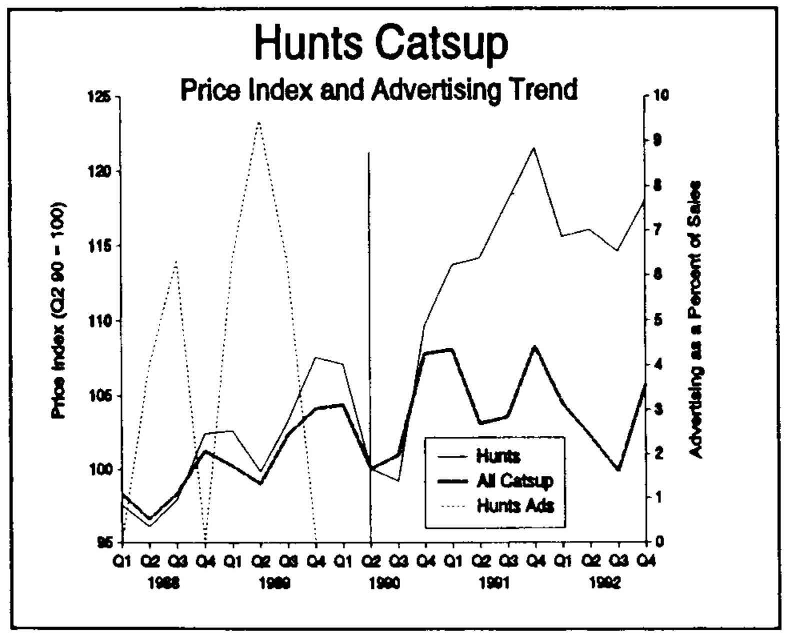

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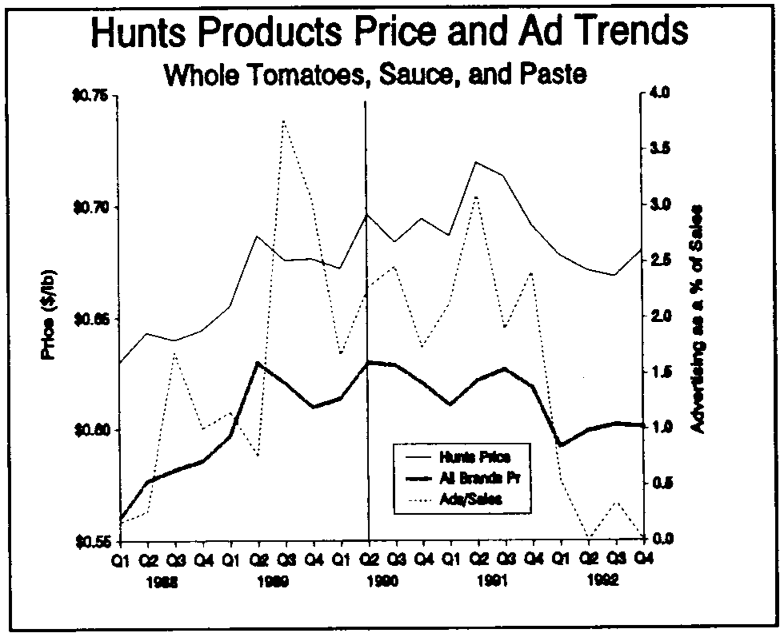

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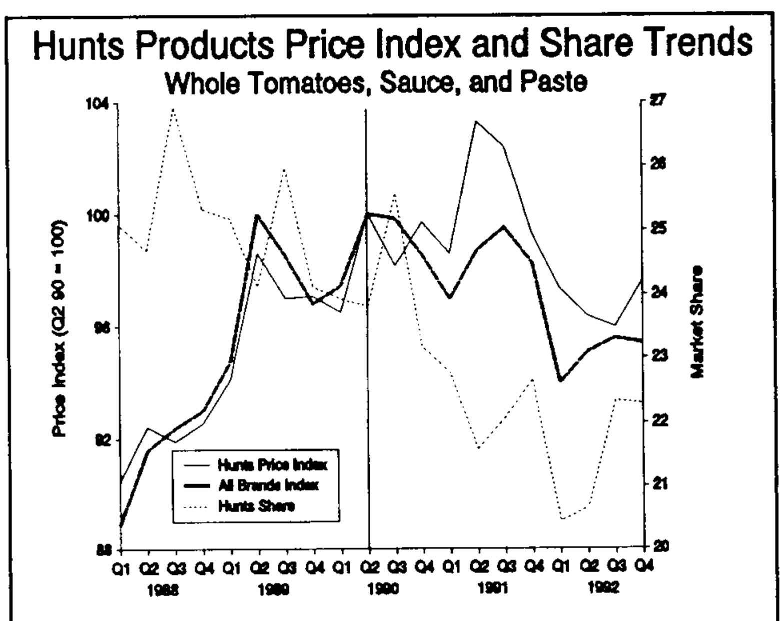

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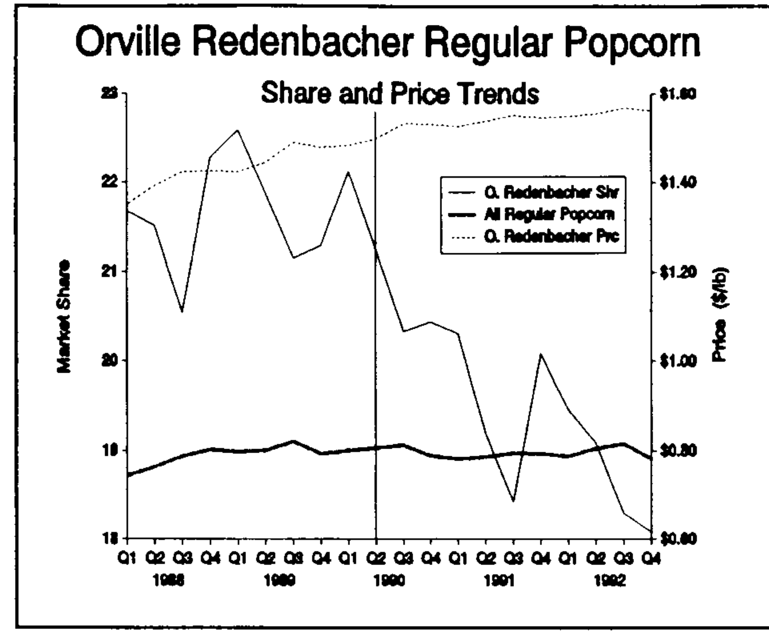
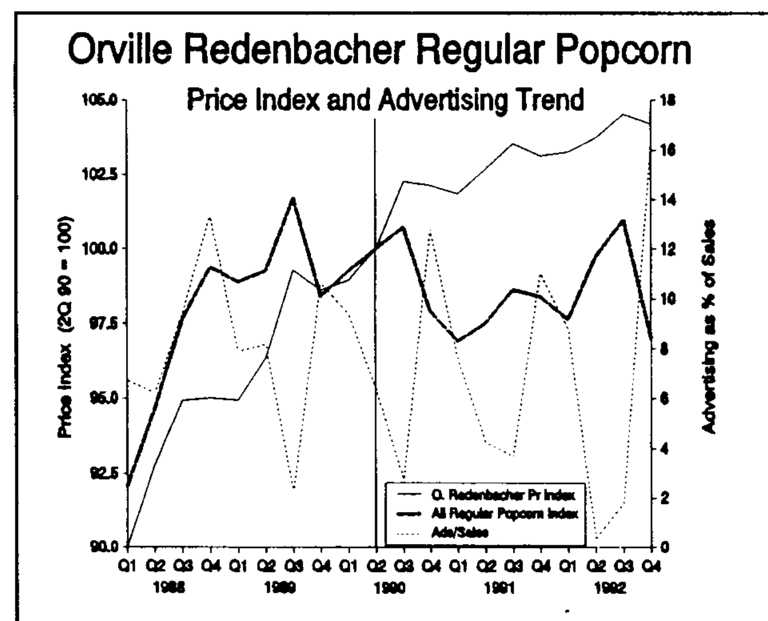


Figure 10



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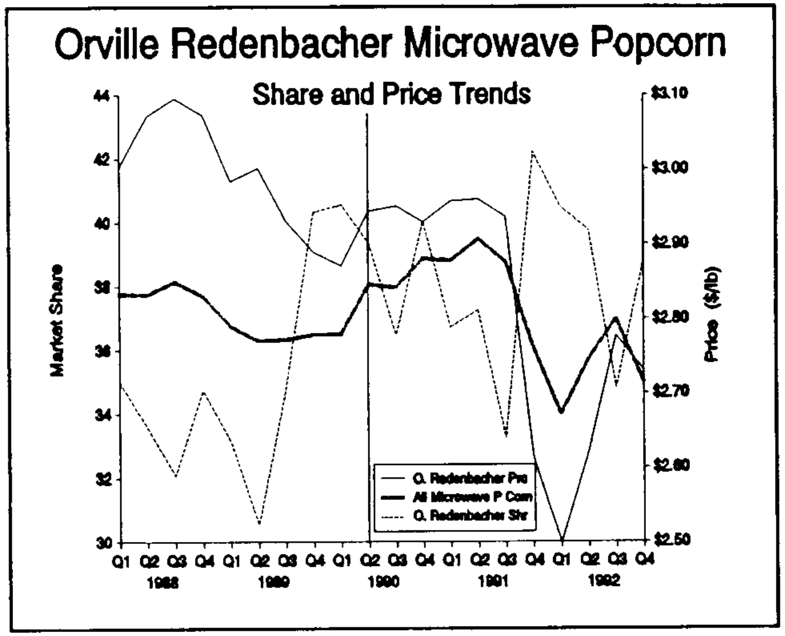
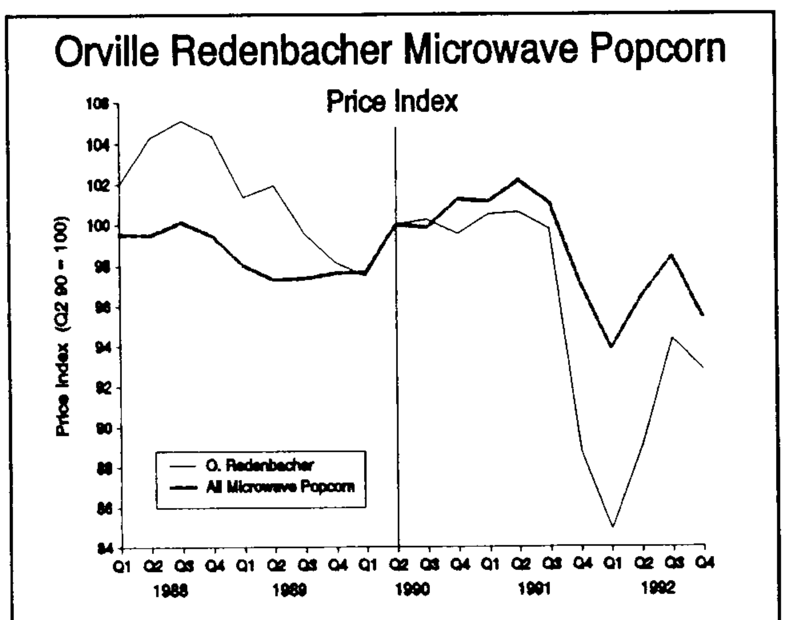


Figure 12



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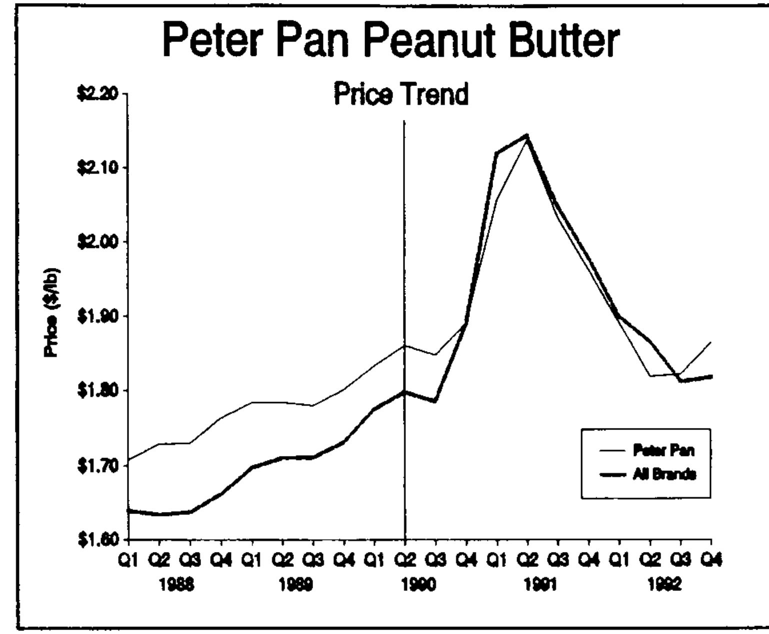

Figure 14

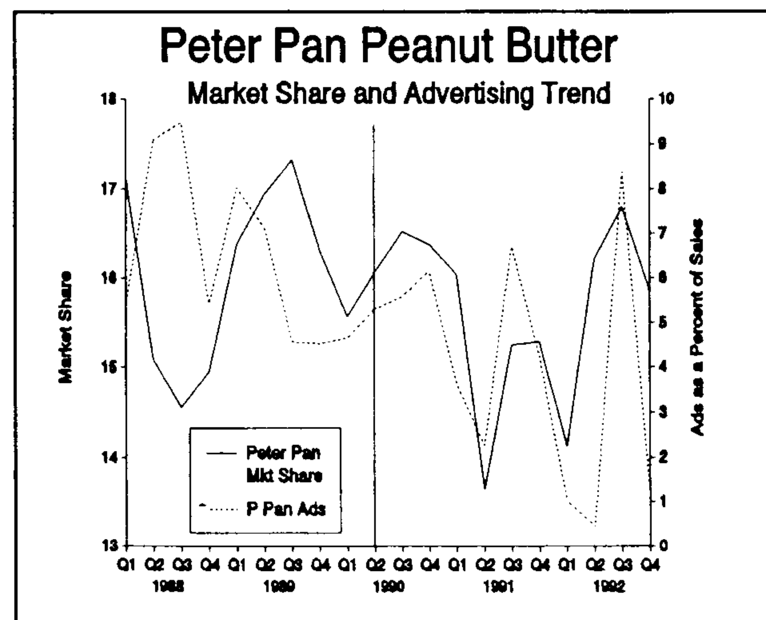

Figure 15

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