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Implications of Conglomerate Mergers to Food Distribution in the 1970's

Discussant - Federal Trade Commission

Some questions on the validity and profitability of conglomerates

Food 70's

Dr. Harrison F. Houghton
Chief, Division of Economic Evidence
Bureau of Economics
Federal Trade Commission

Mr. Stout presents a most interesting brief in behalf of the conglomerate as the wave of the future. Indeed, his presentation in many ways goes well beyond the protestations of the leaders of the conglomerates themselves. The conventional corporate wisdom, concerned with problems of buying, selling, transportation, storage and processing is really old hat. What really counts is the "genuine systems-engineering approach to management." We "have entered the new age of communications," Mr. Stout declares, "which renders obsolete the conventions of an older industrial age . . ." Enough of this product-orientation, building a better mouse trap and all that jazz. Join the conglomerate geniuses who expertise is risk minimization, information specialization, and finance -- "their long suit." The conglomerate, it seems, is not simply diversified. It faces up to the necessity for "full spectrum treatment of marketing management functions." "Conglomerate headquarters," Mr. Stout says, "doesn't know how to run a meat packing plant, nor does it intend to learn." Indeed, that is one of the great virtues of the conglomerate phenomenon. Mr. Stout says more, much more, in a paean of praise for these "brain pickers with hair-thin triggers." Indeed, the mind fairly reels in contemplation of Mr. Stout's high flown rhetoric.

My problem with Mr. Stout's paper is that I question whether it really takes us very far in coping with the title of his paper itself, namely, the "implications of conglomerate mergers to food distribution in the 1970's." First, I am unclear as to whether Mr. Stout feels that the conglomerate revolution has already occurred in food distribution or whether it is the next stage in the organizational development of that sector of the economy. Secondly, in order for the analysis to proceed in more orderly fashion I would like to see some of the terms defined and a careful delineation made between the various elements of the efficiency-profitability issues. Third, I am concerned with the long run implications of the conglomerate development both for competition and consumer welfare. Mr. Stout does not explore many of these areas to my satisfaction.

At the outset I think we should recognize that the conglomerate phenomenon is not new, except in its most extreme form, recently manifested. But, first we must define a conglomerate. Very simply a conglomerate is a firm engaged in a multiplicity of separate markets. The diversity of the firm may be limited, coherent and related to a fairly well defined industrial context, or it may be far flown and devoid of economic coherence. The strategies of the firm will differ widely dependent upon the scope of its multi-market involvements and its

dependence upon any particular segment of its operations.

The food industry has been led by conglomerate firms for a generation or more. General Foods and Standard Brands were established during the 1920's through a series of product-extension mergers. In the dairy industry, the leading firms reached their eminence early in the game through a long series of geographic market-extension mergers. And so on down the line.

Actually, the food distribution business involves two levels of analysis. On the one hand, a group of grocery product manufacturers are vying with one another to promote their products and gain acceptance by channeling their sales through the second segment of the industry, namely, the supermarkets. The scarcity of shelf space, the necessity for pre-selling and all the other attributes of promotion are central to the problem faced by the various sellers.

The structure and conduct of the grocery product industries is undergoing a major transformation reflecting in very substantial measure the promotional power centering in a limited number of leading firms serving the grocery supermarket trade. The core of this development is that the leading organizations in the field are more or less indifferent to the particular products they turn out so long as the products are amenable to the kinds of massive promotional techniques these firms employ with great proficiency.

Actually, it seems to me that in view of this organizational set up, we should think not of food distribution, but of grocery product distribution and broaden our concept to include everything that is being marketed through the means of the supermarket. This would include many non-food items such as soap and detergents and numerous drug products, as well as some tobacco products. Indeed, if we wish to delineate the firms with the greatest economic power in this area, one of the best indices would be the outlays for advertising and promotional expenses undertaken by the leading firms. By this index, such companies as Proctor & Gamble, General Foods, Colgate-Palmolive, Lever Brothers and American Tobacco would be well in the lead. Promotion itself is these firm's most important product, and it is not surprising to see them broadening their activities through mergers to become involved in a wide array of lines, including foods, sold through the supermarkets.

Now there has been a conglomerate merger movement affecting the manufacture and sale of grocery products. However, it is doubtful that it is the kind of conglomeration that Mr. Stout is discussing or that such "conglomerate activities" as the systems engineering approach to management is involved. Actually, a review of recent merger activity suggests that most grocery product mergers have been within the industry, have been promotion oriented and have not involved the type of far flung mergers that place such heavy emphasis on concepts

such as the systems approach. ^{1/} Thus, I am not sure that the primary attributes of Mr. Stout's model really apply to what's going on, at least at present, in the food distribution business. Indeed, the success with which many of the already well established firms are moving I question whether they would be ripe for take-over by the Jimmy Ling's and the Bluhdorn's.

As a matter of fact, if it is true that the power of promotion and magic of television advertising is the real key to success in food marketing, then it's difficult for me to see how the intervention of the far flung conglomerates would have any impact on the operations of food firms. In short, it seems to me that most of the leaders in food distribution have already reached the optimum in promotional technique and are not liable to be threatened by the new conglomerate interventions. On the other hand, there is hardly any question but that the single product firm or even firms which have gained substantial market position in their own particular product lines are succumbing to the merger movement and selling out to the promotional leaders. For example, Coca Cola acquires Minute Maid. Pepsi Cola acquires Frito-Lay.

The growing control over a multitude of product markets by a few leading grocery manufacturers and promoters is a phenomenon to be reckoned with. While such developments may lead to corporate profitability it is likely that such gains reflect private rather than social economies. When Proctor & Gamble took over Clorox ^{2/} the principal advantages it could confer upon Clorox were its tremendous promotional power, its power to gain access to shelf space in the grocery supermarkets, and the advantages it had in securing lower television advertising

^{1/} The just issued staff report of the FTC found that the most prominent conglomerates have only acquired a relatively small number of food companies. The group of 11 "new conglomerate" firms made slightly more than 100 large acquisitions (\$10 million assets or more) during the period 1961-68. Of this total only 4 were food companies: LTV acquisition of Wilson & Company; ITT acquisition of Continental Baking Company; Textron acquisition of Spencer Kellogg; and Gulf & Western acquisition of South Puerto Rico Sugar Company. See Federal Trade Commission, Economic Report on Corporate Mergers, October 1969, Chapters 5 and 8.

Narver found that during the years 1948-1967 about half of 120 large mergers (\$10 million in assets or more) involving food companies were within the food industry. Acquisitions of food companies by non-food companies numbered 25 while food company acquisitions of non-food companies totaled 36. If Narver had classified acquisitions on a broader basis to include all grocery product acquisitions (products sold primarily through supermarkets), as distinguished from food company acquisitions, the "within the industry mergers would have been higher since they would have included such examples as the Proctor & Gamble (detergents) acquisition of J. A. Folger (coffee). See John Narver, "Conglomeration in the Food Industries," Economics of Conglomerate Growth, pp. 36-37.

^{2/} Proctor & Gamble Co. v. Clorox Chemical Co., 356 U.S. 677 (1958).

rates. These were pecuniary advantages rather than economic efficiencies in the real sense.

From the point of view of social welfare we certainly must not be content merely to enhance the profitability of conglomerate firms, whether they be cohesive or far flung, if in the process we reduce the pressures of competition which would force such firms to produce a better product at a lower price and thus benefit the consumer. Private economies without commensurate social economies do not work in the public interest.

My limited time does not permit me to explore other aspects of Mr. Stout's presentation but I would like to, in concluding, raise a question as to his assumption that conglomerates are more profitable. Some conglomerates may be more profitable than single line firms because of scale economies achieved in production, marketing, or management. Others may be more profitable because they gain power or pecuniary advantages. But as everyone knows the new wave of conglomeration has brought so much in the way of fictitious profit reporting that it is extremely difficult to make a proper assessment. Mr. Stout makes no reference to a growing body of literature which suggests that firms that have been taken over by conglomerates often turn out to be less profitable than non-conglomerate rivals in the same industry. ^{3/} Also, according to recent reports, some of the newer conglomerates are suffering in stock market because of poor earnings reports. In any case, the market has now taken a rather dim view of the future of conglomerate stocks. While they moved way ahead of the averages through 1967 they began lagging in the market through 1968, and according to Value Line "fell out of bed with a thud in the first quarter of 1969." Value Line's report of October 17, 1969 rates conglomerates as 42nd among 66 industries in terms of probable market performance during the next 12 months.

Finally, there have been some instances of leading conglomerates moving into the food industry. For example, Jimmy Ling took over Wilson and Company one of the leading meat packers. ITT bought Continental Baking Company, the Nation's leading bakery concern. Mr. Stout may be right that these mergers represent one of the conglomerates techniques of minimizing risk for what risk is there in acquiring the leading firms in an industry? Actually, society would benefit if the conglomerates would take greater risks, make foothold acquisitions in concentrated industries, increase their capacity, thus decreasing concentration, take away the market share of the industry leaders and thus increase the vigor of competition.

^{3/} See testimony of Professor Samuel Richardson Reid, Hearings before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, September 1966, on Economic Concentration, p. 1914, et seq.; also the testimony of Professors Reid, Hogarty, and Eamon M. Kelly, before Senate Subcommittee on Antitrust and Monopoly, November 5, 1969; also see Eamon M. Kelly, Profitability of Growth Through Mergers, Center for Research (GBA), Pennsylvania State University, June 1967.