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MERGERS: BACKGROUND AND CURRENT ISSUES
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A wave of merger activity started in May 1981 and swept through the American business community. The dollar volume of major acquisitions in 1981 exceeded \$82 billion, an increase of 86% over 1980's dollar volume of \$44.3 billion. There were 113 separate mergers in 1981 that exceeded \$100 million, and several of those exceeded \$1 billion.

Why, when many business executives are questioning the stability of the U.S. economy, are corporations so eager to buy each other up?

How are the Federal Trade Commission, Securities and Exchange Commission, and the Department of Justice involved with mergers and acquisitions?

What were the largest mergers of 1981?

This Info Pack explains various types of mergers and acquisitions and provides materials relating to the recent wave of mergers.

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CORPORATE MERGERS IN 1981

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CORPORATE MERGERS IN 1981

INTRODUCTION

Attempts to acquire control of U.S. corporations in 1981 made headlines from the beginning of the year to the end, with the battle for Conoco receiving the most attention. As Fortune magazine noted recently:

Last year was a fabulous one for big deals, for the people who helped make them, and for the shareholders of companies other companies coveted. Du Pont, with 1981 sales approaching \$15 billion, brought off the biggest corporate deal in U.S. history when it swooped up Conoco, white-knight fashion, and rode off with the hefty damsel, whose sales are about \$5 billion greater than Du Pont's own. The gesture cost Du Pont shareholders \$7.2 billion, earned a total of about \$29 million for the principals' respective investment-banking firms, and helped kick Conoco's stock up almost 100 percent. 1/

Particular merger bids in 1981 were considered newsworthy for one or more of the following reasons: the noteworthy size of companies targeted for take-over; the hostile reaction to some of the larger merger attempts; the antitrust implications of some of the proposed mergers; the control of U.S. corporate assets by foreign entities; the impact of merger activity on the general availability of credit; and a multitude of tangential questions (Is bigness necessarily bad? Is industrial concentration--especially in energy--rapidly eroding competition? Are the interests of individual corporate shareholders adequately protected?).

One problem in dealing with these important questions has been the absence of a general perspective on mergers in 1981 in which to view individual merger

1/ Meadows, Edward. Deals of the Year. Fortune, v. 105, January 25, 1982. p. 36.

bids. In general, the media have focused on particular merger attempts, without trying to view these efforts in a context of overall merger activity. This paper summarizes recent studies of the level of merger activity in 1981, identifies some of the highlights of that activity, and presents commentary on merger credit.

MEASURING MERGERS

There is no authoritative measure of total merger activity in the United States. Even though often criticized, measures of economic activity such as the money supply, consumer price index, gross national product, unemployment rate, industrial production, et al., are generally published by Government agencies and accepted as definitive indicators of the subject activity. In contrast, there is no Government agency responsible for collecting and disseminating information on corporate mergers. As a result, there are no uniform standards for measuring mergers so that even when considering a very small universe of data, reputable analysts can fail to agree on the appropriate measure. For example, in considering 1981 mergers, W. T. Grimm & Co. notes that "There were 12 transactions valued over one billion dollars during 1981, while 1980 witnessed only 4 such transactions." 2/ Fortune magazine, on the other hand, has identified eight merger transactions in 1981 with a value exceeding \$1 billion. 3/

Different methods of collecting data, of processing data, and of analyzing data can lead to measures of merger activity which are in general agreement but

2/ W. T. Grimm & Co. Announces Record Year in Mergers. Press release. January 12, 1982. (This is the source for all other information ascribed to Grimm & Co. in this report unless otherwise noted.)

3/ Meadows, Deals of the Year, p. 37.

nonetheless vary widely in detail. This caveat should be kept in mind when considering the information which follows.

Types of Mergers

Chicago-based W. T. Grimm & Co. notes that "Its merger data bank is considered to be the oldest and most extensive of its kind." Using this data base, Grimm & Co. compiled the following categorization of merger activity in 1980 and 1981.

Table 1. Composition of Acquisition Announcements

	<u>1980</u>	<u>1981</u>	<u>% Change</u>
Divestitures	666	830	24.6
Acquisitions of Publicly Traded Companies	173	166	- 4.1
Acquisitions of Privately Held Companies	988	1,332	34.8
Acquisitions of Foreign Sellers	<u>62</u>	<u>67</u>	<u>8.1</u>
Total Announcements:	1,889	2,395	26.8

Source: W. T. Grimm & Co. (Percent calculations by CRS)

Perhaps the most striking statistic in Table 1 is the very small number (166) of publicly held companies which were the subject of acquisition announcements in 1981. This relatively small number of attempted mergers included 75 tender offers for publicly traded companies. A tender offer is the attempt to take control of a company by bypassing the target company's management and making a direct bid to the shareholders, asking them to present their stock for purchase. Almost exclusively, merger attempts through the use of tender offers were the subject of media attention and congressional concern in 1981, yet ac-

According to the data compiled by Grimm & Co., they constitute only 3 percent of all acquisition announcements in that year.

Small Business Mergers

Mergers involving small companies, especially the privately held companies noted in Table 1, are generally regarded as positive, or at worst neutral. The following comments indicate different approaches supporting the acquisition of smaller companies.

The acquisition of independent entrepreneurs may provide people the incentive to start new companies by rewarding a lifetime of work with the lucrative sale of a successful small business. Some mergers may also have a larger public benefit in that the small entrepreneur may not have the same capital or marketing expertise to exploit his new ideas that the larger acquiring firm can provide. 4/

A given takeover may be "productive" in the sense that it may strengthen management, generate resources for increased investment in improved facilities, produce economies of integration or scale, and especially in the case of smaller enterprises, provide for orderly transfer of ownership from one generation to another. 5/

Although depressed conditions make mergers and acquisitions more likely, these types of deals are transacted for a number of different reasons. . . in the case of a closely held company, you'll often find that mergers in bad times mean that an owner just isn't able to make ends meet, and is forced to sell out. 6/

4/ James C. Miller, III, Chairman of the Federal Trade Commission, quoted in Scheibla, Shirley Hobbs. What the FTC's About. Barron's, January 25, 1982. p. 11.

5/ Schultz, Frederick H. (Vice Chairman of the Board of Governors of the Federal Reserve System). Statement before the Domestic Monetary Policy Subcommittee on Banking, Finance and Urban Affairs, House of Representatives. December 11, 1981. p. 3. (Duplicated.)

6/ Tomislava Simic, Director of Research, W. T. Grimm & Co., quoted in Merger Fever Unabated. The New York Times, January 24, 1982. p. F22.

Hostile Tender Offers

As a method of acquiring a company, the tender offer is usually attractive for two main reasons: it is quick, and, most of the time, it is successful. A hostile tender offer refers to a tender offer which is resisted by the target company's management in a series of moves and countermoves analogous to battlefield tactics. The takeover bid and the defensive maneuvers, especially when large companies are involved, become newsworthy items; 1981 examples would include Conoco vs. Dome Petroleum, Seagram, and Mobil; and Grumman vs. LTV. With all the public exposure to hostile tender offers, it is instructive to observe the total activity in 1981.

Grimm & Co. "noted that 1981 witnessed the highest number of hostile tender offers ever recorded..." by their research department. The company has been compiling data on mergers since 1963. ^{7/} Takeover attempts were resisted by 28 firms. The results of the resistance: 13 companies (46 percent) were acquired by the original bidder; 9 companies (32 percent) were acquired by a firm other than the original bidder; and 6 companies (21 percent) successfully defended their independence. It would seem that while it is clearly possible for a company to survive a tender offer, it is more likely that the original tender offer or a more attractive alternative offer will succeed.

High-Cost Mergers

According to Grimm & Co., the total dollar value of all merger transactions has been increasing steadily, primarily because of the increasing number of takeover bids for large companies; they note that "Completed or pending transactions having a purchase price of \$100 million or more numbered 113 in 1981, compared with 94 in 1980." Their record from 1975 to 1981 is shown in Table 2.

^{7/} Ibid.

Table 2. Large Corporate Mergers

<u>Year</u>	<u>Number of Transactions Valued at \$100 Million or More</u>
1975	14
1976	39
1977	41
1978	80
1979	83
1980	94
1981	113

Source: W. T. Grimm & Co.

The following comment by the Chairman of the Federal Trade Commission is an indication of the present policy toward large mergers:

Bigness isn't necessarily bad.... Arguments about the centralization of power in the economy are greatly overblown. It's staying about the same as it has been.... I wouldn't anticipate ever seeking to enjoin a merger because it would be too big. But I would go after one, big or small, if the effects would be anti-competitive.... I want to dispel the argument that laxity in enforcement is solely responsible for the big merger wave we're experiencing. There are a lot of other motives for mergers--tax incentives, technology changes and overall economic activity shifts from one type of goods or service to another. 8/

CREDIT CONCERNS

The first session of the 97th Congress witnessed a general concern about the effects of monetary policy based on a perceived relationship between high rates

8/ Scheible, What the FTC's About, p. 11.

of interest and the allocation of bank credit to finance large corporate mergers. ^{9/} This sentiment was reflected in a number of congressional resolutions introduced in the 97th Congress, 1st session. This concern of the Congress is generally reserved for the financing of large mergers; the following table provides an indication of the relative importance of different methods of financing corporate acquisitions.

Table 3. Financing of Large Mergers in 1981

<u>Financing Method</u>	<u>Total Value (millions)</u>	<u>Number of Transactions</u>
Cash Only	\$21,813	25
Cash and Securities	14,110	8
Exchange of Common Stock	<u>4,090</u>	<u>6</u>
Total:	\$40,013	39

Source: Compiled by CRS from data published in Fortune magazine.
(Meadows, Deals of the Year)

Because the appropriate data is not available, it is not possible to analyze the effect of merger credit extensions on the banking system or financial markets. Policy makers who have commented on the role of credit to finance mergers have generally expressed little or no concern. The position of James C. Miller III, Chairman of the Federal Trade Commission, was recently summarized:

In Senate testimony, Miller observed that even though the current wave of takeovers is soaking up billions of dollars of credit, it

^{9/} See, for example: p. 8, 9 in U.S. Congress. House. Committee on Banking, Finance and Urban Affairs. Monetary Policy for 1981. Sixth Report by the Committee on Banking, Finance and Urban Affairs together with Additional, Minority, Supplemental, and Dissenting Views. 97th Cong., 1st sess. Washington, U.S. Govt. Print. Off., July 31, 1981.

need not boost interest rates, which monetary policy can control. Moreover, he declared, merger borrowings aren't really so large, compared with the total amount of credit in the economy. 10/

In a similar vein, the position of the Board of Governors of the Federal Reserve System was presented to Congress:

I would point out that the several highly publicized merger deals this year have in reality had quite limited impacts on credit markets. The credit flows involved in actually consummated transactions have been considerably smaller than suggested by the aggregation of credit lines that were arranged, including those by unsuccessful bidders. Moreover, mergers generally involve only a transfer of ownership of existing assets and do not tend to absorb the real savings in the economy. Stockholders who sell out obtain funds that are available for reinvestment or for loan repayments, thereby recycling these funds into credit markets.

I do not want to suggest that we should be complacent about takeover loans. They may in some cases be a cause for concern and they should be given close scrutiny. Moreover, they can have a somewhat inhibiting effect on short-run flows of credit. In committing themselves to a large volume of takeover loans, banks may restrict for a time their lending to other potential borrowers, but any such effects should normally be quite small and of short duration. 11/

RELATED CRS PUBLICATIONS

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----- Corporate Mergers through Tender Offers: Measurement and Public Policy Considerations. Report No. 81-260 E, by Kevin F. Winch. December 4, 1981.

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----- Selected Mergers and Acquisitions in the Natural Resources Industry, 1981: Case Histories and Financial Profiles. Report No. 81-205 E, by Jeffrey P. Brown. August 21, 1981.

10/ Scheibla, What the FTC's About, p. 11.

11/ Schultz, Statement, p. 3.

Some Corporate 'Marriages' Blossom but Others Will End in Disaster and Divorce

By LINDA GRANT and KAREN TUMULTY, *Times Staff Writers*

NEW YORK—When International Paper Co. acquired General Crude Co. for \$486 million in 1974, it looked like a great deal.

Emerging as the winner of a bitter bidding contest with Dow Chemical Co., the paper concern claimed two prizes: the small Houston firm's petroleum assets and its drilling expertise, which International Paper hoped to put to use in developing the oil it had discovered on its own acreage.

But this seemingly logical business combination turned out to be a mismatch. The company's own paper business, with its voracious appetite for capital, had been teamed with an oil drilling enterprise whose huge up-front expenses exceeded its cash flow. A choice had to be made, and five years after the merger International Paper opted to focus its basic business, selling off for \$802 million the company it had fought so hard to acquire.

Unpleasant Reality

International Paper's handsome profit of \$316 million on the deal helped obscure an unpleasant reality: the once-ambitious plan to combine two companies had ended in failure. Though not all mergers unravel so quickly, business analysts estimate that roughly half of all acquisitions fail to live up to their promise and end up as divestitures.

"The aura of good feeling and high expectation that surrounds the closing often gives way to distrust, disappointment and recrimination," says Allen H. Seed III, senior consultant for Arthur D. Little Management Counseling.

What often looks like a fine fit on paper gives way to the realities of the business world once the two companies merge.

"Companies (planning to merge) can make financial projections three to five years ahead," says Jack Hennessey, managing director of First Boston Corp., an investment banking firm involved in a number of mergers. "But there are so many external variables that the projections can be off by a lot, either high or low."

In the International-General Crude case, the critical external variable was escalating inflation in the late 1970s, which walloped both businesses by raising the cost of projects.

With "merger mania" sweeping the nation, critics of big business are calling for closer scrutiny of the impact of mergers on acquired and acquiring companies, stockholders, employees and the nation's economic health. Not that mergers are anything new in American business. Economists have identified three previous merger waves this century, and many believe we are currently enveloped in a fourth. But each successive wave sets off political alarms in Washington and generates heated debate on the values—and the dangers—of bigness in American industry.

The current controversy is the result of a spectacular string of marriages this year by corporate giants. Last month's bidding contest for Conoco Inc., won by DuPont & Co. at the stratospheric price of \$7.5 billion, was only the most recent and costliest. Other mergers announced so far this year include American Express Co. and Shearson Loeb Rhoades Inc.; Nabisco Inc. and Standard Brands Inc.; Standard Oil Co. of Ohio and Kennecott Corp.; and Penn Central Corp. and Colt Industries Inc.

For the first six months of the year, W.T. Grimm Co., which tracks merger activity, reports 1,184 transactions worth a value of \$35.7 billion, almost equal the total paid during all 1980.

The blitz has kicked off a barrage of charges by critics concerned about the effects of greater consolidation on the sagging U.S. economy. Some economists, legislators and scholars contend that the nation, beset by low productivity, high inflation, high interest rates and slow growth, can ill afford to have its largest corporations spend crucial investment dollars to buy each other rather than spend on modern plant and equipment to create jobs.

"Mergers do not create badly needed new investment in modern facilities to reindustrialize America," says economics professor Wal-

ter Adams, past president of Michigan State University, "These mergers represent a rearrangement of the deck chairs on the Titanic."

Defenders of consolidation, on the other hand, argue that mergers promote economic efficiencies and economies of scale, which in turn translate into lower prices for consumers, as well as enable companies to compete more effectively in international markets. John

Shad, chairman of the Securities and Exchange Commission, says, "(Mergers produce) a net economic gain by and large."

Despite a cascade of articles and testimony for and against, an assessment of the impact of big mergers is subjective and not easily reduced to quantitative results.

"You can't judge a particular company by its experience, because you can't tell what would have happened if it had not merged," says Alfred Rappaport, a professor at Northwestern University's graduate school of business.

Nonetheless, a few studies, although tentative and out of date, have concluded that success in the merger game is elusive at best, and that acquisition-minded companies apparently fare no better than counterparts unaffected by merger fever. Fourteen economists working with the International Institute of Management in Berlin, West Germany, analyzed 765 mergers that occurred between 1962 and 1972 in Europe and the United States. The economists found that in the seven countries studied, the mergers generally did not increase the profits of companies analyzed, nor did they increase the growth rate of firms measured by sales or assets.

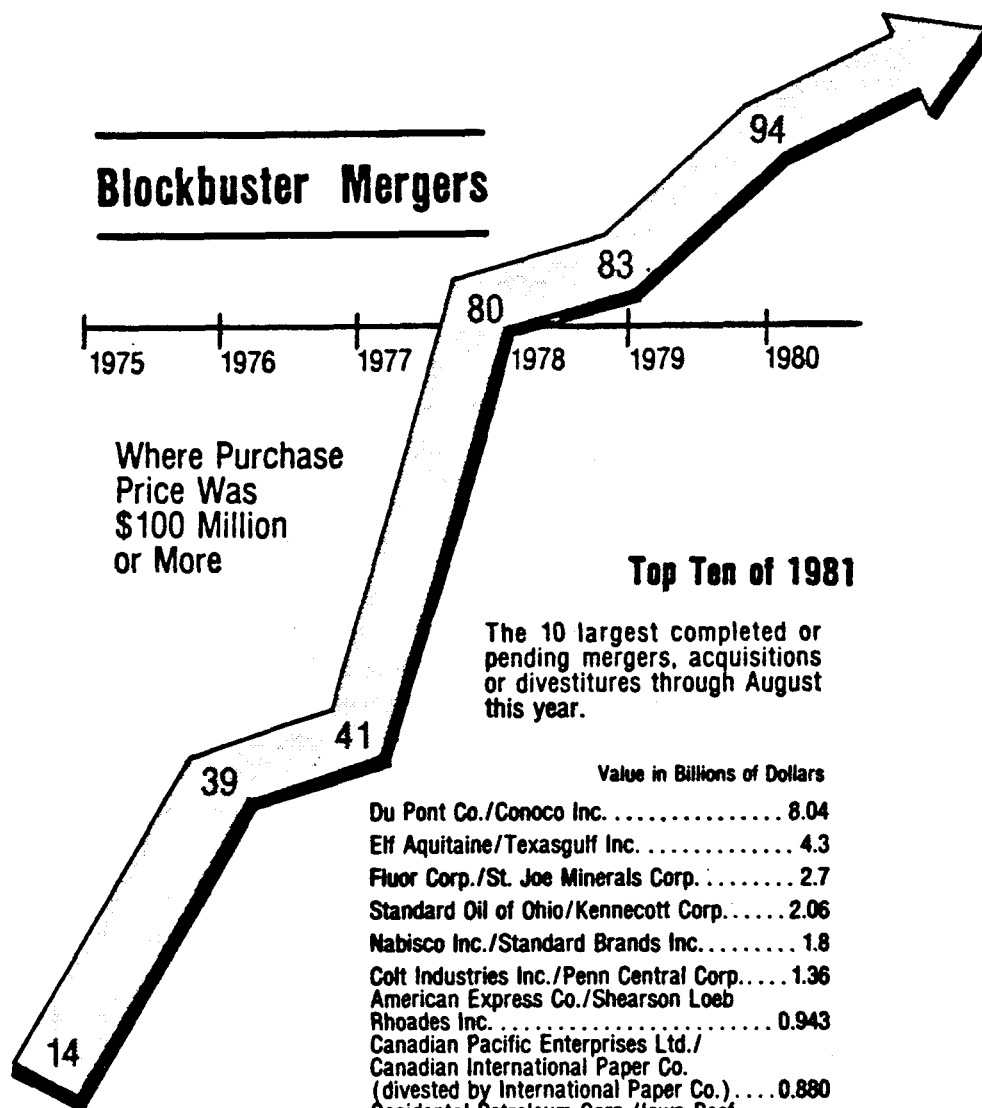
"In the United States, not only did mergers not increase profits or sales, but we also saw a significant decline in growth rates of companies that had merged," says Prof. Dennis C. Mueller, an economist at the University of Maryland and a participant in the study.

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Blockbuster Mergers



Where Purchase Price Was \$100 Million or More

Top Ten of 1981

The 10 largest completed or pending mergers, acquisitions or divestitures through August this year.

Value in Billions of Dollars

Du Pont Co./Conoco Inc.	8.04
Elf Aquitaine/Texasgulf Inc.	4.3
Fluor Corp./St. Joe Minerals Corp.	2.7
Standard Oil of Ohio/Kennecott Corp.	2.06
Nabisco Inc./Standard Brands Inc.	1.8
Coft Industries Inc./Penn Central Corp.	1.36
American Express Co./Shearson Loeb Rhoades Inc.	0.943
Canadian Pacific Enterprises Ltd./Canadian International Paper Co. (divested by International Paper Co.)	0.880
Occidental Petroleum Corp./Iowa Beef Processors Inc.	0.791
GK Technologies Inc./Penn Central Central Corp.	0.699

Source: W.T. Grimm & Co.

JAMES FRANCAVILLA / Los Angeles Times

Concerned that three to five years was not sufficient time to allow for improved profitability, the researchers turned to an examination of stock prices, reasoning that if mergers promise future profit increases, those expectations should be reflected in the prices of the acquiring companies' shares. The result: in all companies surveyed, performance of the acquiring company's stock was worse three years after merger than it was at the time.

Despite the study's conclusions, a look at the record suggests that for every merger that ends in a messy divorce, there may be another one that is a perfect marriage.

In some extreme cases, badly executed mergers have seriously imperiled a company's survival, with severe penalties to both employees and shareholders.

Disastrous Merger

In 1968, Lykes Corp., a holding company engaged primarily in the steamship business, acquired the steel company Youngstown Sheet & Tube Co. with disastrous results for both. Lykes used Youngstown's \$100 million annual cash flow not to modernize the manufacturer's plant and equipment in order to make it a more efficient competitor, but to pay interest and charges for loans to finance the merger and to subsidize shipping operations. By 1978 Youngstown, under pressure from foreign imports, was losing hundreds of millions of dollars on its steel operations, and its future, as well as that of Lykes, looked dim.

Ironically, it took a second merger to undo the damage of the first.

Lykes agreed to merge with LTV Corp., owner of marginally profitable Jones & Laughlin Steel, on the theory that combining the two steel companies would produce one efficient competitor with market heft. The Justice Department allowed the merger under its "doctrine of failing companies."

After closing several plants and laying off thousands of workers, the new Jones & Laughlin has pumped out a continuous stream of profits. The company earned \$69 million during 1980, a disastrous year for

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MERGERS: Some Corporate Marriages May End in Divorce

steel, and during the first half of this year has racked up \$158 million in profits. Lester Wells, LTV's director of corporate information, says, "Everything we expected from the merger has worked out."

Another test of merger strategy is going on today at Pan American World Airways. So far, the seriously ill Pan Am has been unable to successfully integrate the domestic operations of National Airlines, acquired in 1980, into its vast international network. The airline has cut salaries of executives 10% and is preparing to slash routes and lay off thousands of employees.

Defenders of merger, however, remain convinced that in many cases there are substantial benefits to be gained.

"One or two years is not enough time to judge whether a merger is a success," says First Boston's Hennessy. "In many cases a merger energizes a company, either the acquiring company or the acquired business. Most companies fail ultimately because they are exhausted, because they no longer have the creativity and energy to compete. A successful acquisition energizes both sides. And it's very hard to measure."

Miller Benefited

Examples cut across many industries. Miller Brewing Co., which merged with Philip Morris Inc. in 1970, benefited handsomely from the big cigarette manufacturer's bountiful cash flow and marketing expertise. With Philip Morris as a partner, Miller in the past decade has jumped to the No. 2 spot, behind Anheuser-Busch Cos., from No. 5 in the fiercely competitive beer industry.

Time Inc. prospered and gained a new direction as the result of acquisitions in cable television. The big New York company, concentrated principally in the slow-growing magazine business a decade ago, made a key purchase in 1978, American Television & Communications Corp., which has more subscribers than any other system.

Combining ATC with Home Box Office, the nation's top pay-TV programming network, Time today is positioned to capitalize on the explosive future of cable TV. While the company's \$97 million in pretax income from magazines and books in 1980 was flat, compared with the \$37.5 million earned in 1977, profits from video activities had skyrocketed 12 times to \$72.5 million from \$6 million.

A host of mergers among investment banking houses in Wall Street are widely believed to have strengthened

that once-fractionated industry. Merrill Lynch & Co., for example, gained considerable stature in corporate finance after it acquired White, Weld & Co. in 1978. Shearson/American Express Inc., formerly Shearson Loeb Rhoades, grew to become the second largest investment banker and by far the most profitable, through a string of 11 mergers engineered by its chairman, Sanford Weill, over 15 years.

Though all the evidence is not yet in, some analysts also point to the \$3.7-billion acquisition of Belridge Oil Co. by Shell Oil Co. in 1979 as an example of fruitful merger. By this judgment, Belridge, a tiny Kern County oil producer with potentially vast but hard-to-produce heavy oil deposits, should eventually recover far more of the tar-like crude beneath its acreage because Shell is a leader in technical research on new methods of enhanced recovery. While current techniques are capable of producing only 30% to 40% of the heavy oil, Shell's future methods are expected to make it possible for Belridge to recover far more.

But the resources of a huge new owner often come wrapped in red tape. One executive of a major oil company, who asked not to be identified, has been involved in three takeovers. He says he can call on the expertise of his company's 40,000 employees to solve a problem, but "sometimes you don't have a way of getting to the person who is making the decision."

Creativity Stifled

Thus, while business combinations can release creative energy, the opposite is also true: in certain cases, particularly when small, innovative companies are acquired by big corporations, the newly acquired bureaucracy stifles creativity.

In testimony before the House last year, Control Data Corp. Chairman William C. Norris—who once quit a small computer company after it was acquired and subsequently started Control Data—described the process.

"After the acquisition of a smaller company . . . the larger acquiring organization blankets the other with its bureaucracy," Norris said. "The small company is confronted with layer upon layer of parent company management, which often is more adept at blocking, than making, decisions, and . . . proposals for new products languish in limbo for months."

Once a project is approved, Norris added, there is "the foot-dragging, roadblocking administrative processes that have to be contended with" to carry it out. As a

consequence, he said, the more creative employees resign first. "The final result is the dispersal and ultimate loss of the entrepreneurial team."

To business observers, there's a logic to the success or failure of a merger. They believe the evidence suggests that acquisitions related to a company's principal business generally meet with better results than those in unrelated fields.

UCLA assistant professor Richard Rumelt, who has researched diversification mergers over the past decade, concludes, "One strong, persistent result (of the research) is that unrelated business firms don't do well. A bunch of businessmen, who believe they could identify undervalued companies, would be better off to speculate in the stock market than buy (the companies)."

The example of failure in diversification most often cited is the 1974 acquisition by Mobil Corp., the nation's second-largest industrial firm, of Marcor Inc., the big Chicago-based retailer that owns Montgomery Ward & Co. Ward's earnings began to slump in 1978, then slid into the red during 1980. Over the past 15 months, Ward has lost \$210 million, despite a \$355.5-million cash infusion from headquarters last year.

Exxon Falters

Critics also point to Exxon Corp.'s controversial \$1.2-billion acquisition of Reliance Electric Co. two years ago as a notable flop. As justification for the merger, Exxon said it had developed an electronic control for motors that would save mightily on the nation's fuel bill by allowing motors to use less electricity. Exxon said it needed Reliance, a leading Cleveland-based motor manufacturer, in order to introduce the new technology rapidly.

However, Reliance executives testified at antitrust hearings that they did not need Exxon's assistance to develop such a device. Further, oil industry critics as-

MERGERS: Blockbusters

sailed Exxon at the time of the merger, contending the company was exaggerating the significance of its technology in order to use profits from the energy crisis in 1979 to expand into new businesses.

Last March, an embarrassed Exxon quietly announced it was abandoning the revolutionary device because it had proven unreliable.

Perhaps the most glaring examples of how poorly unrelated businesses fit together are the conglomerates built during the last big merger wave of the 1960s. Their spectacular growth made them the darlings of Wall Street during the latter half of the decade. But that vigor proved to be illusory as many slid to the brink of bankruptcy in the recession that ushered in the 1970s.

LTV Hit Skids

Notable among them was the nosedive of high-flyer Ling-Temco-Vought. "LTV lost more money during the past four years than it had made in the previous 10," Fortune magazine commented in 1973.

However, LTV's fortunes—and its merger strategy—have improved in recent years. LTV last week offered to buy 70% of the shares of Grumman Corp. in a deal worth \$450 million. Both companies are leaders in military aircraft production.

Recently, a number of the conglomerates built in the 1960s have been spinning off various businesses in an effort to streamline their companies—the exact opposite of the strategy that won them favor 15 years ago.

Common Pattern

Malcolm S. Salter and Wolf A. Weinhold, in a Harvard University report entitled "Merger Trends and Prospects for the 1980s," said about half of all corporate acquisitions since 1975 have been somebody else's divestiture.

Such a pattern has become common, even among relatively healthy companies.

The corporation that probably swallowed more firms in the past quarter century than any other Fortune 500 company, Beatrice Foods Co., today is actively shedding those that no longer meet rigorous profitability targets. The Chicago-based company, which acquired about 400 companies in its

drive to build a diversified food conglomerate, has sold more than 20 units in the last two years.

Last June Beatrice spun off Dannon Co., maker of the nation's leading yogurt. Though Dannon is perhaps Beatrice's best-known national brand, the yogurt maker encountered problems expanding into Los Angeles and stiff competition from newer entrants in the market. When the French yogurt producer BSN-Gervais Danone, eager to gain a foothold in the lucrative U.S. market, offered \$84.3 million for Dannon, Beatrice quickly shook hands on the deal.

Biggest Selloff

The divestiture record is undoubtedly held by NL Industries Inc., a New York-based chemicals company that has trimmed no fewer than 60 businesses in recent years in an effort to shift its focus to the profitable oilwell services business, where return on investment can surpass the company's new target of 20%. Right now the company has four businesses on the block for a total of \$150 million.

And Esmark Inc., the \$6-billion company with headquarters in Chicago, embarked on a massive divestiture diet last year that slimmed its profile substantially. When Esmark determined the sums required to drill for oil and gas were too burdensome, the company sold its Vickers Energy Co. in 1980 for \$1.1 billion, then divested most of Swift & Co. this year for \$37.5 million in an effort to diversify away from commodity products. The result: though the company's sales are only about half as big as they were two years ago, the price of its shares has just about doubled on Wall Street.

The national debate over the effects of business consolidation would be considerably simpler if all results were either clearcut successes or failures. The problem is, however, that in most cases, the returns are unclear. Take, for example, acquisitions in industries that are plunged suddenly into a prolonged slump due to economic problems beyond their control.

That happened to National Steel Corp., the country's third largest steel producer, which shocked everybody in 1979 when it bought United Financial Corp. of San Francisco, parent of Citizens Savings & Loan.

Continued from Third Page

The leap from metal to mortgages confused a lot of analysts, and angered legislators in Washington who had voted special protection for the U.S. steel industry from foreign imports.

The company's justification for the combination—that United's earnings would help smooth out the cyclical fluctuations in the steel business—was not really accepted by analysts. But today, even after the worst depression in housing ever, those analysts grudgingly admit National's record with United Financial is not bad. The subsidiary contributed \$31 million in pretax operating earnings during 1980 and it managed to eke out a profit during the first two quarters of this year.

As a consequence, National is enlarging its presence in the industry. Recently the company acquired two of the biggest and sickest thrift institutions in the nation, one in Miami and one in New York, and merged them with United. The company's only expense in the deal is \$75 million in new capital it has promised to invest in the S&L, but it will receive about \$10 million a month in subsidies from the Federal Savings & Loan Insurance Corp. to cover losses on the mortgage portfolios of the ailing two for the next 10 years. The subsidies are an almost certain guarantee of profitability.

How will it all work out? Steel analyst David Healy, with Drexel Burnham Lambert Inc., said, "It's just too early to make a judgment."

Drag on Earnings

By the same token, both RCA Corp. and Norton Simon Inc., which acquired Hertz Corp. and Avis Inc., respectively, saw in the rent-a-car business the source of a galloping growth rate and exploding earnings. But the troubled economy has unexpectedly pushed airlines into the severest slump ever. Because the car-rental business depends on airline passengers for the bulk of its customers, both Hertz and Avis are currently a drag on earnings of their parent companies.

Wall Street analysts are similarly uncertain whether United Technologies Inc. and Schlumberger Ltd. made brilliant moves to position themselves for the future by acquiring semiconductor manufacturers, or whether they bought pigs in a poke. Both companies today are absorbing hefty costs from their recently acquired subsidiaries, United's Mostek and Schlumberger's Fairchild Camera & Instrument, because of a steep industrywide plunge in semiconductor sales.

Amid these many uncertainties and problems of analysis, most observers have concluded that mergers are inherently neither good nor bad for companies involved. For a variety of reasons—some predictable and some not—they appear to be good for some and bad for others. While no consistent reasons have been isolated for success or the lack of it, most analysts point to management as the critical difference. Robert Denison, an executive of First Security Co. in New York and an adjunct professor at Columbia University's graduate business school, says, "Why do so many not work out? Because successful management is just so much harder than coming up with good ideas."

No Harm Seen

Most economists, while in agreement that mergers leading to substantial monopoly power should be prohibited, so far believe the business combinations going on today are not harming the overall economy. Lester Thurow, economist at the Massachusetts Institute of Technology, writes: "It is hard to argue that today's mergers will either help or hurt the American economy . . . When it comes to the question, 'Will it (current merger activity) make any real difference?' the answer is clearly 'no.'"

Thurow's conclusion bothers critics, who argue that if mergers don't make any economic difference, then they must be a massive waste of resources.

"I am concerned about the impact on our extraordinarily short capital," says Gar Alperowitz at the Center for Economic Alternatives in Washington, D.C. "(These are) large-order capital movements for nonproductive uses. There's not a dime's worth of new equipment being bought when companies purchase existing equipment."

But others argue that once shareholders receive their money for shares sold in merger, they re-invest those funds in other companies, possibly smaller and faster growing companies, and thus recycle those funds back into productive investments.

Still others simply contend that companies must be free to respond flexibly to constantly shifting economic realities.

"The economic process is one of innovation," says First Boston's Hennessy. "We have businesses grown by venture capital, new businesses starting up, existing businesses growing and acquiring others. It's all part of the economic process."

Suggestions by some critics, therefore, that mergers over a certain size should be prohibited by law, have gathered few adherents. Dennis Mueller, the economist who worked on such a study at the International Institute of Management in Berlin, testified before the House subcommittee on antitrust last year: "Although the evidence on mergers' effects does not constitute a case for them, it also is probably not sufficient for a case against them."



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Kurt Beske
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