محتويات العــــدد

THE FIRM: STRATEGY, MERGER, AND LONG-RUN SURVIVAL

by

Moustafa E. El Shaarawy

Tanta University - Egypt

Research Associate
U.C. Berkeley

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This paper explores the theoretical aspects of the firm's early main strategy, analyzing the course of mergers and acquisitions up to the end of the 1970s. It is found that mergers, acquisitions, and other types of expansion were the result of the execution of the firm's strategy, rather than an outcome of changes in the firm's strategy. The importance of this finding is that it may enable us to assess the probable growth opportunities of the capitalist mode of production and its effects on the stability of the whole system.

I

Firm Strategy:

We start by defining the strategy of the firm under capitalism to explain how capitalism as a system generates economic growth, and how it ensures the survival and development of its economic units. Define firm strategy as the firm's long-run objectives, specifically:

1. achieving a suitable rate of return on invested capital, and
2. identifying investment opportunities for accumulated capital.

These objectives should ensure that the accumulative process can be reproduced and accelerated in the future. It should also ensure the growth and expansion of the firm. The firm turns to different methods of action to achieve these objectives. We will adopt Marx's view on accumulation (as Heilbroner did before)[1] to determine such methods.

The following flow charts (1a, 1b) indicate the three stages of the accumulation circuit and the production process. It is clear that repeating the production process and further accumulation of capital overtime requires enough labor and means of production as well as sufficient markets to absorb output. Thus the firm has to ensure this triangle domination towards achieving its long-run objectives.

II

Our next point of investigation is to explain how the firm executes its triangle strategy.

A. Product Market:

With respect to the domination of the product market, the firm seeks to acquire a share of domestic or international markets. This can be achieved by one of the following methods:

1. The firm can develop its production and/or management techniques to reduce cost of production and as a result, lower prices vis-a-vis competitors.
2. The firm may seek horizontal integration, acquiring other competitors.

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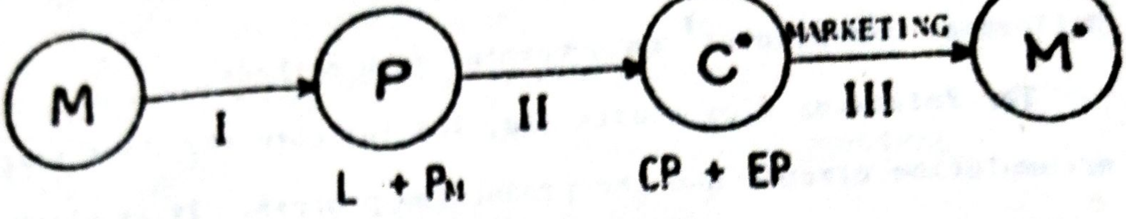
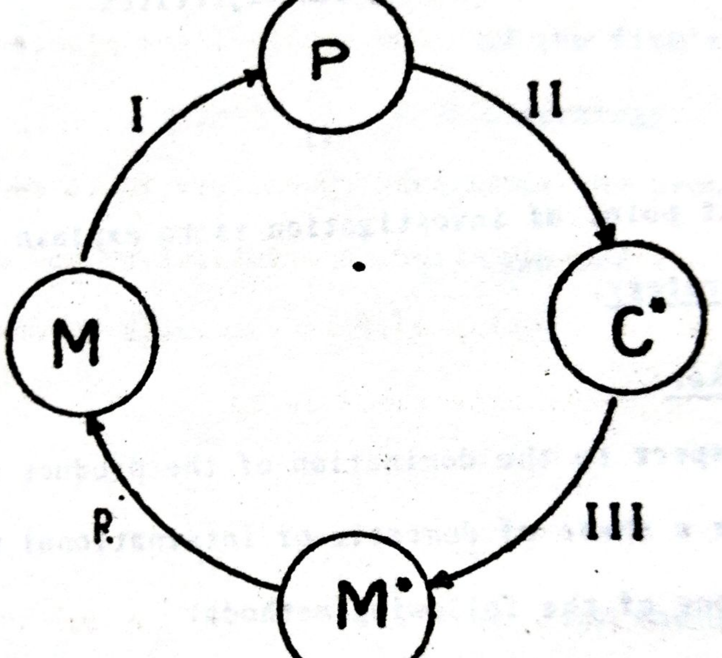
[1] "Marx depicts the process much as a businessman would namely as the complicated way in which money makes money and capital expands. Marx pictures this as a great accumulation 'circuit' that can be divided into three phases." in Robert L. Heilbroner, "Beyond Boom and Crash," U.S.A., 1978, pp. 18-22.



FLOW CHART 1A.



FLOW CHART 1B.

M = Money Capital
M* = Money Capital + Surplus Value
P = Productive Capital
C̄ = Commodity Capital + Surplus Value
P_M - Means of Production
L = Labor
CP = Consumable Products
EP = Equipment and Capital Products
R = Repeating of Production Process

3. The firm may resort to backward or forward integration.

B. Labor Market:

With regard to the firm's insurance of its needs for labor force, it may resort to the following methods:

1. establishing training centers, introducing new and advanced techniques and reallocating plants where cheap labor supply exists.
2. enhancing labor productivity to reduce labor inputs through mechanization, specialization and division of labor.
3. developing unified contracts to ensure strong bargaining power over labor force.

C. Means of Production:

Concerning resources, the firm may achieve control over raw material, inputs, energy resources, finance, technology, transport and communication through the following methods:

1. the acquisition of complementary activities through vertical integration or direct investment in inputs or outputs.
2. the use of alternative inputs in the production process.
3. the efficient use of inputs, reducing technical production coefficients.
4. the attempt to control demand for inputs and the use of resources through horizontal integration and acquiring competing firms. This can also be achieved through agreements among buyers of resources.

GROWTH STAGES OF FIRM

In our analysis we assume that the firm's strategy does not change. Accepting this assumption is very crucial to our analysis because the firm cannot survive without its driving force -- that is, achieving an acceptable rate of return and channeling of accumulated returns in investment opportunities. It is operating strategy, rather than strategy by itself, which has to change to meet changing circumstances such as changes in the firm size, structure of industry, ownership forms and degree of competition in the market.[1] As a result we should be careful not to mix between the long-run objectives of the firm and the means for achieving these objectives.

Now we move to explain the firm's growth stages and trace the relationship between them and the firm's operating strategy.

A. Growth Through Domestic Market:

At this stage, the firm seeks to obtain a larger share of the domestic market for labor, means of production, and products. This is to promote internal growth within the firm and increase the rate of concentration in industry, in order to achieve its objectives. Firms are directed, in this stage, to acquire competing firms until its internal expansion opportunities are exhausted, limited by the large economic size of the firm and/or the scope of technological development. At this point or even earlier other forms of acquisition become necessary to continue the firm's operating strategy, moving from horizontal to vertical integration.

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[1]Gareth P. Dyas and Heinz T. Thanheiser, "The Emerging European Enterprise," U.S.A., 1976, pp. 4-23.

B. Growth through External Market:

At the beginning of this stage, the firm seeks to establish itself in the international market. This move is necessitated by domestic market saturation. At a later part of this stage the firm starts to acquire other corporations to obtain a larger share of the existing market and to increase investment opportunities open to the firm.

Mergers, acquisitions, and other types of expansion in the first stage aim at local interlacing and expansion of the accumulation circuit. In the second stage they aim at international interlacing and expansion.

IV

EMPIRICAL ANALYSIS

A. Mergers Survey:

A merger wave is defined as a period of time characterized by relatively large numbers of mergers reported simultaneously in many industries and lines of economic activity.[1] As a result, four distinct and cyclical waves are discernible (see Tables 1 and 2) in the merger field:

1. the turn of the century merger wave.
2. the late 1920s merger wave.
3. the late 1960s merger wave which began in the 1950s and has continued until the peak of 1969.

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[1] Samuel Richardson Reid, "Mergers, Managers, and the Economy," U.S.A., 1968, pp. 13-18.

4. the late 1970s merger wave which began in 1976 and has continued until now.

In the first stage under the competitive firm mode, a tremendous change in production technique took place which helped firms to achieve growth and concentration through operating their strategies. Also the merger wave played an important part in the growth of the firm. The desire for large size is induced by the firm's operating strategy to gain expected advantage from economies of scale and for market control. The merger wave included the following types of expansion:

1. the consolidation of a number of small or medium sized firms into a leading firm.
2. a leading large firm acquiring another large firm, thus markedly increasing both its absolute and relative share in the industry.

Consolidation dominated the merger wave and the disappearance of firms happened mostly as a result of consolidation (see Table 3). In addition to that most types of mergers were consummated through the domestic market. This led to the prevalence of different degrees of restricted competitive types in the industry. Also concentration increased considerably within industries. Reid,[1] Stigler,[2] and Vernon[3] pointed to this phenomenon.

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[1] Reid pointed to this citing that "of the ninety-two large industrial mergers studied by Moody, seventy-eight controlled 50% or more of the output in their industry, and twenty-six controlled 80% or more." (p. 40).

[2] George J. Stigler, "Monopoly and Oligopoly by Merger," AER, Vol. 40, No. 2, May 1950, p. 28, pointed to the growth of monopoly. He said, "in this country mergers for monopoly began on a large scale only in the eighties, they reached a minor peak at the beginning of the nineties, and they attained their pinnacle at the end of the century."

[3] "By 1900 the American industrialists had already made themselves felt

In the second merger wave, the merger-acquisition replaced the merger consolidation. Also the importance of the horizontal merger declined and the use of vertical and circular types of merger increased.[1] Thus, diversification mergers of geographical and circular mergers became important during the late 1920s, and thereby, the merger tended to achieve or preserve existing oligopoly positions in many industries. This period of mergers was characterized by the rise of financial institutions as powerful promoters of merger. Also the degree of concentration among industries increased markedly.[2]

In addition to the above, the activity of American firms in the international market becomes extensive.[3]

In the thrid wave which started in 1955, horizontal mergers continued to play a role especially in industries which had yet to reach a large economic size and high concentration. At the same time most of the merger-acquisitions became involved in conglomerate and circular types of mergers, aiming at diversification, in which the firm switches from single to multiple products, often in an entirely new line of business. A very important point was witnessed concerning the degree of concentration studied by Shepherd -- that is, "while the degree of intra-industry concentration increased,

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as aggressive and indefatigable rivals throughout Western Europe," Raymond Vernon observed, in "Sovereignty at Bay," U.S.A., 1971, p. 81.

[1]Reid, p. 57.

[2]Reid, p. 46.

[3]Vernon pointed to these changes citing that "while the U.S. was securing a commanding international lead in some of the technologically oriented industries, she was also establishing an international lead in some industries on the basis of other factors, notably on the basis of an ability for producing standardized products on a mass basis and of promoting a related trade name (as corn products of General Foods and Coca-cola during the 1920s and 1930s). These industries, like those associated with industrial innovations, were dominated by large firms and were highly concentrated in structure." p. 85.

the degree of overall concentration increased even greater."[1] In the scope of international activity, World War II left Europe in an economic daze. Concentrating on the repair of the war's destruction, American firms had seven years of war induced bonanza markets. By the end of World War II, the phenomenon of U.S. firms with extensive overseas manufacturing interests was solidly established.[2]

In the fourth wave of mergers, the reported number of mergers increased considerably (since the late 1970s). This wave was characterized by the following:

1. The increased importance of merger in the forms of conglomerate, joint venture, and cooperation agreements.
2. The international industrial concentration increased while the degree of domestic concentration varied from one major country to another.
3. The wide extension of the merger movement in the international market which was accelerated in the post World War I and II periods. Vernon gave an explanation for this extension. He said that "the existence of the EEC probably had powerful effects on the locational decisions of U.S. controlled firms that were establishing subsidiaries in Europe."[3] Furthermore, the fact that U.S. firms developed a dominant position in science, technology, and industrial development, is indisputable.

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[1] Reid, p. 82.

[2] Vernon, pp. 85-87.

[3] Vernon, pp. 89-90.

4. The degree of overall concentration increased during the decade 1971 to 1981. This development can be seen in Table No. 4, which points to the distribution of large firms in the U.S. by group size between 1960 and 1981.

5. Most mergers in the external market were among large corporations (of $100 million or more assets) and small corporations (with $1 million or less assets).[1]

B. Mergers and Firm's Strategy:

Since the early stages of the firm's growth, we notice that merger waves take different shapes reflecting the operation of the firm's strategy. This relationship was questioned on the following basis:

(1) Some empirical studies attempted to measure the success of these mergers in terms of their relative profitability. Their findings were that after sufficient time had elapsed consolidation earnings actually diminished.[2]

As a result, the motive for expansion could not be achieving a certain rate of profit, but personal and professional motives, such as affluence, prestige, community and social recognition, and continuity of their established positions of power and control. In fact the operation of the firm's triangle strategy aims at creating new opportunities for the utilization of accumulated capital in addition to a suitable investment return. Thus, comparing the firm's rate of return before and after merger ignores investment opportunities made possible by the merger or expansion

[1] FTC report on M & A of 1975, in "Mergers and Acquisitions, Journal of Corporate Venture, Spring, 1977, Vol. 12, No. 1, U.S.A., pp. 49-51.

[2] Reid, p. 39.

and also ignores its effects on accumulation. Also the tendency for profit rate to fall results essentially as an outcome of increasing the firm beyond the optimum economic size and the increased relative scarcity of means of production in industry. The firm, in its continuous efforts to overcome these obstacles, seeks mergers to achieve its needs for know-how and technology, or to achieve continuous supply of factors of production or concessions to utilize new resources. Accepting the concept of not using accumulated capital by the firm in the repeated production cycle leads to refusing the dynamic growth of capitalism and firm expansion. Certainly, this does not deny the existence of other motives, such as professional motives or self-interest for management, but such interest plays a minor role in the motive for merger.

(2) Some believe that there is a trend towards diminishing industrial concentration, while the firm's operating strategy leads to expansion and as a result increased concentration. Does this mean that the firm's operating strategy has changed?

As we review the merger movement, we notice that the firm's operating strategy leads to a shift in the corporation, from expansion within the domestic market to the international market. Also, that expansion in the domestic market, led, in the first stage, to increased intra-industrial concentration, and in the following part, it led to greater overall concentration in the economy. In the international market the firm seeks to increase industrial concentration within host markets. This led to diminishing the domestic concentration as a result of reallocation. This cannot be taken as an excuse to say that the firm's strategy has changed, since measuring concentration should be taken on a global basis, i.e., calculating the concentration for home and host markets.

(3) It is unimaginable that the government would challenge the firm's strategy. At the same time, the firm's strategy is expansion. So, how can we explain the antitrust laws which block mergers' paths?

The answer to this lies in two points:

a. The antitrust laws were not effectively executed to prevent merger or expansion.[1,2] Some even believe that they increased expansion.[3]

b. Following the circumstances surrounding the issuance of the antitrust laws, we can explain the possible motives for these laws:

1. To protect American industry from the European international combinations which reached a peak at the end of the nineteenth century,[4] and, currently, to face the rising industrial power of both Japan and Europe.[5]

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[1] Kenneth D. George and A. Silberston, "The Causes and Effects of Merger," in Markets, Corporate Behavior and the State, A.P. Jacquemin and H.W. de Long (eds.), 1976, U.S.A., pp. 133, 135.

[2] J.K. Galbraith, Everyone's Guide to Economics, Boston, 1978, p. 36.

[3] "The record clearly shows that the turn of the century wave developed in the decade following the passage of the Sherman Act in 1890, the late 1920s wave was recorded following the passage of the Clayton Act and the Federal Trade Commission Act in 1914, and the current wave developed following the passage of the so-called anti-merger amendment to the Clayton Act in 1950." Reid, p. 46.

[4] Alfred Plummer, "International Combines in Modern Industries," U.S.A., 1951, pp. 18-46.

[5] Jack N. Behrman, National Interests and MNE, U.S.A.: Prentice Hall, 1970, pp. 116-117.

2. The increased contradictions inside the American economy and the conflict of interest led to the need for government intervention to organize competition in order to create a balance between the different power groups in the U.S.[1,2] The antitrust laws were the government tools to bring concert among conflicting interests.[3]

V

Conclusion

It becomes clear that mergers, acquisitions, and other types of expansion were the result of the execution of the firm's triangle strategy, rather than an outcome of the change in strategy itself. The importance of this finding is that the growth and expansion of the firm cannot take place without the existence of competiton. Thus, economists questioned the future of the free market economy. However, as time passed, the system grew stronger and wider in spite of it chronic and formidable crisis. Competition was, and still is, the cornerstone of capitalism. This competition is based upon private ownership and free choice, promoting innovation, advanced technology, and motivating the firm to grow through operating its strategy. The firm which has failed to operate its strategy should be voluntarily liquidated because it has no place to go except down, and it is better that it sells itself, before the sheriff does it for it.

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[1] Robert G. Hawkins and Ingo Walter, "The MNC," in Challenges to a Liberal IEO, R.C. Amacher and others (editors), U.S.A., 1979, pp. 159-198.

[2] George J. Benstons, Conglomerate Mergers, Causes, Consequences, and Remedies, U.S.A., 1980. p. 5.

[3] Robert E. Baldwin, "Protectionist pressures in the U.S." in Challenges to a Liberal International Economic Order, R.C. Amacher and others (editors), 1979, pp. 223-238.

Thus, the essence of the capitalist system, under competition, is free entry and exit of firms from the market. These movements generate a dynamic force resulting in the prevalence of more efficient firms with advanced technology. As the development of science and health services augmented population growth rates and increased average age for individuals, the development of production techniques and innovations helped to create new firms and expanded opportunities for growth and developed existing ones. On the other hand, competition leads to the concentration of producton in a few firms, resulting in the restriction of competition, leading eventually to monopoly. Fascinating contrast exists, competition creates the constituent units of the system and gives them chances for survival and growth. On the other hand, competition leads to a restrictive market. The consequence of the firm's operating strategy leads to the cessation of competition in both domestic and international markets. Thus, the firms cannot prolong their chances of expansion and growth. We question if there is a possibility for the existence of other forms of competition which can help the firms to find expanded investment opportunities while not reaching beyond the maximum optimum size. Some suggest that the efforts of the state to organize the competition, to prevent monopolizing economic activities, will preserve market competition in part of the economy.[1] But, even if this is possible there is no guarantee that a small firm with new technology or new products will not be acquired by a larger firm, freeing it from the worry and annoyance presented by the smaller competitors. Moreover the scope of the problem is beyond the domestic market. Galbraith

[1] Don E. Waldman, Antitrust Action and Market Structure, U.S.A. 1978, p. 15.

said, assessing the state efforts. "You can't drop a few stones into the river and stop the full force of the Mississippi."[1] While Benston, assailing the suggestion of issuance of new antitrust laws by the Justice Department, said, "I find these arguments are without foundation in fact or logic. Therefore, I conclude that new antimerger legislation is ill-advised. It would bar rational merger activity which provides substantial benefits. In addition, it would impose significant new costs on society without producing new, compensating benefits."[2]

Finally, we can state that the more restricted the market is, the more likely there will be an increase in mergers. It is often the only path available to achieve the firm's objectives. Advanced R & D, and its accompanying technological progress, will be, for some time, key elements in the growth of the firm. As a last resort, merging may provide the capital necessary to maintain these vital elements, and, thus, an opportunity for the firm's survival and further growth.

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[1] J.K. Galbraith, p. 40.

[2] Benston, p. 2,3.

TABLE NO. 1

NUMBER OF REPORTED MERGERS AND ACQUISITIONS IN MANUFACTURING AND MINING, 1895-1972

Year	Annual Total	Year	Annual Total	Year	Annual Total	Year	Annual Total
1895	43	1914	39	1933	120	1952	288
1896	26	1915	71	1934	101	1953	295
1897	69	1916	117	1935	130	1954	387
1898	303	1917	195	1936	126	1955	683
1899	1208	1918	71	1937	124	1956	673
1900	340	1919	171*	1938	110	1957	585
1901	423	1920	206*	1939	87	1958	589
1902	379	1921	487	1940	140	1959	835
1903	142	1922	309	1941	111	1960	844
1904	79	1923	311	1942	118	1961	954
1905	226	1924	368	1943	213	1962	853
1906	128	1925	554	1944	324	1963	861
1907	87	1926	856	1945	333	1964	854
1908	50	1927	870	1946	419	1965	1008
1909	49	1928	1058	1947	404	1966	995
1910	142	1929	1245	1948	223	1967	1496*
1911	103	1930	799	1949	126	1968	1829*
1912	82	1931	464	1950	219	1969	1712*
1913	85	1932	203	1951	235	1970	1318*
						1971	1269*
						1972	1263*

* not directly comparable.

Sources: [1] Mergers & Acquisitions, issues for data from 196801972.

[2] S. R. Reid, "Mergers, Managers, and the Economy," 1968, p. 15, Table 2.1.

TABLE NO. 2

MERGERS AND ACQUISITION ACTIVITY, 1973-1980

	1973	1974	1975	1976	1977	1978	1979	1980
1. Mergers and Acquisition	1064	1088	859	1058	1139	1339	1394	1237
2. U.S. Acquire Foreign / Foreign Acquire U.S.	180	101	121	87	70	106	144	279
3. Joint Ventures	153	117	142	207	170	177	155	183
4. Cooperation Agreements	66	89	164	137	184	171	139	171
Totals	1463	1395	1286	1489	1563	1793	1832	1870

Source: Mergers & Acquisition, The Journal of Corporate Venture, U.S.A., issues from 1973-1981.

TABLE NO. 3

Year	Firm Disappearances By Consolidation %	By Acquisition %
1895	86.1	13.9
1896	84.6	15.4
1897	89.9	10.1
1898	93.1	6.9
1899	91.7	8.3
1900	85.9	14.1
1901	83.2	16.8
1902	70.7	29.3

Source: S.R. Reid, "Mergers, Managers, and the Economy," U.S.A., 1968, p. 38, Table 3.1.

TABLE NO. 4

DISTRIBUTION OF THE 500 LARGEST U.S. INDUSTRIAL CORPORATIONS BY SIZE GROUP, 1960-1981

(Size Group $ Billion Sales)

Year	1 bil to 10 bil	10 bil to 20 bil	20 bil to 30 bil	30 bil to 50 bil	50 bil to 75 bil	75 bil to 125 bil	Sales of the 500 Largest Corp. ($ billion)
1960	39	1	-	-	-	-	204
1961	40	1	-	-	-	-	209
1962	48	1	-	-	-	-	229
1963	47	2	-	-	-	-	245
1964	53	2	-	-	-	-	266
1965	57	2	1	-	-	-	298
1966	77	2	1	-	-	-	332
1967	80	2	1	-	-	-	358
1968	101	2	1	-	-	-	405
1969	112	2	1	-	-	-	444
1970	117	3	-	-	-	-	463
1971	124	2	1	-	-	-	502
1972	136	1	2	1	-	-	557
1973	158	6	2	1			667
1974	192	7	2	2	-	-	833
1975	192	6	3	2	-	-	865
1976	215	7	3	2	-	-	971
1977	228	8	2	2	2	-	1.086
1978	241	9	3	2	2	-	1.218
1979	265	11	4	3	2	-	1.445
1980	276	16	5	2	3	1	1.650
1981	285	17	6	4	2	1	1.773

Source: Fortune, issues from 1961-1982.