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AN INVESTIGATION OF THE TEN MOST ACTIVE ACQUISITORS

IN THE PAPER AND ALLIED PRODUCTS INDUSTRY

1950-1965

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AN INVESTIGATION OF THE TEN MOST ACTIVE ACQUISITORS IN THE PAPER AND ALLIED PRODUCTS INDUSTRY

1950-1965

CHAPTER I

INTRODUCTION

The paper and allied products industry is one of the most complex and diversified manufacturing industries in the country, and its astounding growth over the last fifteen years or so has paralleled the over-all growth of the American economy. Increased consumer demand for over 100,000 paper and paperboard products reflects a steady rise in income and a higher standard of living. To meet this phenomenal demand, substantial funds for research and development are being allocated within the industry, thus creating the impetus for new and improved products. This, ultimately, will reinforce the dynamic role which the industry plays in the economy.[1]

The industry produced 43.7 million tons of paper and paperboard in 1965 with total net sales of approximately $16 million.[2] For the same year, per capita consumption reached an all-time high of 501.3 lbs.[3] At the same time the combined sales of the ten most active acquisitors, the

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[1]See Chapter II.

[2]See p. 21.

[3]See p. 29.

representative firms under consideration, accounted for approximately 35 percent of the industry's total sales.[4] In other words, the growth experienced by these firms paralleled the growth of the industry. "The industry has been increasing its productive capacity steadily to keep pace with the needs of the nation. It can now produce about twice as much paper and paperboard each year as it could at the start of the post-war period."[5]

Diversification seems to be a natural bent of many corporate ventures, and during the years 1950-1965, the industry became highly diversified; this is especially true of the larger producers. These larger firms now have fully integrated mills which produce both pulp and paper, and aside from selling the pulp and paperboard to other companies, they have their own converting facilities. The Mead Corporation, for instance, has become increasingly active at the merchant level by selling products directly to the wholesalers and retailers. Through vertical and horizontal integration, the leading producers of paper products have integrated their facilities all the way forward to the operation of merchant houses, and all the way backward to the ownership of extensive timber resources.

There is general agreement that the period between 1950 and 1965 was a significant merger era. Significant not only to the paper and allied products industry, but to all facets of the manufacturing and mining sector of the economy.[6] Decidedly, the "urge to merge" has

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[4]See p. 30.

[5]"How Paper Serves America," The New York Times, A Special Supplement, October 17, 1965, p. 35.

[6]See p. 54.

become an important corporate tool for growth. Nineteen sixty-seven saw a record number of mergers and acquisitions accomplished by firms in the manufacturing and mining industries. In fact, approximately 3,000 such ventures were completed among companies with net assets worth more than $1 million.[7]

Economic concentration, which is often measured by the behavior of the 200 largest manufacturing companies, has become the bugaboo of the business community. A study was prepared by the Bureau of Economics, Federal Trade Commission, in which Dr. Willard F. Mueller, Director, Bureau of Economics, presented the findings of the organization to the Subcommittee on Antitrust and Monopoly. The Bureau compiled data relating to the 100 most active acquiring companies within the 200 largest manufacturing companies between 1950 and 1963. In addition, 29 select industries were considered. During this period, firms in the paper and allied products industry acquired firms with assets valued at $760.9 million.[8] Of the 29 selected industries, the paper and allied products industry ranked second in dollar value of acquired assets and in number of acquisitions.[9]

Theoretical economics easily embraces mergers and acquisitions--fundamental analysis of the long-run relates to various sized operations which a given firm might undertake, and any growth can, theoretically, be achieved by external or internal means. A merger or acquisition will

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[7]"Mergers Soared in '67, and Accelerated Pace is Expected for '68," Wall Street Journal, January 3, 1968, p. 13.

[8]U. S., Congress, Senate, Committee on the Judiciary, Economic Concentration, Hearings, before the Subcommittee on Antitrust and Monopoly, Senate, 89th Cong., 1st sess., 1965, Part 2, p. 963.

[9]Ibid.

diminish by one, or more, the number of firms in the industry. The potential realization of both internal and external economies of scale to the surviving economic entity is enhanced through mergers. Assuming further that an acquiring firm is faced with a negatively sloped demand curve, the additional output will be sold at lower prices; the consumer will benefit. Though the structure of the industry suggests vigorous price competition, it is a common social assumption that mergers decrease competition and increase the degree of monopolization. An attempt of this thesis will be to relate theoretical structures with realistic results of the merger activity of the ten most active acquisitors.

The Employment Act of 1946 states that "it is the policy of the federal government to help achieve the 'maximum production, employment and purchasing power' consistent with maintaining a free, private enterprise system."[10] In the respect that government is concerned with economic stability, so also is any economic system. And, it must provide for growth. The implication is the same for an individual firm in which corporate growth is essential, especially to management. Sales--the direction of change--is one of the most obvious indicators of corporation performance. Sales become a corporate barometer. As William Baumol has suggested, sales maximization has replaced profit maximization:

> Though businessmen are interested in the scale of their operations partly because they see some connection between scale and profits, I think management's concern with the level of sales goes considerably further. In my dealings with them I have been struck with the importance which the oligopolistic enterprises attach to the

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[10] George Leland Bach, Economics (5th ed.; Englewood Cliffs: Prentice-Hall, Inc., 1966), p. 221.

> value of their sales. A small reversal in an upward sales trend which can quite reasonably be dismissed as a random movement sometimes leads to a major review of the concern's selling and production methods, its product lines, and even its internal organizational structure.[11]

This is evidence enough that one method of overcoming a lagging sales picture can be through acquisition.

Nineteen sixty-five noted record production figures, climaxing the increase in output which occurred each year (with the exception of four) between 1950 and 1965. Per capita consumption increased approximately 75 percent for the same period.[12] These data reflect a greater consumer demand for paper and allied products. This would further suggest that the industry is expanding its capacity. Although mergers effectively contribute to an acquiring company's production, they do not necessarily increase the industry's capacities. During the period covered, the industry pumped millions of dollars into new facilities, and the most active acquisitors invested large capital outlays into improvements and expansion.

The United States is the largest consumer of paper and allied products, but the potential markets for these products throughout the world affords the industry a vast new market. Using newsprint as one example, the 1964 per capita consumption for several selected countries ran from a low of 0.3 lbs. in India, to a high of 37.9 lbs. for the United States (see Table 1). These figures are impressive in a number of ways. First, they suggest a low rate of literacy throughout the world. Second, changing consumption patterns indicate a change in a country's

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[11]William J. Baumol, Business Behavior, Value and Growth (New York: Macmillan Company, 1959), p. 45.

[12]See

standard of living, reflecting ultimately a change in its national economy. Third, and perhaps most important, considering the current U. S. balance of payments problems, is the vastness of the potential markets being opened up by the industry. "In 1950 U. S. paper companies had $378,000,000 invested abroad in various manufacturing enterprises. Today, investments are about $1,100,000,000. And as these investments have been made over a considerable period of years, a percentage of foreign earnings are continually being repatriated."[13]

"Until very recently economists widely assumed that a competitive structure produced the best possible performance results."[14] On the other hand, Schumpeter wrote, "The trail leads not to the doors of those firms that work under conditions of comparatively free competition but precisely to the doors of the large concerns . . . and a shocking suspicion dawns upon us that big business may have had more to do with creating that standard of life than with keeping it down."[15] Mergers point up the basic dichotomy confronting the regulating bodies, the academic community, and the practitioner. The issue of expanding corporate unit by means of merger and acquisition is quite obviously not a simple one. Perhaps, as Marshall suggests, a lesson may be learned from the young trees of the forest as they struggle in the shade of their older rivals:

> Many succumb on the way, and a few only survive; those few become stronger with every year, they get a larger share of light and air

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[13]"How Paper Serves America," op. cit., p. 34.

[14]Walter J. Mead, Competition and Oligopsony in the Douglas Fir Lumber Industry (Berkeley: University of California Press, 1966), p. 2.

[15]Joseph A. Schumpeter, Capitalism, Socialism, and Democracy (3rd ed.; New York: Harper and Brothers, 1950), p. 82.

TABLE 1

PER CAPITA NEWSPRINT CONSUMPTION FOR SELECTED COUNTRIES: AVERAGE FOR 1955-59 and 1964 (In Pounds)

Country	Average 1955-59	1964
Australia	28.5	31.3
Canada	22.8	23.3
Denmark	15.6	26.0
France	10.4	11.3
West Germany	7.8	11.7
Ghana	0.4	1.5
India	0.2	0.3
Japan	6.0	12.5
Mexico	2.4	2.9
New Zealand	26.2	26.3
Poland	1.8	1.8
Spain	1.9	3.1
Sweden	23.8	29.9
Turkey	0.7	1.1
U.S.S.R.	1.6	2.7
United Kingdom	19.7	26.0
United States	35.7	37.9

Source: United Nations, Statistical Yearbook: 1965, (Statistical Office of the United Nations, New York, 1966), pp. 723-724.

> with every increase of their height, and at last in their turn they tower above their neighbours, and seem as though they would grow on forever, . . . But they do not . . . Though the taller ones have a better access to the light and air than their rivals, they gradually lose vitality; and one after another they give place to others, which though of less material strength, have on their side the vigour of youth.[16]

Similarly, mergers and acquisitions can be utilized to retain vigor. They also can be utilized to avoid corporate obsolescence.[17]

Economics consists of tools which can be used to formulate a basis for social prognosis. Schumpeter notes:

> Analysis, whether economic or other, never yields more than a statement about the tendencies present in an observable pattern. And these never tell us what <u>will</u> happen to the pattern but only what <u>would</u> happen if they continued to act as they have been acting in the time interval covered by our observation and if no other factors intruded.[18]

It is therefore fitting that the patterns evolved by the ten most active acquisitors in the paper and allied products industry be examined. It is necessary in order to formulate patterns of behavior which <u>may</u> occur in the future.

Purpose

Since mergers and acquisitions cogently affect the economic climate of both community and nation, it is the expedient purpose of this paper to investigate the motives and subsequent participation of the ten most active acquisitors in the paper and allied products industry during the merger movement from 1950 through 1965. The main objective is to

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[16] Alfred Marshall, <u>Principles of Economics</u>, Vol. I: Text, with annotations by C. W. Guillebaud (9th ed.; New York: Macmillan Company, 1961), pp. 315-316.

[17] See "Building Defenses Against Obsolence," <u>Financial Executive</u>, August, 1967, pp. 23-24.

[18] Schumpeter, <u>op. cit</u>., p. 61.

analyze the structure, behavior patterns, and performance records of the firms within the industry, and to evaluate the conditions under which significant merger activity existed. The issue is fundamentally the reconciliation of theoretical concepts with realistic performances.

Scope

Since the paper and allied products industry was so intensively engaged in acquisitions, it was recognized that an investigation of the industry would indicate a judgment, although perhaps not a conclusive judgment, upon the economic climate of these particular years. Because economic theory of the firm is based upon behavioral patterns within a given industry, and since various sized firms were represented, it seemed appropriate to delimit the study to the ten most active acquisitors.

Method of Approach

Once the purpose and scope of this study was determined, the study started with a detailed analysis of the available industry data. Unfortunately, it became readily apparent that there are few studies specifically related to the paper and allied products industry. Turning to the trade organizations, namely the American Paper Institute and The National Paper Trade Association, it was soon discovered that these agencies leave much to be desired as to pertinent data of mergers. A number of government publications provide partial insight into various merger activities of the industry and an overall impression of the merger movement but provides limited data for the individual firms. Thus, it was necessary that the author correspond with the companies themselves. The materials furnished by these companies, mainly corporate histories and annual reports, provided the most essential insights into corporate policies of individual mergers. A number of local paper merchants was interviewed and they provided cogent aspects of the merger movement in its effect on the community. A vast volume of trade publications was made available by these merchants, especially by Roger Arnold, President of Empire Paper, Wichita Falls, Texas, and interlibrary loan service helped to fill in gaps of specific materials.

Sources

There has been little written on mergers and acquisitions in the paper and allied products industry. The references available are of a general nature, and specific materials are related to the aggregation of industry figures. As to industry, two of the primary sources used were provided by the American Paper Institute: The Statistics of Paper, and Monthly Statistical Summary. The U. S. Department of Commerce, Business and Defense Services Administration publishes a monthly bulletin, Pulp, Paper, and Board, which proved helpful. An annual report--U. S. Industrial Outlook--cites recent trends and the current outlook on an industry-by-industry basis. Other publications of the Department of Commerce, Business Statistics: 1965, and the Census of Manufactures, Industry Statistics, of the U. S. Bureau of the Census, contributed useful industry data. Specific materials came mainly from the companies. Legal sources were derived from decisions rendered by the Supreme Court, the Federal Trade Commission, and the Justice Department on specific paper cases, and various sections of the Sherman Act, the Clayton Act, and the Cellar-Kefauver Act were cited.

Secondary sources include research reports from the National Industrial Conference Board, Mergers and Markets. These reports were extremely helpful in cross-checking merger cases which involved the ten firms in this study. Paper Sales, a trade publication serving paper merchants and their salesmen from 1950 to date, was used. Perhaps the most valuable issue was the "25th Anniversary Issue," January, 1966. This edition provided a wealth of information concerning the evolutionary processes of the industry. Often consulted was Moody's Industrial Manual, one of the most complete sources for mergers and acquisitions. A number of annual series published by leading business journals were valuable: The Fortune Directory of The 500 Largest U. S. Industrial Corporations which compares industrial rankings before and after merger; Dun's Review--"The Ratios of Manufacturing"; and Forbes--"Annual Report on American Industry," which ranks companies and industries by their performance records.

Of great importance were the Hearings before the Subcommittee on Antitrust and Monopoly. Economic Concentration, a five-part series, provided a comprehensive study. Earlier Hearings were also informative: Current Antitrust Problems, Parts I, II, III, 1955; A Study of the Antitrust Laws, Parts I and II, 1955; and Legislation Affecting Corporate Mergers, 1956.

Many significant books have been published by the National Bureau of Economic Research. Of particular value to this thesis were: Merger Movements in American Industry: 1895-1956 by Ralph L. Nelson; Diversification and Integration in American Industry by Michael Gort; and Capital and Rates of Return in Manufacturing Industries by George J. Stigler. Three additional books provided background relevant to managerial problems faced by corporations--problems that arise from the time of an initial decision to that of a final integration. These works were designed for the practitioner, rather than for the academician. One of the most authoritative works was written by Myles L. Mace and George G. Montgomery, Jr.--Management Problems of Corporative Acquisitions. Mergers and Acquisitions: Planning and Action prepared for the Financial Executives Research Foundation, and The Corporate Merger, edited by William W. Alberts and Joe E. Segall, which pertains to the merger-acquisition process as a means of corporate growth, were invaluable.

Organization of Chapters

Chapter II describes the paper and allied products industry and provides data for the selected firms. Chapter III entails the number of mergers which these firms completed between 1950 and 1965, and includes a detailed analysis of the specific mergers. Significant factors of merger activity are discussed in Chapter IV. Chapter V pertains to formidable obstacles to mergers. In Chapter VI a discussion of possible results of the merger movement is discussed. Chapter VII is devoted to a summary.

CHAPTER II

DESCRIPTION OF THE INDUSTRY

Introduction

It would be naive to assume that the direction in which the paper and allied products industry moves presupposes the direction of the American economy. Nevertheless, a striking suggestion of parallelism exists, and such an assumption would not be entirely inordinate.

A sequential direction of growth has made the paper and allied products industry one of the largest industries on the American manufacturing scene. Using 1964 as a starting point, this industry, based on dollar assets per employee within the industry, was ranked as the sixth largest in the country. There were only five other industries--petroleum refining, tobacco, mining, chemicals, and metal manufacturing--which utilized more assets per employee.[1] For paper and wood products, a typical employee was supported by $21,250 worth of assets with $22,726 worth of sales per employee.[2] The figure for assets per employee was approximately three and one-half thousand dollars higher than the all industry average, and sales per employee were a few hundred dollars less in paper than the all industry average.[3]

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[1] U. S. Bureau of the Census, Statistical Abstract of the United States: 1966 (87th ed.; Washington, D. C.: Government Printing Office, 1966), p. 493.

[2] Ibid.

[3] Ibid.

Overall, the paper and wood products industry remained in sixth position in 1965 in terms of assets per employee; however, there was a gain for the industry in terms of sales per employee when the industry moved from eleventh to ninth in this category (see Table 2 for 1965 data). Based on the industry median, each worker was supported with $23,690 worth of assets, with sales of $23,644, slightly less than dollar for dollar, assets for sales.[4] For all industries, each worker was supported by less assets in dollar figures, but sales per worker was approximately fifteen hundred dollars higher. The sales per dollar of invested capital was $1.58 for paper and wood products with a 6.0 percent return, and a 9.9 percent return on invested capital. With the exception of return on sales, these figures do not compare favorably with all industries.

The industry has more than 5,200 manufacturing plants spread across 48 states which produce more than 43 million tons of paper and paperboard. This represents about an even split of the volume for each commodity.[5] In addition, the paper and allied products industry employs approximately 650,000 workers whose average hourly earnings as of 1965 were $2.75 per hour.[6] In wages, salaries and fringe benefits, the industry paid some $4.5 billion to its employees.[7] The total sales of the industry were in excess of $15 billion in 1965 when the industry realized $1.2 billion in net profits before taxes.[8] Taxes paid to the

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[4]See Table 2.

[5]"How Paper Serves America," op. cit., p. 9.

[6]"Monthly Statistical Summary," American Paper Institute, Vol. XLV, No. 1, p. 2.

[7]"How Paper Serves America," loc. cit.

[8]"A Capital and Income Survey of the United States Paper Industry: 1939-1965," American Paper Institute (New York, 1966), p. 22.

TABLE 2

SELECTED FINANCIAL DATA FOR THE LARGEST INDUSTRIAL CORPORATIONS, BY INDUSTRY,[1] 1965

Industry	Assets per Employee[2]	Sales per Employee[2]	Sales per Dollar of Invested Capital[2]	Return on Sales[2]	Return on Invested Capital
Petroleum refining	$80781	$62108	$1.27	8.3%	10.4%
Mining	57482	40940	1.28	11.1	13.9
Tobacco	52874	42864	1.37	8.6	13.5
Chemicals	28625	28714	1.70	7.5	12.6
Metal manufacturing	23774	25532	1.67	6.0	10.6
Paper and wood products	23690	23644	1.58	6.0	9.9
Glass, cement, gypsum, concrete	21196	22700	1.52	7.0	10.9
Pharmaceuticals	20411	23758	1.71	10.3	18.0
Food and beverage	20228	41845	3.50	2.8	10.2
Shipbuilding and railroad equipment	20118	24330	1.90	6.4	11.6
Soaps, cosmetics	18061	32906	2.78	6.5	14.9
Publishing and printing	17735	24366	2.15	6.9	14.7
Measuring, scientific and photographic equipment	17113	20413	1.63	6.1	13.5
Rubber	15799	22334	2.73	4.1	11.1
Farm and industrial machinery	14597	20615	2.11	5.5	14.0

TABLE 2--Continued

Industry	Assets per Employee[2]	Sales per Employee[2]	Sales per Dollar of Invested Capital[2]	Return on Sales[2]	Return on Invested Capital
Motor vehicles and parts	$14337	$24392	$2.80	4.4%	13.6%
Metal products	13012	20426	2.35	4.8	11.3
Textiles	12825	17788	2.18	4.4	11.1
Office machinery (includes computers)	11753	13825	2.37	5.0	12.3
Appliances, electronics	11751	18113	2.69	5.0	12.5
Aircraft and parts	9366	19911	4.38	3.3	14.3
Apparel	9226	13692	3.28	4.1	13.8
All industry	17608	24141	2.20	5.5	11.8

[1]Includes only those companies in 500 largest industrials

[2]Industry medians

Source: "The Fortune Directory," Fortune, Vol. LXXIV, July 15, 1966, p. 250.

Federal government for the same year were over $500 million,[9] and an additional sum of about half this figure was paid in the form of state and local taxes.[10]

But there is more than statistics to the story of paper. Paper is, in effect, the story of civilization. The history of paper-making is concerned not so much with the development of the printed page, but rather with the thousands of applications and potential applications of this versatile material. Through research and development, the applications to which paper and its by-products have been adapted forces us to conclude that one facet seems paramount, and that is change. As for the paper and allied products industry, with its amelioration and diversification, it has culminated in advantageous change. The efficacy with which it provides Americans a better standard of living is evident in the technologically improved products which are now available in the consumer market.

In view of the general importance of paper in the development of civilization, and recognizing its particular relevance to the American economy, it is compatible that the characteristics of the industry be examined. The development of the ten most active acquisitors in the industry between 1950 and 1965 needs exploration also in order to particularize the basic elements of this thesis.

The Paper and Allied Products Industry

This industry manufactures, as a major group, pulp primarily from wood, rags, and other fibers and converts it into paper and board. The Bureau of Census, in its 1963 Census of Manufactures, further includes

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9 Ibid.

10 "How Paper Serves America," loc. cit.

the converted products such as coated paper, paper bags, paperboard boxes and envelopes.[11] However, some of the industries' products are classified in other major groupings: carbon paper is included in Industry 3291; group 26 includes pulp, paper, and board mills; converted paper and paperboard products, except containers and boxes; and paperboard containers and boxes.

While there is some overlap of products, the degree of specialization is significantly high. In 1963 shipments by mills in this group of industries consisted of 99 percent pulp, paper and paperboard and only 1 percent of other products. These were chiefly converted paper and board products and basic chemicals produced as a by-product of the pulp operations.[12] These mills also accounted for nearly all of the pulp, paper and board produced in all manufacturing industries.[13] There is a high degree of integration within this group, especially paperboard mills and various container converting industries. In many cases, the same industries which produce paperboard boxes, corrugated and solid fiber boxes as well as sanitary food containers, also manufacture and convert a substantial part of the paperboard. This is accomplished either at the same, or separate locations.[14] Integration between primary mills and converting plants is less noticeable in the manufacture of other converted paper and paperboard products. As in the case of manufactures of

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[11]U. S. Bureau of the Census, Census of Manufactures: 1963, Vol. II, Industry Statistics, pt. 1, major groups 20 to 28 (Washington, D. C.: Government Printing Office, 1966), pp. 26-31.

[12]Ibid.

[13]Ibid.

[14]Ibid.

paperboard containers and boxes, these other converting industries display relatively high specialization and coverage ratios.[15] With the exception of part of the bag industry, the overall composition of these firms is characterized, on the whole, by "independent" or nonintegrated plants--plants not associated or affiliated with a primary paper or board mill.[16]

Net Sales

In terms of net sales the overall growth pattern for the industry has been an impressive one. In 1950, net sales in the paper and allied products industry were $6,377 million. By 1965 this figure had increased nearly three-fold, reaching $16,224 million.[17] This would represent a relative change of 154 percent over the sixteen year period covered by this study, with a 38 percent increase in net sales for the industry between 1960 and 1965. The following table shows the changes in dollar amounts as well as percentages for each year; it is noted that the industry has experienced an increase in its net sales every year since 1961. With the exception of four years, the industry experienced increased sales, and this is roughly seventy-five percent of this time period.

Part of the industry's net sales are attributable to sales made by foreign owned manufacturing affiliates. However, not all of these affiliates are consolidated with the parent company. The figures shown in Table 4 indicate the importance of these foreign affiliates to the parent company; of how great an importance will be recognized later when

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[15] Ibid.

[16] Ibid.

[17] "A Capital and Income Survey," loc. cit.

a discussion of specific mergers enables us to see that nearly a third of the mergers involved the acquisition of foreign companies.

In order to get a realistic picture of foreign affiliates, it is necessary to point out that, with the exception of Canada, both the production and distribution of these products was mainly local or within the immediate area. Only a small amount of these sales represent sales to the United States. Canada is an exception. Canada exported over fifty percent of its production to the United States.[18]

Selected Balance Sheet Data

The paper industry was in a relatively sound financial position throughout the years 1950-1965, showing a net profit of more than a half billion dollars each year with the exception of four. It is difficult to generalize about the rate of return and net profit without making both intraindustry and interindustry comparisons. Nineteen sixty-five reports by the Industry Studies Department of Dun and Bradstreet cited median data for numerous ratios of manufacturing industries, including paper, having utilized year-end financial statements of various concerns, and by ranking each firm individually from highest to lowest, came up with these figures: net profits as a percentage of net sales, paper, with 54 concerns reporting, had a ratio of 4.63 as compared to 7.20 for the upper quartile, and 1.70 for the lower quartile.[19] These median data are a little lower, though, than the figure reported by the FTC-SEC for the same year. The same ratio listed for paper boxes was

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[18] U. S., Department of Commerce, Office of Business Economics, Survey of Current Business, Vol. XLV, No. 5 (Washington, D. C.: Government Printing Office, 1966), p. 8.

[19] Dun's Review, Vol. LXXXVIII, November, 1966, p. 76.

TABLE 3

NET SALES, PAPER AND ALLIED PRODUCTS INDUSTRY
1950-1965

Year	Net Sales (Millions of Dollars)	Percentage Change from Previous Year (Percent)
1950	6,377	23.2
1951	8,022	25.4
1952	7,688	-4.8
1953	8,371	8.9
1954	8,492	1.4
1955	9,847	15.9
1956	10,686	8.5
1957	10,420	-2.5
1958	10,256	-1.6
1959	11,824	15.3
1960	11,764	-0.5
1961	12,525	6.5
1962	13,698	9.4
1963	14,050	2.6
1964	14,771	5.1
1965	16,224	9.8

Source: "A Capital and Income Survey of the United States Paper Industry: 1939-1965," American Paper Institute (New York, 1966), p. 22.

TABLE 4

SALES OF FOREIGN OWNED MANUFACTURING AFFILIATES IN PAPER AND ALLIED PRODUCTS INDUSTRY BY AREA 1957, 1959, and 1961-65 (Millions of Dollars)

Year	AREA				
	Canada	Latin America	Europe	Other Areas	Total All Areas
1957	769	55	34	23	881
1959	800	60	50	30	940
1961	870	85	70	35	1060
1962	945	100	80	55	1180
1963	1042	130	105	65	1342
1964	1212	145	148	90	1595
1965	1366	178	166	110	1820

Source: U. S., Department of Commerce, Office of Business Economics, Survey of Current Business, Vol. XLV, No. 5 (Washington, D. C.: Government Printing Office, 1966), p. 8.

3.33, and for paper products, the figure was 4.16 for the yearly average.[20] On the other hand, there were a number of industries which experienced smaller ratios: shoes (2.00), structural iron and steel fabricators (3.44), meats and provisions (0.83), and dairy products (1.58). But there were also a number of businesses which enjoyed a greater rate of net profit to their net sales: drugs (5.93), general industrial machinery (5.75), mechanical instruments (6.37), medical, surgical and dental equipment (6.16), books, publishing and printing (7.36), chemicals (6.08), and petroleum refining (5.31).[21] These figures, indicating net profits, represent the subtraction of all expenses, including in this case federal income taxes, from net sales to ascertain net profits after taxes.

However, there has been an overall decline in the ratio for the industry during the period examined. In 1950 the ratio was 8.7 for the industry as compared with 5.4 in 1965. Table 5 notes that the percentage of net profit to sales for paper and allied products moves, in general, in the same direction as the ratio for all manufacturing industries. A downward movement of the ratios during the 1950's, changing to an upward spiral during the mid 1950's, is a pattern that is apparently repeating itself, though not as clearly, in the sixties. The similarity of the overall growth pattern of the economy with the pattern of profits to net sales within both the paper and allied products industry and all manufacturing industries reinforces the parallelism

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[20] Ibid.

[21] Ibid.

TABLE 5

PROFIT AFTER TAXES AS A PERCENT OF SALES AND NET WORTH, PAPER AND ALLIED PRODUCTS INDUSTRY, ALL MANUFACTURING INDUSTRIES,[1] 1950-1965

	Percentage of Sales		Percentage of Net Worth	
Year	Paper & Allied Prods.	All Mfg. Indus.	Paper & Allied Prods.	All Mfg. Indus.
1950	8.7	7.1	15.6	15.0
1951	7.0	5.2	14.1	11.4
1952	5.7	4.3	10.3	10.2
1953	5.4	4.3	9.9	10.4
1954	5.6	4.5	9.7	9.8
1955	6.1	5.4	11.2	12.3
1956	6.1	5.3	11.4	12.0
1957	5.0	4.8	8.9	10.7
1958	4.5	4.2	7.3	8.4
1959	5.2	4.8	9.3	10.2
1960	5.0	4.4	8.4	9.1
1961	4.7	4.3	7.7	8.7
1962	4.6	4.5	8.1	9.6
1963	4.5	4.7	8.0	10.1
1964	5.1	5.2	9.1	11.4
1965	5.4	5.6	10.0	12.6

[1]As reported by FTC-SEC

Source: "A Capital and Income Survey of the United States Paper Industry: 1939-1965," American Paper Institute (New York, 1966), p. 25.

of the industry and the general economy.[22] It is interesting to note that the industry paid federal income taxes ranging from a low of $424 million in 1950 to a high of $858 million in 1951. The amount of federal taxes paid, with the exception of 1950, were greater than net profits until 1955 when the trend reversed itself. Primarily, this was due to a reduction in the tax rate from 52 percent to 48 percent (see Table 6). The percentage change in federal taxes paid by the industry between 1950 and 1965 was 46 percent; net sales increased by 154 percent; net profits grew by some 56 percent. Furthermore, when net profits after taxes are combined with depreciation, depletion and amortization, cash flow increased from $720 million in 1950, to $1,540 million in 1965, a 114 percent increase. The principal factor was the change in depreciation, et. al., which amounted to more than a 300 percent increase between 1950 and 1965. The significance of this increase in cash flow has become more meaningful in recent years in investment analysis. Many analysts prefer using cash flow as opposed to net income as a means of evaluating the performance of a given industry. Another growth indicator is dividends paid. Here the industry has increased its dividends approximately 130 percent since 1950, and about 31 percent from 1960 until 1965.

The growth of the industry over the last decade and a half is further evidenced in the increase of its assets which were slightly more than $5 billion in 1950 (see Table 7). By 1965, the industry experienced an increase of 174 percent when total assets grew to nearly

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[22]An excellent source of data for manufacturing ratios is Dr. Leo Troy's Manual of Performance Ratios for Business Analysis and Profit Evaluation (Englewood Cliffs: Prentice-Hall, Inc., 1966). This work discusses a number of industries, and allows one to make good intra-industry comparisons which are so meaningful when evaluating a firm's performance.

TABLE 6

SALES, PROFITS AND CASH FLOW, PAPER AND ALLIED PRODUCTS INDUSTRY, 1950-1965
(In Millions of Dollars)

Year	Net Sales	Net Profit Before Taxes	Federal Taxes	Net Profits After Taxes	Dividends	Retained Earnings	Depreciation Depletion Amortization	Cash Flow[1]
1950	6,377	982	424	558	178	N.A.	162	720
1951	8,022	1,417	858	559	200	N.A.	183	742
1952	7,688	1,000	563	437	196	N.A.	222	659
1953	8,371	1,005	554	450	203	N.A.	242	692
1954	8,492	970	493	479	227	252	268	747
1955	9,847	1,206	601	604	259	345	310	914
1956	10,686	1,283	626	657	273	384	360	1,017
1957	10,420	1,020	497	521	270	251	376	897
1958	10,256	899	440	460	286	220	406	866
1959	11,824	1,204	585	619	290	329	459	1,078
1960	11,764	1,135	546	587	312	275	480	1,067
1961	12,525	1,120	535	583	328	255	531	1,114
1962	13,698	1,212	584	628	340	288	583	1,211
1963	14,050	1,215	581	634	348	286	615	1,249
1964	14,771	1,312	557	754	376	378	641	1,395
1965	16,224	1,488	619	869	409	461	671	1,540

[1]Net profits after taxes plus depreciation, etc.

N.A. Not Available

Source: "A Capital and Income Survey of the United States Paper Industry: 1939-1965," American Paper Institute (New York, 1966), p. 22.

$14 billion by 1965. During this same period the industry increased its total capital from $4,075 million to $11,111 million. This represents a 173 percent increase. Another important factor affecting the growth of the paper and allied products industry is the amount it has been willing to invest in new capital expenditures. Impressive in this respect is the increase of nearly 275 percent in capital expenditures between 1950 and 1965; an increase in expenditures each year over the previous year occurred, with only a few exceptions. These figures echo the prominent part which the paper and allied products industry plays in the growth of the national economy.

Production of paper and board for the United States also increased every year except in 1952 and 1957. In 1950, over 24 million tons of paper and board were produced, and by 1965 production had climbed to nearly 44 million tons, representing a 79.4 percent increase (see Table 8). The change in the manufacturing index, obviously, paralleled actual production, and further implies the growth of the industry.

Per capita consumption is a relevant and important factor. Consumption of paper and board in the United States for 1966 totaled 48.8 million tons, the equivalent of 501.3 pounds for every individual within the country.[23] Since the utilization of paper products is so closely related to the general activity of the economy, one can expect that consumption will tend to level off or decline during periods of lower industrial production, and rise when output increases. Given an expanding population, the per capita consumption of paper and board, in general, has been increasing each year since 1950. In 1955 consumption reached the 400 plus pounds per person level, and it was not until 1965

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[23]Apparent consumption is production plus imports less exports.

TABLE 7

SELECTED BALANCE SHEET DATA, PAPER AND ALLIED PRODUCTS INDUSTRY, 1950-1965
(In Millions of Dollars)

Year	Total Assets	Property, Plant & Equipment	Net Property Plant and Equipment	Net Worth	Long Term Debt	Total Capital	Capital Expenditures
1950	5,055	N.A.	2,285	3,585	490	4,075	300
1951	6,005	N.A.	2,600	3,963	625	4,588	390
1952	6,301	4,643	2,777	4,298	784	5,082	370
1953	6,825	5,349	3,272	4,559	803	5,362	400
1954	7,085	5,694	3,367	4,963	908	5,871	N.A.
1955	7,785	6,171	3,623	5,403	1,010	6,413	560
1956	8,492	7,028	4,213	5,772	1,286	7,058	750
1957	8,407	7,502	4,509	5,809	1,309	7,118	770
1958	9,170	8,200	4,818	6,341	1,500	7,841	580
1959	9,721	8,740	5,062	6,642	1,500	8,142	630
1960	10,087	9,432	5,385	6,956	1,499	8,455	750
1961	11,051	10,447	5,857	7,612	1,670	9,282	680
1962	11,670	11,058	6,062	7,766	1,755	9,521	720
1963	11,859	11,420	6,079	7,886	1,900	9,794	720
1964	12,560	12,380	6,585	8,304	1,964	10,268	940
1965	13,850	13,378	7,321	8,672	2,439	11,111	1,120

N.A. Not available

Source: "The Statistics of Paper," American Paper Institute (New York, 1966), p. 15.
"Monthly Statistical Summary," American Paper Institute, January, 1967, p. 2.

TABLE 8

PAPER AND BOARD PRODUCTION, AND CONSUMPTION FOR THE UNITED STATES 1950-1965

Year	Production (1000's)	Manufacturing Index, Paper & Allied Products (Percent)[1]	Consumption[2] Tons (1000's)	Consumption[2] Lbs. Per Capita
1950	24,375	73.8	29,012	382.5
1951	26,047	78.2	30,561	395.9
1952	24,418	74.5	29,017	369.7
1953	26,605	81.1	31,360	393.0
1954	26,876	82.0	31,379	386.4
1955	30,178	92.5	34,719	420.1
1956	31,441	96.9	36,496	434.0
1957	30,666	96.2	35,268	412.0
1958	30,823	97.2	35,119	403.5
1959	34,015	106.7	38,725	435.5
1960	34,444	107.7	39,138	433.2
1961	35,698	113.7	40,260	438.2
1962	37,543	119.7	42,218	452.4
1963	39,231	125.1	43,716	461.6
1964	41,748	133.4	46,429	483.4
1965	43,746	N.A.	48,773	501.3

[1]1957-1959 = 100

[2]Consumption is production plus imports minus exports.

N.A. Not available

Source: U. S., Department of Commerce, Office of Business Economics, Business Statistics: 1965 (Washington, D. C.: Government Printing Office, 1965), p. 17.

that it reached the 500 plus pounds per person plateau--an increase of a little over 30 percent. This reflects to some degree the changing patterns in a number of areas served by paper products, such as in packaging materials as well as the tremendous change in the area of education, and the uses to which paper are incorporated in order to serve these changes.

The United States is the world's largest producer of paper and board; yet the country has, between 1950 and 1965, imported large quantities from other countries. As was pointed out earlier, Canada is the major supplier to the United States. According to Table 9, imports of paper and board were over 5 million tons in 1950, increasing to nearly 7 million tons by 1965. Conversely, exports were less than 400 thousand tons in 1950, but very significantly increased to nearly 2 million tons by 1965, representing an approximate five-fold increase. Imports increased about one-third during the same period.

The industry, historically, has been faced with production increases as paced by papacity increases which, as will be discussed in more detail later, has helped keep prices of the various products fairly constant. Table 10 shows some interesting relationships among various wholesale price indices involving pulp, paper and allied products. Considering initially the percentage changes between 1950 and 1965, one can see that only one index, waste paper, reflected a decrease in prices. Moreover, the other indices increased by twenty or more percent. This compares with an 18.1 percent increase for all commodities, and a 23.6 percent increase for all commodities except farm and food. Using a comparison of 1959 with 1965, there is a complete reversal of the previous pattern. One observed that all but one index, paper, experienced

TABLE 9

IMPORTS AND EXPORTS OF PAPER
AND BOARD, UNITED STATES
1950-1965
(In Tons)

Year	Imports	Exports
1950	5,008,222	371,546
1951	5,149,517	635,303
1952	5,190,859	592,388
1953	5,230,866	475,345
1954	5,189,880	687,098
1955	5,385,786	845,227
1956	5,836,309	781,762
1957	5,471,512	869,736
1958	5,148,634	853,010
1959	5,622,175	911,917
1960	5,721,133	1,026,962
1961	5,777,811	1,215,570
1962	5,867,973	1,192,817
1963	5,825,775	1,340,798
1964	6,386,247	1,704,933
1965	6,802,259	1,775,339

Source: "The Statistics of Paper," American Paper Institute (New York, 1966), p. 24.

TABLE 10

SELECTED WHOLESALE PRICE INDEXES
1950-1965

(1957-59 = 100.0)

Year	All Commod- ities	All Commodities Except Farm and Food	Pulp, Paper & Allied Products	Wood Pulp	Waste Paper	Paper	Paper- board	Converted Paper & Board Products	Bldg. Paper & Board	Average Value Per Ton
1950	86.8	82.9	77.1	79.4	128.9	74.7	77.1	76.8	74.9	74.8
1951	96.7	91.5	91.3	95.0	203.2	83.6	96.8	92.0	78.9	86.7
1952	94.0	89.4	89.0	92.6	75.7	87.0	93.6	89.6	80.3	86.5
1953	92.7	90.1	88.7	90.6	97.9	88.1	91.3	88.3	84.5	86.9
1954	92.9	90.4	88.8	91.1	86.8	88.9	91.4	88.1	88.9	87.5
1955	93.2	92.4	91.1	93.8	119.5	91.1	93.3	89.6	91.1	91.2
1956	96.2	96.5	97.2	97.8	121.2	96.4	99.0	96.9	95.3	97.1
1957	99.0	99.2	99.0	98.7	83.3	99.6	100.1	99.2	98.5	99.6
1958	100.4	99.5	100.1	100.7	95.3	99.8	100.0	100.4	99.7	99.1
1959	100.6	101.3	100.1	100.7	121.4	100.6	99.9	100.3	101.8	101.1
1960	100.7	101.3	100.8	100.2	90.3	102.0	99.4	102.8	101.4	99.8
1961	100.3	100.8	98.8	95.0	80.5	102.2	92.5	99.5	100.8	98.7
1962	100.6	100.8	100.0	93.2	97.5	102.6	98.1	101.0	97.2	99.6
1963	100.3	100.7	99.2	91.7	92.2	102.4	94.7	99.7	96.2	97.2
1964	100.5	101.2	99.0	96.1	92.4	103.6	96.4	98.3	94.2	96.6

TABLE 10--Continued

Year	All Commod-ities	All Commodities Except Farm and Food	Pulp, Paper & Allied Products	Wood Pulp	Waste Paper	Paper	Paper-board	Converted Paper & Board Products	Bldg. Paper & Board	Average Value Per Ton
Percentage Change 1950-1965										
	+18.1	+23.6	+29.6	+23.6	-22.9	+39.4	+25.0	+29.2	+24.0	+31.1
Percentage Change 1959-1965										
	+ 1.9	+ 1.2	- 1.2	- 2.6	-18.2	+ 3.5	- 3.5	- 1.0	- 8.8	- 3.0

Source: "A Capital and Income Survey of the United States Paper Industry: 1939-1965," American Paper Institute (New York, 1966), p. 26.

a decrease in the level of wholesale prices. In some cases, the change was small, with converted paper and board products down 1 percent; whereas in other cases, as that of waste paper, the index was down 18.2 percent. These changes, though, were counter to all commodities which experienced about a 2 percent increase for the period. The overall pattern of relatively stable prices not only reflects the ability of the industry to keep capacity in line with expanded demand, but helps explain the fairly constant rate of net profits, after taxes, to net sales. Increased capacity has been one of the principal factors in holding in check the prices of the industry. Given an increase in demand, it would be expected, *ceteris paribus*, that prices would increase. However, this has not been the case in the last few years; though it has been true for the overall scope of this study.

Compensation to Employees

The role of the worker in the paper and allied products industry is undoubtedly as important to the overall growth of the industry as any other factor of production. During the period covered employment increased from 484,000 full-time equivalent employees to 640,000 by 1965, representing an increase of 32.2 percent (see Table 11). However, the number of workers which were directly involved in production increased from 415,000 in 1950 to 497,000 in 1965 (refer to Table 12). Thus, it is noted that production workers accounted for approximately 78 percent of the labor force of the industry. This is significant when compared to 1950 figures when production workers represented about 86 percent of the work force, pointing up the ever-expanding role played by non-production employees.

Though the labor force increased by a third, wages and salaries saw an even greater change. For example, in 1950, the industry paid $1,684 million in wages and salaries to its employees. Sixteen years later the figure rose to a little more than $4 billion which amounts to an increase of 153 percent; however, this figure does not include supplements to wages and salaries. It is in this area that the workers have made significant gains. They have realized over a fourfold increase as wage and salary supplements grew from $96 million in 1950 to $409 million by 1965. By combining these items--wages, salaries and supplements to wages and salaries--we see that the total compensation to employees grew from $1,780 million, the figure for the initial year, up to 1965 when the total had increased 162 percent, reaching a record high for the industry of $4,662 million at the close of the period. The average earnings for each full-time employee in the industry increased from $3,479 in 1950 to $6,645 in 1965. This represents a relative change of 91 percent in money terms. However, to better comprehend these data, it might be interesting to convert the data from money terms to real terms, and thus be able to evaluate the emphasis on the money illusion. In this case, the Consumer Price Index will be used as a deflator since it is, in general, the index commonly used in labor negotiations. Using an index of 83.8 for 1950 and 109.9 for 1965, annual average earnings paid to each worker in 1950 would, based on 1957-59 dollars, be equal to $2,010 as compared to $3,870 for 1965--nearly a doubling of real wages.[24] The relative change amounted to a 92.5 percent increase which means that

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[24]U. S. Bureau of the Census, Pocket Data Book: 1967 (Washington, D. C.: Government Printing Office, 1967), p. 196.

TABLE 11

COMPENSATION TO EMPLOYEES,
PAPER AND ALLIED PRODUCTS INDUSTRY
1950-1965

Year	Wages and Salaries	Supplements to Wages & Salaries	Number of Full-Time Equivalent Employees (In Thousands)	Average Annual Earnings Per Full-Time Employee
	- - - (In Millions) - - -			
1950	$1,684	$ 96	484	$3,479
1951	1,919	126	509	3,770
1952	1,999	129	503	3,974
1953	2,217	146	531	4,175
1954	2,284	159	532	4,293
1955	2,489	175	549	4,534
1956	2,701	196	567	4,764
1957	2,804	210	565	4,963
1958	2,855	219	555	5,144
1959	3,138	248	579	5,420
1960	3,273	271	590	5,547
1961	3,461	285	595	5,817
1962	3,680	340	615	5,984
1963	3,830	367	622	6,158
1964	4,030	384	625	6,448
1965	4,253	409	640	6,645

Source: Data 1950-59, "The Statistics of Paper," American Paper Institute (New York, 1966), p. 17; Data 1960-65, "Annual Compilation of American Paper Institute's Monthly Statistical Summaries for 1966," American Paper Institute (New York, 1967), p. 59.

TABLE 12

NUMBER OF WORKERS, HOURS WORKED,
AND EARNINGS FOR PRODUCTION WORKERS,
PAPER AND ALLIED PRODUCTS INDUSTRY
1950-1965

Year	Number of Production Workers (Thousands)	Average Weekly Gross Hrs. per Production Worker (Hours)	Average Weekly Gross Earnings per Production Worker (Dollars)	Average Hourly Gross Earnings per Production Worker (Dollars)
1950	415	43.3	60.53	1.40
1951	434	43.1	65.08	1.51
1952	421	42.8	68.05	1.59
1953	442	43.0	71.81	1.67
1954	440	42.3	73.18	1.73
1955	454	43.1	78.01	1.81
1956	464	42.8	82.18	1.92
1957	463	42.3	85.45	2.02
1958	454	41.9	87.99	2.10
1959	472	42.8	93.30	2.18
1960	480	42.1	95.15	2.26
1961	478	42.5	99.45	2.34
1962	486	42.5	102.00	2.40
1963	486	42.7	105.90	2.48
1964	489	42.8	109.57	2.56
1965	497	43.1	114.22	2.65

Source: Data 1950-64, for average gross hours and earnings, U. S., Department of Commerce, Office of Business Economics, Business Statistics: 1965 (Washington, D. C.: Government Printing Office, 1965), pp. 75, 79, 83. Data for Number of Workers, and all 1965 data, "Annual Compilation of American Paper Institute's Monthly Statistical Summaries for 1966," American Paper Institute (New York, 1967), p. 42.

the workers experienced a significant increase in purchasing power over this period.

It is an interesting point that even though average weekly gross earnings per production worker increased from approximately $60 a week in 1950 to $114 in 1965, the average weekly gross working hours fell only slightly from 43.3 hours to 43.1 hours for the same period. By the same token, the average hourly gross earnings for production workers increased from $1.40 to $2.65 which has, for the industry, reflected a pay scale well above the federal minimum.

Research and Development

Earlier in this chapter the industry's expenditures on capital equipment was discussed.[25] The industry's projection of the need for additional capacity in order to maintain its competitive position in the economy was noted. "Intensive competition from other industries, such as plastics, has had a considerable impact on the industry, compelling it to adopt new marketing techniques and, of greater importance, develop new products."[26] Table 13 shows data relating to expenditures on research and development for all industries as well as the paper and allied products industry. The figures for 1960-64 were based on a R & D survey released by the National Science Foundation, and published by the American Paper Institute. The 1965 figures are compiled from estimates prepared by the Economics Department of McGraw-Hill.

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[25]See p. 28.

[26]"Annual Compilation of American Paper Institute's Monthly Statistical Summaries for 1966," American Paper Institute (New York, 1967), p. 53.

Companies within the paper and allied products industry spent $77 million on R & D in 1965 which represented an increase of 37.5 percent over the $56 million spent in 1960. On the average, the industry has increased its expenditures by $3.5 million since 1960. "Omitted from the totals indicated for 1960 through 1964 are about $2 or $3 million paid annually to research organizations outside the industry."[27] If this were included, it would raise the annual average to approximately $6 million. However, this is only a small fraction of the industry's total net sales which in 1965 amounted to over $16 billion. It should be mentioned that research and development as a percentage of sales has experienced an upward trend since 1960.

The paper and allied products industry, though, did not keep pace with dollar expenditures by other industries for research and development. "Only two other industries spent sums below those indicated for the Paper and Allied Products Industry: Lumber and Textiles. In contrast to other industries, however, the Paper and Allied Products Industry financed its R & D expenditures entirely from company funds."[28] Along the same line, it would be well to note the sizable contributions made to total industrial expenditures for research and development by the Federal Government. Since 1960 federal funds have averaged approximately 57 percent of all such expenditures.[29]

"Despite the huge sums spent by the industry on new plant and equipment and the rising expenditures on R & D projects since 1960,

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[27] _Ibid._

[28] _Ibid._, p. 54.

[29] _Ibid._

TABLE 13

EXPENDITURES ON RESEARCH AND DEVELOPMENT FOR PAPER AND ALLIED PRODUCTS, AND ALL INDUSTRIES 1960-1965

Year	Funds for R & D		R & D as a percent of Sales		Full Time Equivalent Number of R & D Scientists and Engineers	
	All Indus.	Paper	All Indus.	Paper	All Indus.	Paper
	-(Millions of Dollars)-		-----(Per Cent)-------		-------(Thousands)-----	
1960	10,509	56	2.87	.44	292.0	2.4
1961	10,908	59	2.94	.44	312.1	2.6
1962	11,464	65	2.91	.45	312.0	2.6
1963	12,686	70	2.94	.46	327.3	2.5
1964	13,353	73	2.85	.46	347.5	2.6
1965	13,636	77	2.77	.47	346.3	2.6

Source: "Annual Compilation of American Paper Institute's Monthly Statistical Summaries for 1966," American Paper Institute (New York, 1967), p. 55.

financial results to date have not fully reflected the gains that should accrue from these progrsms. . . Certainly, the capital expenditures projects undertaken by the Paper Industry during the period have enabled it to affect rising costs by increasing productivity at an impressive rate. Furthermore, as over half the paper industry's present capacity has been installed during the past ten years, it should be in a sound position to meet successfully competition in its markets."[30] Should the economy continue to grow, it would appear that in order for the industry to maintain its competitive edge, expenditures for research and development must, in all likelihood, move ahead at a faster rate in future years.

The Ten Most Active Acquisitors

During the period 1950 to 1965 the ten most active acquisitors in the paper and allied products industry were the following corporations: The St. Regis Paper Company, The West Virginia Pulp & Paper Company, The International Paper Company, The Kimberly-Clark Paper Company, The Champion Paper Company, The Container Corporation of America, The Crown Zellerbach Corporation, The Mead Corporation, The Scott Paper Company, and lastly, The Union Bag-Camp Paper Company.[31] These firms are characterized by one word--diversification. They produce literally thousands of products. But diversification applies not only to product; it carries a geographical connotation as well. For example, Mead

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[30] Ibid.

[31] In 1966 the name of Union Bag-Camp Paper was officially changed to Union Camp Corporation; also, Champion Paper merged with U. S. Plywood in the same year.

Packaging International serves customers in 30 countries, delivering products from its plants and affiliates and licensees in 11 nations.[32]

Particular examples of diversification can be seen through Crown Zellerbach and Kimberly-Clark. Crown Zellerbach's diversification can be considered through its varied facilities. The corporation has 66 principal sales offices spread over twenty-four of the continental United States. It has more than two million acres of timber lands, and operates sixteen pulp and paper mills in addition to its six lumber mills and plywood plants.[33]

Kimberly-Clark is representative of product diversification. It produces more than 100 products in three broad areas: sanitary paper products, communicative papers, and industrial papers and specialities. "Sales of the company's consumer products, including facial and bathroom tissue, feminine hygiene products, table napkins, towels and wipers represent about 45 percent of the corporate total. Its branded products, stocked in about one-half million retail stores throughout the country and sold to more than 34,000 direct customers, are marketed through one of the most effective and wide-ranging distribution systems in the industry."[34] Product development includes both the redesigning and improvement of existing lines, plus the creation of new products. For example, it is now creating new lines to meet special needs: disposable sheets, pillowcases, surgical gowns and mattress covers for hospitals.[35]

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[32]Drexel Harriman Ripley, A Study of The Mead Corporation (Philadelphia: Drexel Harriman Ripley, Inc., 1966), p. 7.

[33]Crown Zellerbach, Profile of a Corporation (San Francisco: Crown Zellerbach Corporation, 1964), p. 51.

[34]Kimberly-Clark, Information 1967 (Neenah: Kimberly-Clark, 1967), p. 6.

[35]Ibid., p. 7.

TABLE 14

FACILITIES OF THE CROWN ZELLERBACH CORPORATION
1964

Type of Facility	Number
Pulp and paper mills	16
Packaging and converting plants	36
Lumber mills and plywood plants	6
Chemical products plants	5
Research laboratories	4
Engineering offices	3
Paper merchandising outlets	35
Retail building materials outlets	50
Building materials sales--warehouses	6
Marine terminals	3
Principal sales offices	66

Source: Crown Zellerbach, Profile of a Corporation (San Francisco: Crown Zellerbach, 1964), p. 51.

The product line termed communicative papers consists primarily of newsprint, printing papers, business writing papers and envelopes. Kimberly-Clark sells its newsprint on long-term contracts which includes over 200 newspapers. Overall, this segment of the company's production accounts for about 25 percent of its sales. Whereas industrial papers represent about 14 percent of corporate sales, the remaining 16 percent of consolidated sales include pulp, lumber and lumber products, non-woven materials and chemical by-products, and the operation of a whole-sale paper merchant business.[36]

Industrial Sales

One of the most important economic indicators of any industry or firm is its sales. Sales serve as a basis for corporate planning, and as William J. Baumol suggested ". . . the businessman has gone still further in his regard for sales volume. I believe that to him sales have become an end in and of themselves."[37] As Baumol points out, the movement of sales becomes a significant factor in terms of the *modus operandi* of the business community.

Fortune Directory, with sales as its major criteria, annually ranks the 500 largest industrials, and the ten most active acquisitors have been among the leading 300 since the first directory was published in 1955. It is noted in Table 15 that Crown Zellerbach Corporation has ranked among the top 100 industrials since that year, and that International Paper Company has continuously been in the top 50. The majority of the ten firms have remained in the upper 200. Only two

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[36] *Ibid*.

[37] Baumol, *op. cit*., p. 47.

TABLE 15

INDUSTRIAL RANKINGS AMONG THE
500 LARGEST INDUSTRIALS OF THE
TEN MOST ACTIVE ACQUISITORS, IN PAPER, BY SALES
1954-1965

Year	St. Regis	Int'l	Scott	Mead	Cham- pion	Con- tainer	Crown Zell.	Union- Camp	Kimberly- Clark	West Virginia
1954	161	36	133	267	240	171	103	281	177	190
1955	140	37	146	230	258	172	83	273	164	196
1956	117	34	148	233	253	144	82	242	160	208
1957	113	39	153	221	249	173	83	257	136	224
1958	109	38	143	161	237	156	85	258	128	196
1959	92	39	153	138	262	139	83	250	125	198
1960	84	40	149	138	240	141	79	224	118	193
1961	82	40	143	124	158	144	83	210	121	190
1962	87	40	147	121	144	153	83	225	103	190
1963	93	43	151	124	154	161	88	237	105	193
1964	99	40	158	122	157	153	91	238	113	197
1965	111	43	145	124	164	168	96	243	117	211

Source: <u>The Fortune Directory: The 500 Largest U. S. Industrial Corporations</u> (New York: Time, Inc.).

firms ranked lower in 1965 than in 1950; the two were International and West Virginia Pulp & Paper. Chapter III will consider mergers and their relationships to the sales picture.[38]

Determination of market share is important in the identification of industry structure. For example, if one firm controls all of the sales within a market area, it is said to be a monopoly, and if a company enhances its market share through a number of mergers, there is also the implicit connotation of monopolization. Thus it is vital to determine the relative share of the industry's market which the leading acquisitors maintained during the period 1950-65 in order to evaluate the significance of monopolization. Table 16 notes that the total net sales for the ten firms was $1,666 million in 1950, representing approximately 26.1 percent of the industry's total net sales. These firms experienced substantial growth, and by the early 1960's, their sales accounted for approximately one-third of the industry's sales. Additional factors are relevant: there was an increase of 240.8 percent in the total sales of the ten firms as compared to a 154.4 percent increase in sales for the industry from 1950 until 1965; from 1960 to 1965 the growth in sales of the leading acquisitors was 32.6 percent compared to 37.9 percent for the industry, particularly noteworthy since the 1960's saw a decline in merger activity of these firms; and the overall concentration within the industry did not appear alarming when compared to a number of other industries in which the market share of their top ten firms represented considerably more than 35 percent of the industry's sales.

In terms of individual performance, The Mead Corporation experienced the largest growth with its net sales increasing from $93 million

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[38]See p.63.

TABLE 16

NET SALES FOR THE TEN MOST ACTIVE ACQUISITORS
PAPER AND ALLIED PRODUCTS
1950-1965

Year	Net Sales (Millions of Dollars)	Net Sales as a Percent of Total Net Sales for Industry (Percent)
1950	1,666	26.1
1951	2,106	26.2
1952	2,056	26.7
1953	2,230	26.6
1954	2,375	27.9
1955	2,817	28.6
1956	3,320	31.0
1957	3,498	33.5
1958	3,628	35.3
1959	4,080	34.5
1960	4,281	36.3
1961	4,548	36.3
1962	4,780	34.8
1963	4,982	35.4
1964	5,353	36.2
1965	5,677	34.9

Source: Table 3 and Table 17.

in 1950 to $461 million in 1965 (see Table 17). This is an increase of nearly 500 percent. Running a close second was Champion Paper with sales increasing 403.5 percent over the sixteen years. Crown Zellerbach experienced the smallest percentage change even though its sales increased impressively from $286 to $709 million, a 147.9 percent increase. All in all, the 1960's reflected a continuous growth for each company. Still, Mead remained foremost with a 61.6 percent increase in sales from 1960 to 1965; Champion was unable to match Mead's pace, showing only a 28.9 percent increase. Scott Paper experienced a 47.2 percent increase when its sales grew from $313 million in 1960 to $461 million in 1965, and though International Paper's sales have trailed the overall average, in 1959 the company's sales reached the impressive level of over one billion dollars a year. This level has risen considerably each year since.

Concentration within an industry is often the basis for policy recommendations, and it is sometimes the criteria used in antitrust cases. Table 18 indicates concentration performance of the individual firms. The five most active acquisitors within the paper and allied products industry provide insight into the significance of concentration as reflected in net sales. In most cases of the selected years the companies increased their relative share of the industry's sales. The most active acquisitor, The Mead Corporation, realized the largest gain. The largest company, International, experienced a relative decline in its market share over the last decade. For example, in 1955, the company had 9.3 percent of the total sales; in 1965 its share had dropped to 8.0 percent. It appears that the merger activity within the industry did not bring about the concentration which might have been expected.

TABLE 17

NET SALES FOR THE TEN MOST ACTIVE ACQUISITORS,
BY COMPANY, PAPER AND ALLIED PRODUCTS
1950-1965
(In Millions of Dollars)

Year	St. Regis	West Va.	Int'l	Kim.-Clark	Champion	Container	Crown Zell.	Mead	Scott	Union-Camp
1950	155	96	498	120	85	155	286	93	98	80
1951	196	116	637	143	106	213	329	112	150	104
1952	183	109	631	155	121	178	336	100	147	96
1953	200	118	674	164	118	188	386	111	165	106
1954	200	165	681	179	128	187	388	112	229	106
1955	257	176	916	178	135	215	419	151	247	123
1956	370	188	969	294	154	276	468	168	270	163
1957	376	191	956	324	285	256	466	208	275	161
1958	409	208	915	346	288	290	474	256	285	157
1959	506	233	1,030	368	292	322	527	324	297	181
1960	536	250	1,013	404	332	327	554	339	313	213
1961	565	252	1,045	486	340	330	563	406	333	228
1962	579	277	1,096	515	359	343	589	435	354	233
1963	594	290	1,145	539	364	357	616	468	370	239
1964	617	302	1,246	555	386	391	662	510	426	258
1965	635	325	1,304	577	428	406	709	548	461	284

TABLE 17--Continued

Year	St. Regis	West Va.	Int'l	Kim.-Clark	Cham-pion	Con-tainer	Crown Zell.	Mead- [illegible]	Scott- [illegible]	Union-Camp
Percent Change										
1950-1965	310	238	162	381	404	162	148	489	370	255
1960-1965	18	31	29	43	29	24	28	62	47	33

Source: Annual Reports

TABLE 18

NET SALES OF FIVE MOST ACTIVE ACQUISITORS
AS A RELATIVE OF THE INDUSTRY'S NET SALES
FOR SELECTED YEARS: 1950, 1955, 1960, and 1965
(In Percent)

Year	Mead	St. Regis	Container	Kimberly-Clark	International
1950	1.4	2.4	2.4	1.8	7.8
1955	1.5	2.6	2.1	1.8	9.3
1960	2.8	4.5	2.7	3.4	8.6
1965	3.3	3.9	2.5	3.5	8.0

Source: Table 3 and Table 17.

CHAPTER III

THE MERGER MOVEMENT FOR SELECTED FIRMS IN THE PAPER AND ALLIED PRODUCTS INDUSTRY 1950-1965

Throughout the years 1950-1965 the merger movement steadily gained momentum. The initial year saw 219 acquisitions made by manufacturing and mining firms alone, and by 1965 the figure had risen to 1,008 (see Table 19). This does not reflect the countless discussions and proposals for mergers and acquisitions which were, for some reason or other, never consummated. There is every indication that corporate growth by this method, impressive as it was during this period, has an even greater projected significance.

It is rare for a firm to produce a perfectly homogeneous product. Production of a single product implies the need for different qualities, sizes, colors, and other such variations. Because of this need diversification has become an important objective of most firms. This drive toward diversification might well reflect a firm's motivation for maximization of profits, and it obviously indicates a projected change of either an internal or external nature. Any firm, contemplating diversification, must determine which method--internal growth or external acquisition--is the more economically feasible for development. It is fitting that the methods used by the paper and allied products industry between 1950-1965 be considered.

Types of Mergers

The economist appraises the competitive aspects of a given industry's structure. In respect to mergers, the relationship between the acquirer and the acquired is of great importance. To discern market impact, mergers can be broadly categorized: (1) horizontal, (2) vertical, and (3) conglomerate or "negative space."

Generally speaking, horizontal mergers are classified as "breadth" mergers and involve a combination of companies which produce one or more similar products. These firms also serve the same geographical market.

Vertical mergers may be broadly classified as "depth" mergers, and they are basically and extension of a firm's production facilities. Extension may be forward with final output sold more directly to the ultimate consumer; or it can be backward with the resources of suppliers acquired by the producer. In paper products, a producer can acquire a wholesaler (forward extension), or he can buy large tracts of timber land (backward extension). In general, mergers of the first two types are the most common combinations in the paper and allied products industry.

The last category of mergers, currently termed conglomerate, instinctively lends itself to a more exact terminology--"negative space." In economic theory, traditional combinations are considered to be either horizontal or vertical. It has been assumed of conglomerate mergers that a mutual interest exists between an acquiring and an acquired company. However, the recent development in mergers and acquisitions has deviated significantly from this traditional theory. It may be that no such relationship exists. For example, a paper mill may acquire an electronics firm (no functional relationship in manufacturing or distribution between companies). In a product extension merger, a functional relationship

TABLE 19

MERGERS AND ACQUISITIONS IN MANUFACTURING AND MINING IN THE UNITED STATES 1950-1965

Year	Number
1950	219
1951	235
1952	288
1953	295
1954	387
1955	683
1956	673
1957	585
1958	589
1959	835
1960	844
1961	954
1962	853
1963	861
1964	854
1965	1,008
Total	10,163

Source: U. S. Bureau of the Census, Statistical Abstract for the United States: 1966 (87th ed.; Washington, D. C.: Government Printing Office, 1966), p. 501.

exists between firms, but their products do not compete directly with one another (the acquisition of a plastics company by a paper manufacturer). A market extension merger is one in which the production facilities of both companies are the same, but each serves a different geographical market area. This last classification is significant because it is often the basis for antitrust cases when relevant market area served becomes the point of departure as far as the courts are concerned.

Manner of Effecting Combinations

There are a number of ways in which companies combine. An acquiring company may purchase an acquired company outright for cash; but, more typically, an acquiring company may use some form of stock exchange. In a research study conducted for the American Institute of CPA, Arthur R. Wyatt found that most combinations fell into one of several "typical" patterns:

1. Acquiring Company A issued voting stock for all the voting stock of the acquired Company B, with one company, A, resulting.

2. Acquiring Company A issued voting stock for all of the voting stock of the acquired Company B with both companies remaining in existence.

3. Acquiring Company A issued voting stock for the assets of acquired Company B, with B either being liquidated shortly thereafter through a distribution of shares of A to B's shareholders or remaining in existence as an investment company.

4. Acquiring Company A issued voting stock and other equity claims and/or assets in exchange for the stock of acquired Company B, with one company, A, resulting.

5. Acquiring Company A issued voting stock and other equity claims and/or assets in exchange for the stock of acquired Company B with both companies remaining in existence.

6. A new company C was formed and issued its voting stock in exchange for all the voting stock of both A and B, New Company

> C might have a name different from A or B, or might leave the same name as either of these companies.[1]

Consummation of mergers between 1950-1965 employed one or another of these six techniques. The exchange of stock was most popular; it was used in nearly 90 percent of the mergers and acquisitions.

To determine the value of assets there are basically two methods: the purchase method, and the pooling of interest method. Under the purchase method, the assets of an acquired firm are recorded at their fair market value. This method treats the acquisition as if the dominant firm had bought the net assets of another business and established a new cost basis for the acquired assets. In the pooling of interests method, the assets are valued according to their stated value as cited in the company's accounts prior to the merger. Underlying this method is the assumption that no new business entity has been created.[2]

Number of Mergers

During the period covered there were 179 mergers and acquisitions completed by the ten acquisitors with the greater activity appearing the latter part of the 1950's and early 1960's (see Table 20). Between 1957 and 1960 there were 81 mergers which represented approximately 46 percent of all the mergers and acquisitions completed. When these data are related to the Index of Industrial Production, a close relationship is established between the trend in the number of mergers and the upward

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[1]Arthur R. Wyatt, A Critical Study of Accounting for Business Combinations (New York: American Institute of Certified Public Accountants, 1963), p. 10.

[2]F. Robert Madera, "Intercorporate Investments and Business Combinations," Unpublished Technical Note, Harvard Business School, 1966.

TABLE 20

NUMBER OF MERGERS AND ACQUISITIONS
BY THE MOST ACTIVE ACQUISITORS IN THE
PAPER AND ALLIED PRODUCTS INDUSTRY
1950-1965

Year	Number
1950	1
1951	5
1952	1
1953	5
1954	13
1955	14
1956	12
1957	18
1958	16
1959	25
1960	22
1961	14
1962	10
1963	7
1964	10
1965	6
Total	179

Source: Moody's Industrial Manual.

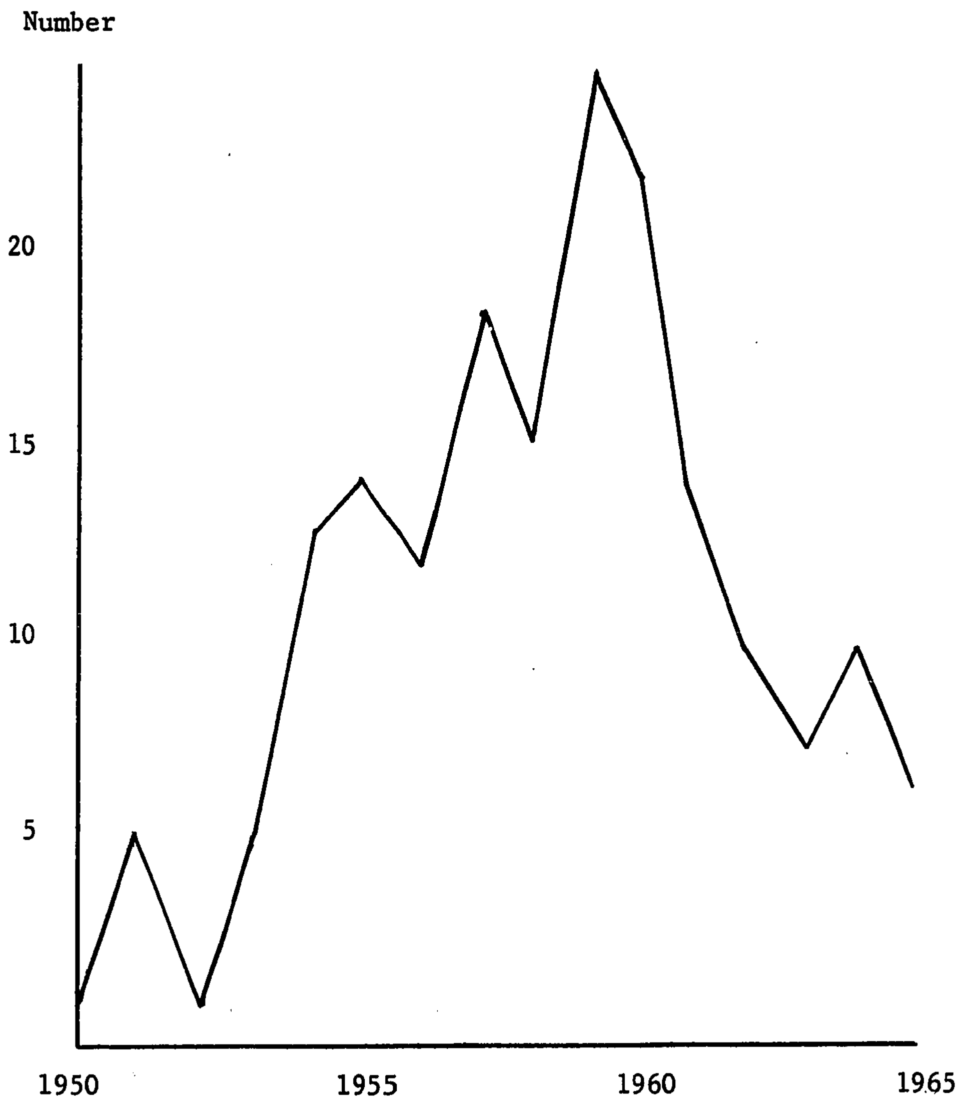
movement of the Index. During the sixteen year period industrial production increased every year except two. These similar movements tend to support the thesis that merger cycles are coincidental with industrial production; a point which imposes further discussion.

Of the ten corporations studied, St. Regis Paper Company and The Mead Corporation were by far the most active acquisitors during this period (see Table 21). The former completed 36 mergers, whereas the latter completed 37. The Container Corporation of America acquired 25 companies, and Kimberly-Clark added 20 new firms to the parent corporation. International Paper Company averaged one merger per year, and the remaining companies averaged less than one consolidation per year. The Crown Zellerbach Corporation and the West Virginia Pulp and Paper Company had the least number of acquisitions when both companies acquired seven firms. The resultant overall growth of these companies was a combination of both internal and external developments.

To meet the rising consumer demand for paper products (per capita consumption cited in Table 8), a corporation has two possible approaches. First, it can expand existing facilities as well as build new plants which will increase capacity for both the corporation and the industry. This approach was utilized by the paper companies when new capital outlays, millions of dollars annually, were allocated for new capital investments. In fact, the majority of these firms relied more upon internal growth--expanding their capacity through capital investments in existing or new facilities--than upon mergers. Secondly, a corporation can meet the increased demand for its products by additional capacity--the acquisition of new facilities through mergers. In this case, the problem may be posed that although a firm might be able to meet its requirements for additional capacity, capacity for the industry remains unchanged in the short-run. Be that as it may, utilization of mergers and acquisitions by the ten firms in the study averaged approximately eleven per year, or about one merger per year per company. Although at the time of merger the capacity of the industry was unchanged, capacity eventually increased for both the firm and the industry when

FIGURE 1

NUMBER OF MERGERS AND ACQUISITIONS
BY THE MOST ACTIVE ACQUISITORS IN THE
PAPER AND ALLIED PRODUCTS INDUSTRY
1950-1965



Source: Table 20.

TABLE 21

MERGERS AND ACQUISITIONS BY THE MOST ACTIVE ACQUISITORS
IN PAPER AND ALLIED PRODUCTS INDUSTRY, BY COMPANY, 1950-1965

Year	St. Regis	Int'l	Scott	Mead	Cham-pion	Con-tainer	Crown Zell.	Union-Camp	Kimberly-Clark	West Virginia
1950							1			
1951			2	2					1	
1952									1	
1953	1						2			2
1954	2	1	3		1	5			1	
1955	3	2	2	2		2	2		1	
1956	5	2		1			1	1	2	
1957	4			6		4		1	2	1
1958	1	1	2	6		3		2		1
1959	5	5		8	1	2		2	1	1
1960	11	1		1	1	4		1	2	1
1961	1	1		2	1	1		1	7	
1962	1	1		2	2	1	1	1	1	
1963	1		4	1					1	
1964		1		5	1	1		1		1
1965	1	1		1	1	2				
Total	36	16	13	37	8	25	7	10	20	7

Source: Moody's Industrials Manual.

succeeding periods saw extensive capital outlays by the acquiring company used to increase the manufacturing facilities of the acquired company.

Mergers and acquisitions have been notable in the development of these companies. Ranked according to sales, St. Regis was the 99th largest manufacturing firm in 1964, as compared to 164th in 1954.[3] During this ten-year period St. Regis acquired thirty-four of its thirty-six mergers covered by this study. Furthermore, in testimony before the Subcommittee on Antitrust and Monopoly hearings in March of 1965, Dr. John M. Blair cited the 17 most active acquiring companies, of which St. Regis was one, among the 100 most active acquisitors in manufacturing. The assets of the companies acquired by St. Regis between 1950-1963 were $247.9 million.[4]

Mead, the most active acquisitor in the industry with thirty-seven mergers, was ranked the 122nd largest industrial firm in 1964, and 267th largest in 1954. In general, though, the companies which were acquired by Mead were not among the 500 largest firms prior to 1950. There were only four companies which were ranked among the 500 largest in 1948 which were purchased between 1950-1963 by the ten most active acquisitors in the paper and allied products industry (see Figure 2).

Although outside the scope of this study, there was a highly significant merger between U. S. Plywood and Champion Papers in 1966. The combined net sales for these two corporations was in excess of one billion dollars. _The Fortune Directory for 1965_ ranked U. S. Plywood in 152nd place, and Champion Papers was listed in 164th position.

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[3]See _The Fortune Directory_ (New York: Time, Inc., 1954, 1964).

[4]Testimony of Dr. John M. Blair, _Economic Concentration_, p. 965.

FIGURE 2

COMPANIES AMONG THE 500 LARGEST IN 1948 PURCHASED BY THE 10 MOST ACTIVE ACQUISITORS; 1950-1963

Rank in 1948	Acquired Company	Industry	Acquiring Company
231	Long-Bell Lumber Co.	Sawmill and planning mills	International Paper Co.
379	Hollingsworth and Whitney Co.	Paper and paper-board mills	Scott Paper Co.
391	Gaylord Container Corp.	Paper and paper-board mills	Crown-Zellerbach Corp.
451	International Cellucotton Products, Inc.	Paper and paper-board mills	Kimberly-Clark Corp.

Source: Economic Concentration, Hearings before the Subcommittee on Antitrust and Monopoly, pt. 2 (Washington, D. C.: Government Printing Office, 1965), p. 966.

Their subsequent merger raised them to the 76th largest industrial firm in 1966, making this combination one of the most significant in the industry.[5] However, International Paper still retained its number one ranking within the industry.

The U. S. Plywood-Champion Papers merger indicated that each company doubled its sales by means of the combination. Another example of increased operational size via the merger route is the Crown-Zellerbach merger with St. Helen's Pulp and Paper Company in 1955. At the time of this merger, Crown-Zellerbach had sales of $253 million and St. Helen's sales were $9 million. In this case the percentage growth, in terms of sales, amounted to only 3.5 percent from 1955 to 1956. This is typical

[5]The Fortune Directory (Time, Inc., 1967), p. 167.

of the industry when a merger, though involving millions of dollars in sales, is viewed in relation to the aggregate sales figures of the acqui acquired company. It usually represents less than a 10 percent increase in the overall sales figure.

There are, of course, a number of combinations such as U. S. Plywood and Champion Papers where the acquired firm contributes significantly to the aggregate sales picture. For instance, when the Union Bag and Paper Company, whose sales were $106 million at the time of the merger, acquired the Hankins Container Company in 1955. Hankins sales were $24 million, or about 23 percent of Union's sales, and obviously an addition of this size to the sales volume of Union was significant. Soon after this merger had been completed, Union Bag and Paper began negotiations to combine with the Camp Manufacturing Company of Franklin, Virginia.[6] In 1955 Union had sales of $123 million but in 1956, the year of the merger of these two companies, net sales of Union Camp Paper Corporation rose to $163 million, an increase in net sales of 30 percent. Considering that Union's sales were $105 million in 1954 and reached $163 million two years later, the speed by which sales growth is accomplished through the utilization of merger techniques can readily be seen. It should be noted, however, that an approximate sixty percent increase in a company's sales during a two year period is not typical of any company in this study. Surprisingly, the sales of Union Bag had for a seven year period prior to 1955 been oscillating up and down without any definite trend.[7]

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[6]Annual Report: 1960, Union Camp Paper Corporation, p. 7.

[7]Annual Report: 1955, Union Bag and Paper Company, p. 27.

One year, an increase in the company's sales; the next year, declining sales. However, such sporadic growth is no more typical than sixty percent growth over two years.

Another such case pertains to Scott Paper Company, whose total net sales figure was $98 million in 1950. The acquisition of Soundview Pulp and Paper Company in November of 1951 boosted its sales approximately twenty-four percent over pre-merger levels, since the sales of Soundview were about $23 million at the time. Additional acquisitions by Scott in 1954 were Detroit Sulphite Pulp and Paper Company and Hollingsworth and Whitney Company. Detroit Sulphite had sales of $13 million; Hollingsworth and Whitney $40 million.[8] With 1950 as the base period, Detroit Sulphite added approximately thirteen percent, and Hollingsworth and Whitney another forty-one percent to Scott's sales. These three companies, merged into Scott Paper Company, increased the total net sales of Scott by nearly eighty percent over a three year period. This once again magnifies the significance of mergers.

The size of an acquiring company is important in the evaluation of sales growth anticipated by means of the acquisition route. Consider the case of International Paper Company: in 1965 it was ranked by Fortune as the 43rd largest industrial firm in the United States with sales of over one billion dollars.[9] Hence, it would take a merger amounting to hundreds of millions of dollars in sales to achieve the percentage increases experienced in some of the previously cited mergers. One of the most significant mergers in the history of International

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[8] Annual Report: 1955, Scott Paper Company, p. 18.

[9] The Fortune Directory (Time, Inc., 1966), p. 198.

Paper was its acquisition of the Long-Bell Lumber Corporation and the Long-Bell Lumber Company on November 5, 1956. At the time, International Paper had net sales of $799.5 million, and Long-Bell had approximately $106 million--an amount nearly equal to the sales of Scott Paper and Union Bag and Paper Company prior to their major acquisitions. When the sales of Long-Bell were added to those of International, the sales of the latter only increased by approximately thirteen percent. Today, a merger of $100 million would contribute less than a 10 percent increase to the sales of International Paper.

Another example of mergers and their effect on total net sales is the case of Kimberly-Clark's acquisition of International Cellucotton Products Company in September of 1955. The year before, International Cellucotton ranked as the 214th largest industrial company with sales of $145 million, whereas Kimberly-Clark ranked 177th largest with sales of $177 million.[10] Since the merger transpired in 1955, it would be expected to have significantly affected the 1955 ranking of Kimberly-Clark. A company whose combined sales were in the neighborhood of over $300 million should be ranked around the 110th largest industrial. However, Kimberly-Clark ranked 164th in 1955, with total net sales of only $224 million.[11] This was an atypical combination because all of the sales International Cellucotton had made as a separate entity did not carry over proportionately into the new amalgamation. This was a case where the sales growth experienced in other mergers did not materialize. Where other acquiring companies had realized a gain of nearly eighty percent, Kimberly-

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[10] The Fortune Directory (Time, Inc., 1954), p. 107.

[11] The Fortune Directory (Time, Inc., 1956), p. 114.

Clark realized only about a 27 percent increase in its sales for the year in which the merger was completed.

The effect on the sales growth of West Virginia Pulp and Paper Company exemplifies the importance which mergers play. Initially, one of West Virginia's most significant mergers was its acquisition of the Hinds and Dauch Paper Company in 1954. Sales for the parent company increased from $118 million in 1953 to $165 million in 1955. West Virginia made its most significant merger in 1960 when the company acquired the controlling interest in The United States Envelope Company. Though West Virginia had the controlling interest, the latter was treated as a subsidiary not consolidated into the financial data of the controlling company. In August 1960, the Antitrust Division of the Department of Justice brought a civil action under Section 7 of the Clayton Act seeking divestiture by West Virginia of its stock interest (53 percent of the voting stock[12]) in U. S. Envelope.[13]

Due to the pending antitrust case, it is assumed that the consolidation of the financial statements of the two companies has not been completed. But the significance underlying this merger was that U. S. Envelope had net sales in excess of $50 million annually which would have meant about a 20 percent increase in sales for West Virginia for 1960. It would represent about the same percentage of increase in the controlling company's sales any year since if consolidation had been completed. And, incidentally, West Virginia would have improved its position among the country's largest industrials. According to <u>The Fortune Directory for 1960</u>, West Virginia was ranked as the 193rd largest

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[12] <u>Annual Report: 1963</u>, West Virginia Pulp and Paper Company, p. 21.

[13] See p. 81.

industrial with sales of $250 million. If approximately $50 million were to be added to this sales figure (if consolidation with U. S. Envelope had materialized), West Virginia would have ranked as the 157th largest.[14] In 1962, West Virginia was ranked as the 190th largest, but again if the net sales of U. S. Envelope were to be added, the former would rank as the 155th largest.[15] However, in 1965, West Virginia had dropped out of the largest 200 industrials and was ranked 211th with sales of $325 million. The incorporation of U. S. Envelope's sales would have enabled the company to remain in the top 200; in fact, West Virginia would be ranked as the 178th largest industrial.[16] One may conclude from this that the sales growth of the companies discussed in this section were, for the most part, significantly changed through the acquisition of new companies.

Legal Aspects of Mergers

Until 1950 there was legal, as well as economic, justification for a corporation to acquire the assets rather than the stock of the acquired company. This resulted from a Supreme Court decision rendered in 1926 which stated that the Federal Trade Commission had no power to interfere with a merger if the acquiring corporation had used its stock to purchase the assets prior to the time the complaint was issued.[17] The court went even further in 1934 when it ruled that the Federal Trade Commission could not prevent the acquisition of physical assets of

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[14] The Fortune Directory (Time, Inc., 1960), p. 117.

[15] The Fortune Directory (Time, Inc., 1962), p. 123.

[16] The Fortune Directory (Time, Inc., 1965), p. 214.

[17] See Chapter V, where a detailed analysis of the legal aspects of mergers is developed.

competing firms if such action transpired before the commission had rendered its final decision concerning the merger. As a result, the court had nullified the action taken by Congress in 1914 to prevent monopolistic mergers.

This loophole in the law existed until 1950 at which time the Cellar-Kefauver Act was passed. This was an amendment to Section 7 and Section 11 of the Clayton Act of 1914. The amendment read, in part:

> Sec. 7 That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.[18]

As a result, the choice of acquisition of either assets or stock was no longer predicated upon F.T.C. control since the commission now had control over both techniques. Thus, from a legal standpoint, neither approach has any advantage.

However, there are advantages to stock or asset purchases for other reasons. If the acquiring company seeks to obtain only a portion of the assets which are of some particular value to it, the purchase of assets would be better than the acquiring of stock. Such a purchase would void all the liabilities of the seller except mortgages that might exist on the specific assets acquired.[19] Still, there are advantages to stock purchases. This is one way in which an eventual purchase might

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[18] Public Law No. 899, (O'Mahoney, Kefauver-Cellar Act).

[19] J. Fred Weston and Eugene F. Brigham, Managerial Finance (2nd ed.; New York: Holt, Rinehart, and Winston, 1966), p. 640.

be completed without the prior knowledge of the company whose stock is being purchased. This could be accomplished by the purchase of a company's stock in the open market, especially in small amounts over a period of time. The acquiring company could amass enough shares to place a member on the board of directors and eventually, perhaps, gain complete control.[20]

Other legal aspects of mergers are important. The term merger has been used in a broad sense and denotes any type of acquisition or combination. But from a legal point of view, there are several distinctions made between mergers and acquisitions. There are statutory mergers which consist of a tax-free exchange of shares between two companies one of which will remain and the other will be dissolved as a separate entity.[21] The acquiring company receives all of the assets and all of the liabilities of the absorbed company. In addition, the action to be taken must be approved by the vote of the stockholders of both companies. "Bonds and preferred stock may be used in part, but the shareholders of the disappearing company must receive some equity interest in the surviving company under the 'continuity of interest' doctrine."[22] The importance is that one of the companies will be dissolved while the other remains. A consolidation results in the formation of a new company when two or more companies decide to join forces. From a legal standpoint, the previous individual companies cease to exist.

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[20] Ibid., p. 641.

[21] Jerome B. Cohen and Sidney M. Robbins, The Financial Manager (New York: Harper and Row Publishers, 1966), p. 810.

[22] Ibid., p. 811.

In dealing with the financial aspects of mergers and combinations, there is a technical differentiation between purchase and pooling of interest. A purchase involves the acquisition and complete absorption of a smaller company by a larger company. A pooling of interests involves a combination of two companies, relatively equal in size, in which the identity of the managements of both remains. The acquired firm continues to carry out important functions (The Long-Bell Lumber Company as a division of The International Paper Company).[23]

The transfer of stock is the usual method used to implement mergers and consolidations.[24] Approximately 80 percent of the 179 mergers within the scope of this study utilized this method with the use of cash technique applied in 18 percent of the mergers (see Table 22). The use of debt securities as well as the stock and cash method of handling the merger was used in only about two percent of the cases. Considering the tax laws it is understandable that there are definite advantages in utilizing the <u>tax-free</u> exchange of stock method. If the sellers accepted cash, the transaction would be subject to the higher rate of personal income tax. If the sellers accepted stock, the maximum tax would be 25 percent, when the stocks are sold.

Only St. Regis used the debt securities method of acquisition. In 1954, when it acquired 50 percent of Class and Paper Ltd. of Alberta, St. Regis financed the $23 million transaction using debt securities.[25] When the same company acquired the Andre Paper Box Company in 1962,

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[23]<u>Ibid</u>.

[24]See p. 55.

[25]<u>Moody's Industrials Manual</u>.

TABLE 22

METHODS USED TO IMPLEMENT THE MERGERS AND ACQUISITIONS IN THE PAPER AND ALLIED PRODUCTS INDUSTRY 1960-1965

Method	Number	Percent of Total
Cash	32	17.9
Stock Exchange	137	79.8
Debt Securities	1	0.6
Stock and Cash	3	1.7
Totals	179	100.0

Source: Moody's Industrial Manual.

both stock (25,000,000 common shares) and cash ($200,000) were used to complete the transaction.[26] With the exception of Union Bag Camp Paper Corporation, Champion Paper Company was the only other firm applying the stock and cash technique of acquisition. All the other companies used either the stock or cash method (see Table 23). The exchange of stock was by far the most popular method. One company, International Paper, used both techniques on a fifty-fifty basis--eight of their acquisitions were completed through the exchange of stock and eight were cash transactions.

Types of Mergers

The three basic merger categories--horizontal, vertical, and conglomerate--entail product areas which demonstrate diversification within the industry. A fluctuating degree of diversification can be seen

[26] Ibid.

TABLE 23

METHODS USED TO IMPLEMENT THE MERGERS AND ACQUISITIONS IN THE PAPER AND ALLIED PRODUCTS INDUSTRY, BY COMPANY, 1950-1965

Company	Stock	Stock Cash	Cash	Debt Securities
St. Regis	29	1	5	1
Champion	5	2	1	...
Mead	34	...	3	...
Kimberly-Clark	15	...	5	...
Crown-Zellerbach	6	...	1	...
International	8	...	8	...
Union-Camp	10	...	...	...
Container	18	...	7	...
West Virginia	6	...	1	...
Scott	12	...	1	...
Total	143	3	32	1

Source: Moody's Industrials Manual.

in the years 1924-1964. When International Paper became less diversified; Kimberly-Clark's diversification remained static; and, both St. Regis and Crown-Zellerbach increased their diversification. The latter increase was due to merger activities.[27]

There were approximately seven general industrial classifications which accounted for 90 percent of the mergers. The most frequently

[27] Economic Concentration, p. 973.

appropriated product line was paper. Nearly four out of every ten mergers involved the acquisition of a paper company (see Table 24). The second most popularly acquired product line--boxes, bags, and other types of containers--involved the acquisition of container companies. The acquisition of pulp companies, plastic companies, and lumber companies numbered about the same as this latter group.

With the exception of a few, most of the acquirers gained new companies in only a couple of product areas. Both Union Bag Camp Paper and The Mead Corporation concentrated the bulk of their acquisitions in two areas, paper and containers. The Container Corporation acquired eighteen container and five paper companies, and of the seven acquisitions West Virginia Pulp and Paper completed, six involved these two product areas. Only St. Regis Paper Company had a notable cross-section of all product areas, but even so over half of its acquisitions were paper and container companies. Scott and Kimberly-Clark alone made no acquisition of a container company; the former acquired seven paper companies and the latter added twelve paper companies. St. Regis was the only acquirer of waxed paper companies, and Kimberly-Clark accounted for half the mergers involving envelope companies.

The significance of these acquisitions is that the products involved are all within the paper and allied products industry, and the mergers have entailed both horizontal, vertical, and conglomerate--"negative space"--integration. Considering geographical dispersion, an impressive number of these mergers were motivated from the desire to gain access to a new market area.

Between 1959 and 1962, 206 manufacturing facilities were acquired within the paper and allied products industry (see Table 25). The scope

TABLE 24

MERGERS, BY TYPE OF PRODUCT, AND BY COMPANY
1950-1965

Company	Pulp	Plastics	Paper	Container	Lumber	Envelope	Waxed Paper	Other	Total Mergers
St. Regis	1	4	11	10	3		2	5	36
International		1	7	1	2			5	16
Container		2	5	18				[illegible]	25
West Virginia			2	4		1			7
Crown Zell.	1	1	2	11	2				17
Union Camp			5	4				1	10
Kimberly-Clark	2		12	[illegible]	1	2		8	20
Mead	1		12	20				4	37
Champion			4	1		1		2	8
Scott	3	1	7		2				13
Total	8	9	67	59	10	4	2	20	179

Source: Moody's Industrials Manual.

TABLE 25

PAPER AND ALLIED PRODUCT MANUFACTURING
FACILITIES ACQUIRED BY COMPANIES
ENGAGED IN MANUFACTURING, BY TYPE OF PRODUCT
1959-1962

Type of Paper and Allied Products	Number of Companies Making Acquisitions	Manufacturing Facilities Acquired				
		Total	1959	1960	1961	1962
Pulp, paper, and board	30	95	27	30	15	23
Paperboard container and boxes	36	76	25	17	14	20
Other paper and allied products	23	35	9	7	9	10
Total	89	206	61	54	38	53

Source: Economic Concentration, Hearings of Subcommittee on Antitrust and Monopoly, pt. 2 (Washington, D. C.: Government Printing Office, 1965), p. 1025.

of this study deals with only ten companies, but during this four year period there were 89 companies involved in acquiring manufacturing facilities in the paper and allied products industry. When the numbers approach to the merger problem is used, it is evident that the ten firms accounted for only a small percentage of the total mergers taking place within the industry. The four year total was 206 acquisitions by these 89 companies, while the number of mergers completed by the ten firms accounted for 71. This denotes that approximately one-third of the acquisitions within the paper and allied products industry were made by the ten firms, and further implies that other companies see the value in acquiring such manufacturing facilities.

The distribution of large corporations acquired during the period 1948-1965 concerns 100 mergers in the lumber and woods products industry as well as in the paper and allied products industry (see Table 26). Though there has been a large number of mergers within these industry groups, the percent of the total assets of the industry are relatively small, representing less than ten percent in each case.

Joint Mergers

During the period 1950 through 1965, there were eight joint mergers. In 1957 St. Regis, International, and Scott acquired the assets of Alger-Sullivan Lumber Company. In 1961 Scott, along with Eastern Paper Mills Company, formed a partnership called the Eastern-Scott Paper Company. Two years later, however, Scott acquired Eastern's half, making the company a wholly owned subsidiary. The Mead Corporation was also involved in two joint acquisitions. The first was in 1951 when, with the Inland Container Company, the Rome Kraft Company was formed;

TABLE 26

NUMBER OF LARGE CORPORATIONS ACQUIRED DURING 1948-1965 BY INDUSTRY OF ACQUIRED FIRM AND PERCENTAGE DISTRIBUTION, USING 1959 INDUSTRIAL ASSETS

Industry Group	Number of Acquisitions	Percentage of Total	Value of Acquired Assets (Millions)	Percentage of Total
Lumber and wood products	28	3.4	$ 736.6	2.7
Paper and allied products	72	8.8	2,061.6	9.5

Source: Economic Concentration, Hearings before Subcommittee on Antitrust and Monopoly, pt. 5 (Washington, D. C.: Government Printing Office, 1965), p. 2024.

later, in 1962, the Rome Kraft Company was merged with one of Mead's subsidiaries and established as The Georgia Kraft Company. Another joint venture was completed in 1964 when Mead and Northwood Mills Ltd. formed Northwood Pulp Ltd., with each company having 50 percent control. Another company involved in two or more joint acquisitions was Kimberly-Clark, which along with International Cellucotton Products Company and Reed and Company Ltd., acquired the stock in Cellucotton Products Ltd. Each received one-third of the stock of the acquired company, but the following year, 1955, Kimberly-Clark acquired International Cellucotton. The other five companies did not participate in any joint ventures during this period.

Mergers Involving Foreign Controlled Subsidiaries

Of great interest is the number of mergers by foreign owned or foreign controlled subsidiaries of these ten acquisitors (see Table 27).

TABLE 27

NUMBER OF FOREIGN MERGERS BY PARENT COMPANY AND BY FOREIGN OWNED OR CONTROLLED SUBSIDIARIES, BY COMPANY 1950-1965

Company	Parent	Subsidiary	Total
St. Regis	1	0	1
International	0	14	14
Container	0	16	16
West Virginia	2	0	2
Crown-Zellerbach	1	3	4
Union Camp	0	0	0
Kimberly-Clark	7	2	9
Mead	1	0	1
Champion	0	0	0
Scott	3	2	5
Total	15	37	52

Source: Moddy's Industrial Manual.

Approximately 30 percent of all foreign mergers involved the acquisition by the parent company, and 70 percent negotiated by foreign subsidiaries.

Neither the Champion Paper Company nor Union Bag Camp Paper Corporation acquired any foreign companies during this period. These companies were also among the least active corporations in so far as domestic mergers were concerned. St. Regis Paper Company and the Mead Corporation were by far the most active domestic acquisitors; yet, during this period, these companies acquired only one foreign based company each. The acquisition patterns of The Container Corporation and the International Paper Company are in striking contrast. The former negotiated 26 acquisitions during the 16 year period, averaging one foreign acquisition a year, which represents approximately 64 percent of the corporation's merger activity. The International Paper Company's record of foreign acquisitions is even more impressive. International completed 16 mergers and acquisitions between 1950 and 1965, of which 14 pertained to mergers by its foreign subsidiaries (see Table 21). The largest share of its merger activity, nearly 90 percent, consisted of acquisitions completed by foreign subsidiaries. This was also the case with the Container Corporation when mergers by its foreign subsidiaries accounted for all 16 acquisitions of the company during this time.

There are two apparent motives for undertaking foreign ventures: taxes and capital flows. The tax structure in many countries is more favorable to corporations than is the tax structure of the United States. Over the last decade the United States has been running a deficit in its balance-of-payments accounts, and by allowing a company's subsidiary to negotiate the merger the possibility of a cash flow out of the United States is avoided. The balance-of-payments position of the country is thereby not endangered. However, the more favorable tax structure appears to be the stronger motive for foreign acquisitions by foreign owned or controlled companies.

Acquisitions Challenged by Regulatory Agencies

Not all of these acquisitions escaped the scrutiny of the regulatory bodies in Washington. Seven of the ten corporations were involved in one or more complaints issued by either The Federal Trade Commission or the Antitrust Division of the Justice Department. Figure 3 lists the acquisitions which were challenged by The Federal Trade Commission, and Figure 4 cites those challenged by the Antitrust Division.

In the main, the seven acquisitions challenged by the F.T.C. were settled by consent order, and divestiture of part of the acquired facilities was ordered. The Antitrust Division challenged only two mergers during this period: the Kimberly-Clark acquisition of Blake, Moffit and Towne in 1961, and the West Virginia Pulp and Paper Company's acquisition of the majority of the outstanding stock in United States Envelope Company in 1960. As of March 5, 1965, both cases were pending final disposition.

FIGURE 3

ACQUISITIONS CHALLENGED BY THE FEDERAL TRADE COMMISSION
1951-1965

Companies (and year of acquisition)[1]	Markets	Industry Concentration	Status of case as of April 30, 1965
Crown-Zellerbach Corp. (St. Helen's Pulp & Paper Co.), 1953[a]	Purchasing of pulp & manufacturing, converting, & jobbing of Kraft paper & paper products in the Western States, particularly the Pacific Coast States.	85% of Pacific Coast sales of specified Kraft paper & paper products in 3 companies; Crown-Zellerbach 2d in the U.S. and 1st in Pacific Coast States in manufacture of pulp & paper; Crown was 1st and St. Helen's 2d in Pacific Coast States in manufacture of specific Kraft paper & paper products.	Order of divestiture, Dec. 26, 1957. Upheld by court of appeals (CA-9) in 1961 and ceritiorari denied by Supreme Court in 1962. Divestiture accomplished (1964).
International Paper Co. (Long Bell Lumber Corp.), 1956[b]	Papers & paperboard nationally and Western States particularly.	International Paper [illegible] largest in capacity to produce paper & paperboard & in the production of Kraft board; Long Bell 2d in Pacific Northwest in production of lumber & a leading company in the production of plywood.	Consent order, June 17, 1956, requiring divestiture of 12% stock int. held by Long Bell in Longview Fibre Co. and requiring specific output from proposed Western paper and paperboard mill to be sold to independents. Divestiture not yet fully accomplished.

FIGURE 3--Continued

Companies (and year of acquisition)[1]	Markets	Industry Concentration	Status of case as of April 30, 1965
Mead Corp. (York Container Corp.; Jackson Box Co.; Industrial Container & Paper Corp. Grand Rapids Container Co., Inc.; Industrial Container Corp.; Gibraltar Corrugated Paper Co., Inc.; Container, Inc.; Taylor Container Co., Inc.), 1956-1964[c]	Manufacture and sale of container board, corrugated products, and solid fiber products.	4 largest companies had 30% of 1962 U.S. production of container board; 8 largest, 51%; and 20 largest, 81% with Mead ranking as 3d largest.	Consent order, Feb. 12, 1965, requiring divestiture of 7 corrugated box converting plants and 1 sheet plant; further acquisitions by Mead in the container board manufacture or converting industries, without prior FTC approval, prohibited for a 10 year period Divestiture not yet accomplished.
Scott Paper Co. (Soundview Pulp Co., Detroit Sulphite Pulp & Paper Co.; Hollingsworth & Whitney Co.), 1951-54.[d]	Production, distribution, and sale of sanitary paper products & household waxed paper.	Scott 1st in the U.S. in sale of sanitary paper products (approximately 3 times more than nearest competitor).	Consent order, Apr. 23, 1964, prohibiting specified acquisitions and other acquisitions for a 10 year period. Divestiture of certain paper machines ordered.
Union Bag-Camp Paper Co. (Camp Manufacturing Co.; Universal Paper Bag Co.; 51½% of stock of Highland	Production & sale of grocery bags and sacks, corrugated shipping containers, liner board & corrugating	8 largest companies accounted for 36% of corrugated container shipments in 1958 & the 20 largest 55%.	Consent order, Feb. 12, 1965, requiring divestiture of 5 corrugated box plants located in Maryland, Michigan,

FIGURE 3--Continued

Companies (and year of acquisition)[1]	Markets	Industry Concentration	Status of case as of April 30, 1965
Container Co.; majority of stock of Eastern Box Co.; Allied Container Corp.; River Raisin Paper Co.), 1956-1961.[e]	material, merchandise bags, shipping sacks, & bag & shipping bag paper in Eastern United States.		Illinois, & Pennsylvania & the grocers bag and sack plant in Richmond, Va. The order prohibited further acquisitions for a 10 year period, without prior FTC approval, in Kraft paper & in the board-converting field and required Union Bag to make available to jobbers, distributors, users, & converters specified amounts of course paper. Divestiture not yet accomplished.
Union Bag & Paper Corp (agreement to increase holdings of Hankins Container Co. to 66 2/3 per cent of authorized and outstanding stock), 1954.[f]	Manufacture, sale, and distribution of container board, corrugated boxes and sheets particularly east of Mississippi River.	4 largest companies accounted for 42% of 1954 U. S. container board shipments, 8 largest 59% and 20 largest 83%.	Consent order, Mar. 23, 1956, limiting future acquisition of stock in Hankins.

FIGURE 3--Continued

[1]Date of Complaint and FTC docket no.

[a]February 15, 1965	6180
[b]November 6, 1956	6676
[c]February 20, 1965	C-880
[d]June 1, 1956	6559
[e]June 15, 1960	7946
[f]June 30, 1955	6391

Source: Economic Concentration, Hearings before the Subcommittee on Antitrust and Monopoly, pt. 2 (Washington, D. C.: Government Printing Office, 1965), pp. 992-1000.

FIGURE 4

ACQUISITIONS CHALLENGED BY ANTITRUST DIVISION
1951-1965

Companies (and year of acquisition)[1]	Markets	Industry Concentration	Status of case as of March 5, 1965
Kimberly-Clark Corp. (Blake, Moffit & Towne), 1961[a]	Sale of paper and paper products in Western United States	(Kimberly leading producer of some types; Blake, a big western wholesaler).	Pending
West Virginia Pulp & Paper Co. (U.S. Envelope Co., majority of outstanding stock), 1960[b]	Production and sale of paper and paper products, including envelopes.	U.S. Envelope has 18% of domestic sales.	Pending

[1]Date of Complaint

[a]February 15, 1962

[b]August 25, 1960

Source: <u>Economic Concentration</u>, <u>Hearings</u> before the Subcommittee on Antitrust and Monopoly, pt. 2 (Washington, D. C.: Government Printing Office, 1965), p. 977.

CHAPTER IV

FORCES CONTRIBUTING TO MERGER ACTIVITY

As previously noted, corporate growth by merger and acquisition has had a perceptible impact upon the development of the paper and allied products industry. To reiterate, there were nearly two hundred mergers by the leading acquisitors. This chapter will analyze motivation; general objectives of corporations will be considered and an attempt will be made to particularize these objectives in their relationship with the merger movement of 1950-1965. Both theoretical models and concrete examples will be examined.

Traditional Reasons Cited for Mergers

There are a number of authoritative reasons cited for the acquisitive phenomenon which occurred over the last decade and a half. The starting point for such citations is often a discussion of the role or objectives of a corporation.[1] St. Regis Paper Company, in describing the function of its Long-Range Planning and Policy Committee, states:

> An early task was to set up corporate strategies and objectives through 1975, with goals defined in terms of sales and net earnings and with forecasts of the new capital investment required to reach them. In addition, financial guidelines were established to specify the rate of net earnings required for each operating group in the company in relation to investment. Standard financial procedures

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[1]See Mergers and Acquisitions: Planning and Action, A Research Study and Report (New York: Financial Executives Research Foundation, 1963), Chapter 1.

> were drawn up for evaluating new undertakings in the light of growth and profit potentials.[2]

Future plans formulated by a corporation are especially significant in terms of methods to be utilized in achieving corporate growth. These plans may be realized either internally or externally--by joint venture or merger acquisition.[3]

> Corporate objectives, simple or complex, are the foundation for all future plans and their implementation because they provide a basis for decision-making and for evaluating results. Since merger and acquisition often have a long-term impact on a company's operations, management should define objectives which will be valid for a maximum period of time. Nevertheless, the definition--and periodic review and revision--of corporate objectives is a continuing job since the environment in which a company operates, and the relative importance of various influences on its course of action, are constantly changing.[4]

There emerges one basic objective around which all others seem to revolve: growth. In a study of growth by Gardiner C. Means, his basic conclusion is that large corporations are growing more rapidly than all other corporations. His analysis includes an investigation as to how this growth takes place. "A given corporation can increase the wealth under its control in three major ways: by reinvesting its earnings, by raising new capital through the sale of securities in the public markets, and by acquiring control of other corporations by either purchase or exchange of securities."[5] Means further points out that these

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[2]Annual Report: 1965, St. Regis Paper Company, 1966, p. 5.

[3]Ibid., p. 9.

[4]Ibid.

[5]Gardiner C. Means, "The Growth in the Relative Importance of the Large Corporations in American Economic Life," Richard C. Lane and Selle C. Riemersma, eds., Enterprise and Secular Change (Homewood: Richard D. Irwin, Inc., 1953), p. 144.

techniques far outweigh any other such methods which might be used to bring about corporate growth.

Since the acquiring of control over other corporations plays an important part in corporate growth, it is appropriate to consider numerous reasons, categorically cited, for mergers and acquisitions.

A. Financial Reasons:
1. Exploit an opportunity
2. Avoid the risk of internal development programs
3. Use idle capital
4. Take advantage of a tax loss, i.e., secure one or apply an existing one
5. Increase market value of stock
6. Effect more rapid growth
7. Improve on profit level or trend in present business
8. Secure a source of capital
9. Spread the business risk
10. Provide a market for stock

B. Operating Reasons:
1. Improve upon volume level or trend in the present business
2. Offset seasonal or cyclical fluctuations in the company's present line
3. Satisfy customers' demands for additional services or items
4. Reduce dependence on a single product
5. Broaden the customer base
6. Obtain business in a new territory
7. Acquire new customers and new markets
8. Take advantage of an existing reputation
9. Obscure the details of the primary area of activity from competitors through diversification and the publication of the consolidated statement
10. Obtain a research and development group
11. Strengthen the management
12. Acquire particular products
13. Increase utilization of present resources--any or all types of resources which the company has at its disposal, including physical facilities, individual skills, surplus funds. Find opportunities to use raw materials whose source of supply it owns
14. Enhance power and prestige of the owner, president, or management of the company
15. Provide an outlet for frustrated interests or excess management capacity
16. Add glamour and greater interest to the company[6]

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[6]Mergers and Acquisitions, pp. 40-41.

In essence, a firm should try to identify its basic objectives when contemplating merger activities. Otherwise, the company becomes caught up in merger activity merely not to be outdone by other companies. In other words, the "demonstration effect" of merger and acquisition activity is applicable--merging for the sake of merging rather than for the achievement of a clearly defined corporate objective. It should be noted that the above list of objectives is not necessarily all inclusive, but many are exemplified in the mergers which occurred during 1950-65.

Myles Mace and George Montgomery point out that methods used to achieve corporate goals may take various forms. "But one method, which more and more managements are recognizing, is the process of acquisition."[7] Corporate goals may, in some instances, be other than growth. An investment banker notes that companies do not always carefully consider alternatives: "The main objective of growth through acquisition in a few cases seems to be to permit the executives to fly bigger DC-3s."[8] But in general, Mace and Montgomery's reasons for the acquisition of one firm by another agree with those previously stated.

At this point, having approached the problem as a function of the management process, a greater insight into the area of consolidations may be gained by considering the primary objectives of the firm as traditionally stated in economic theory. The primary motivation of a given firm, theoretically, is that of profit maximization. The firm selects that output which enables it to cover the cost of the factors of

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[7]Myles L. Mace and George G. Montgomery, Jr., Management Problems of Corporate Acquisitions (Boston: Graduate School of Business Administration, Harvard University, 1962), p. 9.

[8]Ibid., p. 10.

production, including the return for entrepreneurial ability. It is further assumed theoretically that the objectives of management are acceptable to stockholders. The traditional approach in economic theory is based upon production. Through production, the firm provides those goods which the consumer has displayed a willingness to purchase. Since mergers will definitely affect production, an analysis of the production function is an important theoretical tool to be used to gain a better understanding of merger activity.

The Production Function

The production function is one of the basic tenets of microeconomic theory. Simply, there is a functional relationship between inputs employed and output realized, in the production process. The relationship may be expressed mathematically:

$$X = f\ (a, b, c, \ldots n),$$

X represents the quantity of goods produced, and a, b, . . . are the factors of production. This yields a basic relationship between inputs and outputs which permeates economic writings about the behavioral patterns of individual firms. There are two aspects of this relationship which should be noted. First, there is the technological process which, by its very nature, enables the producer to choose from a number of alternatives when deciding upon the level of production. Second, since technological facets will provide a solution devoid of some factor costs, the consideration of all factor costs as the principal determining factor of output will result in the selection of those precise factors to be used to produce the desired output.[9]

[9]Sidney Weintraub, Intermediate Price Theory (Philadelphia: Chilton Books, 1964), p. 25.

Theory provides a number of tools to show this relationship, i.e., the total physical product curve. This curve denotes that a firm, in the short run, is able to increase output by adding variable factors to a given number of fixed factors. Given the scale of plant, reflecting the fixed factors of production, output will increase to a maximum, a zenith; if additional variable factors are employed, there will either be no change in output, or total output will be reduced. In the short run a firm is limited by its fixed factors. As Professor W. J. L. Ryan points out, the number of units to be produced for a given time period will reflect the objectives of a firm. Also, a firm is faced with a number of alternatives when it formulates its sales plan. "The data on which a firm's sales plan is based are partly technical and partly economic."[10]

Technical aspects may be demonstrated through isoquant analysis. Initially, an isoquant shows a relationship between two or more variable factors which are to be added to a given quantity of fixed factors. As a consequence, the entrepreneur will expect that when all these factors are combined, a number of production possibilities will result. The choice, as reflected by entrepreneurial decisions, will then yield the desired results. These results will be subject to the limits of diminishing returns.[11] It is further assumed that, given fixed factors, capacity becomes the technical limit to the model. In order to find the best combination of variable factors, costs must be determined by incorporating isocost lines which reflect equal expenditures anywhere along

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[10] W. J. L. Ryan, Price Theory (London: Macmillan Co., 1958), p. 48.

[11] Ibid., Chapter 2.

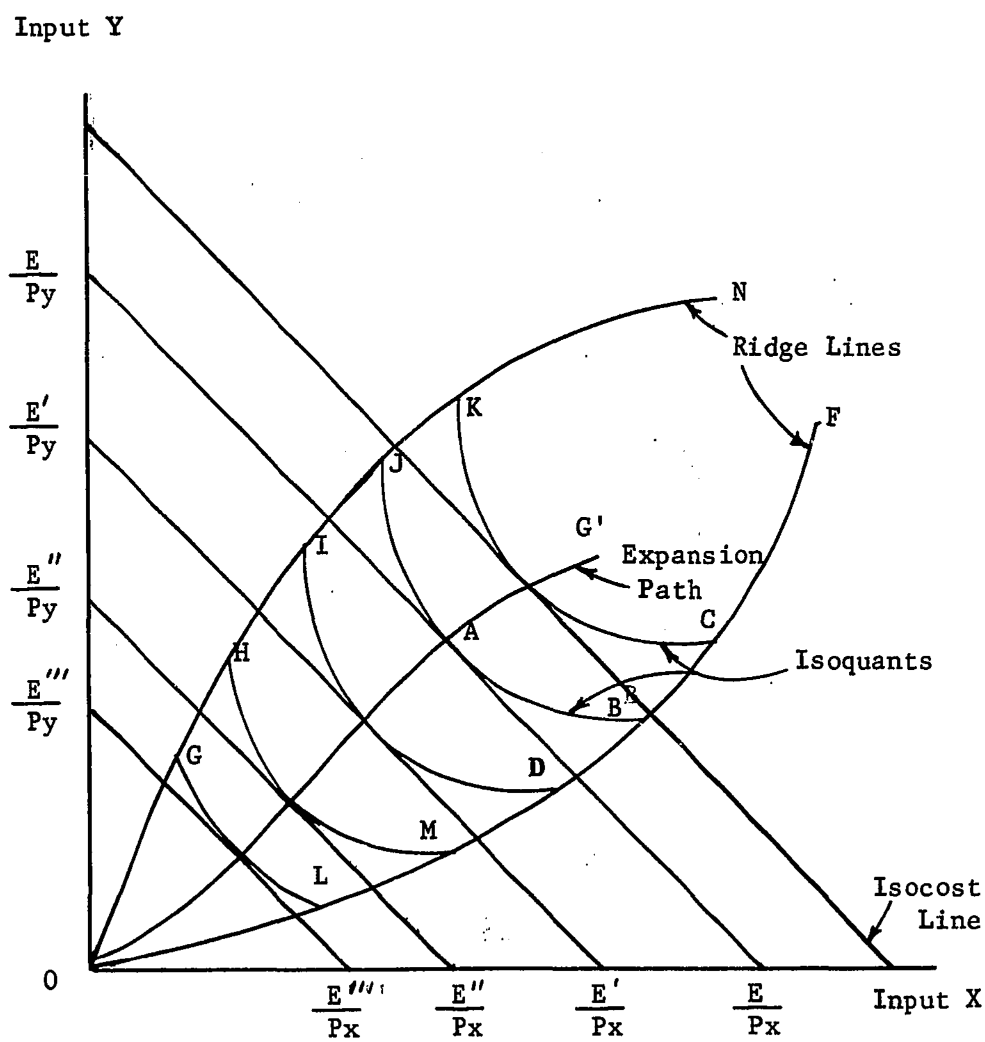
these lines. Having decided upon the expenditure for variable factors, the entrepreneur, being a profit maximizer, will produce where a given isocost line is tangent to an isoquant. The point of tangency will yield the greatest output for the given expenditures, or the lowest cost per unit to produce that given output.

Figure 5 shows the relationship between a given isoquant and a given isocost line. For example, isocost line $E/P_x - E/P_y$ is tangent to an isoquant at point A. The significance of this point is that it reflects the greatest output for the variable expenditure E. Stated differently, it means that at A, the entrepreneur will either maximize output, given expenditure E, or minimize the per unit cost, given expenditure E. It can be noted that points J, A, and B fall on the same isoquant, indicating that the various combinations of X and Y at these points will yield the same output. From purely a technical standpoint, there would be little justification for selecting any particular one of these combinations over any other combination provided this was the desired level of output. However, a production plan is only partially technical. With the introduction of cost, point A is clearly the best combination of factors X and Y. This may be further seen by considering points J and B which, though falling on the same isoquant, would necessitate the allocation of increased expenditures to purchase the various combination of inputs. To reach points J and B, the isocost line would have to shift to the right. Output remains constant, but expenditures have increased, a non-optimal solution.

There are two other aspects of product indifference curves which should be mentioned. First, a brief explanation of ridge lines: ridge lines serve as technical boundaries for the various combinations of inputs

FIGURE 5

PRODUCT INDIFFERENCE CURVES



X and Y. At points L, F, D, B, and C for example, the marginal rate of technical substitution, MRTS, becomes zero. A substitution of X for Y at these points would mean a shift to a lower isoquant. Furthermore, the isoquant takes on a positive slope beyond these points, reflecting that if the same level of output is to be maintained, additional units of both variable factors are needed. Obviously, this adds to the cost of production without adding to output levels. Consequently, ridge lines serve as the technical boundaries within which the entrepreneur should stay. Second, the expansion path should be mentioned. The expansion path may be succinctly described as the optimal output levels for the combination of inputs X and Y, given the prices of these two factors. Therefore, the entrepreneur, once having decided upon the output, needs only to determine what combinations of X and Y will be necessary to reach the point of intersection of the expansion path with the selected output, as shown by the appropriate isoquant.

Determination of Output

In order to determine the best output of a given firm under the profit maximization constraint, Rule I is applied. Rule I briefly states that a firm should produce where marginal cost is equal to marginal revenue. At this point, the firm will either maximize profits or minimize losses. The latter is applicable only in the short run. The former is applicable in both the short and long run. However, Rule I does not of itself reveal a profit or loss situation. In order to determine profits or losses, attention must be directed to Rule II, the relationship between average cost and average revenue. If AR = AC at the desired output, then the firm is operating at the break-even point. Such a relationship is further characterized for the firm as one in which normal returns or normal profits are being realized. On the other hand, if output is characterized by AC > AR, usually a short run phenomenon, the firm is said to be experiencing economic losses. Should the firm find itself in a position where AR > AC, economic profits would be realized. It is this last situation to which George Stigler refers to as one of the purposes of mergers. Mergers are often undertaken to achieve a monopolistic position within the industry.[12] The assumption is that if a firm can achieve such a position, the chances of realizing an economic profit are enhanced.

At this point the concern is with the scale of operations for a given firm. Traditionally, scale refers to the production possibilities function which was discussed earlier. Growth is often reflected by greater scale of plant. As a firm grows it will become increasingly specialized which, hopefully, will lead to economies of production. "Looking more closely at the economies arising from an increase in the scale of production of any kind of goods, we found that they fell into two classes--those dependent on the general development of the industry, and those dependent on the resources of the individual houses of business engaged in it and the efficiency of their management; that is, into <u>external</u> and <u>internal</u> economies."[13] An attempt to realize these economies is one of the reasons cited in support of mergers.

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[12]George J. Stigler, <u>The Theory of Price</u> (3rd ed.; New York: Macmillan Company, 1966), pp. 230-238.

[13]Alfred Marshall, <u>Principles of Economics</u>, Vol. I., Text, with annotations by C. W. Guillebaud (9th ed.; London: Macmillan and Co., Ltd., 1961), p. 314.

Economic theory states that in the long run a given firm may be faced with increasing, constant, or decreasing returns. Whichever situation is encountered will be significant in terms of prices to be charged and profits, either economic or normal, which will be realized. First, if a firm has constant returns to scale, it will experience, over the long run, approximately the same minimum average cost as the scale of production increases, allowing the price to remain constant. Second, decreasing costs will result in a diminishing minimum per unit cost. Moreover, assuming entry is possible, the price of the product will tend to fall over a period of time. Lastly, the firm, which is faced with increasing costs such as a period of inflation produces, will find that as the scale of plant increases; internal economies will be overcome by greater internal diseconomies to scale. The firm will, in order to maintain normal returns, be faced with the need to raise the price of its product in order to cover these increased costs. Over the last few years, the general level of industrial prices has increased. This upward spiral reflects the increased cost of production, apparently echoing the phenomenon of cost-push inflation.

Acquisitions, The Modus Operandi, For Growth

All companies formulate an operating plan, part of which is the provision for growth. The paper and allied products industry has been faced with an increasing demand for its products, which stresses the need for provisions to keep pace. The choice of expanding its capacity may be achieved by a number of acceptable techniques: internal and external expansion--joint ventures, mergers or acquisitions. Further, it is assumed for the purpose of this analysis that internal growth will be coincidental with other techniques. Internal growth is dependent upon the amount of funds allocated by the firm for capital improvements which is included in a typical operational plan. Here the analysis is not concerned directly with internal growth, but rather with those factors upon which management bases its decisions for acquiring another firm. In other words, how are mergers utilized in order to realize a firm's operational plan?

a. Demonstration Effect:

Edward McSweeney, a management consultant, when discussing the merger era of the 1950's, wrote: "Only time will tell whether the current wave of mergers and acquisitions has been built on a firm foundation or on political quicksand."[14] He begins his analysis by noting that in a recent issue of The Business Record, "four pages of small type were required to list mergers and acquisitions reported in a 30-day period. And experts estimate that, due to SEC regulations and closely held businesses, less than 50 percent are actually reported to the public."[15] To give support to the proliferation of merger activity, McSweeney cites "an abridged list of companies engaged wholly or to a substantial extent in the paper industry, stocks of which are publicly held, which have acquired other companies by purchase or merger since 1953."[16] For the period 1953-1958 he shows where 68 different companies acquired 159 companies. To this list he adds a supplement for the period 1958-1960, a period in which 91 different companies acquired approximately 170

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[14] Edward McSweeney, "Urge to Merge: Story of 50's," Pulp and Paper, June, 1960, p. 75.

[15] Ibid., p. 74.

[16] Ibid., p. 75.

companies. Included in the totals are those companies not only acquiring other companies, but in a number of cases, these companies found themselves being acquired by someone else at a later date.[17] It would appear that based upon the sheer volume of mergers and acquisitions which have taken place within the industry during the past decade or so a "demonstration effect" is apparently one of the motivating factors underlying merger activity.

b. Integration

The industry has been characterized by the term "integrated paper company." How does the term apply? A paper company processes trees into paper which is sold to converters which, in turn, convert the paper into various product lines which the ultimate consumer desires. These products are sold to wholesalers or distributors, and the latter provides the paper merchants with the products. It is the merchant who provides the retailers with the products produced by the industry. Integration means to control the several steps between the paper producer and the paper merchant who sells these products.

Consider the case of the West Virginia Pulp and Paper Company. "Whereas we were servicing only a few hundred customers 15 years ago, our customer list today runs to more than 11,000. Whereas 15 years ago our sales and service departments numbered less than 50 employees, today these departments consist of nearly 800 employees."[18] These statements reflect the ever expanding role taking place within the company as it moves in both horizontal and vertical directions. However, West Virginia

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[17] Ibid., pp. 75-78.

[18] Annual Report: 1959, West Virginia Pulp and Paper Company, p.28.

adds "Growth for growth's sake will be avoided."[19] Nevertheless, partially due to mergers, the company has found itself becoming more involved in direct consumer sales.

c. Diversification

Diversification is a catchall term which is often applied to merger activities; yet, its meaning is as varied as the mergers and acquisitions to which it is applied. The term may be framed in a set of definitions that Michael Gort developed in his study for the National Bureau of Economic Research in which he defined his concept of diversification:

> Diversification may be defined as an increase in the heterogeneity of markets served by an individual firm. Heterogeneity of production is distinct from diversification if it involves minor differences of essentially the same product, or if it takes the form of vertical integration.[20]

Gort's definition notes that diversification is related to markets served by an individual firm.

An example of product extension, or greater product heterogeneity, may be seen through the terms of the agreement to merger between The Mead Corporation and the directors of Westab, Inc., the latter becoming a wholly owned subsidiary of Mead. "The move adds a fourth major area of service for Mead with markets in education, business, and communications. Mead President G. H. Pringle said when the plan was announced, 'With Westab's familiarity and experience in serving the important market combined with Mead's technical know how, we can make a contribution

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[19]Ibid.

[20]Michael Gort, Diversification and Integration in American Industry, A Study by the National Bureau of Economic Research, Princeton University Press (Princeton, 1962), p. 8.

to the field of education that neither company could make separately.'"[21] School supplies account for the bulk of Westab's sales. However, the raw materials used by Westab have been purchased from outside suppliers, half of which are covered by long-term contracts with such companies as Champion and Crown Zellerbach.[22] The merger, thereby, has created a new area around which Mead can plan new units as well as provide the nucleus from which the parent company can service the educational scene. The addition of Westab complements other product areas handled by Mead. For example, their Sargent Art Division provides a broad range of art supplies--crayons, oil paints, water colors, chalk, etc.--to augment the company's line of art papers.[23] Obviously, there appears to be an ever expanding market in the growing field of education. Mead, which has excellent merchant facilities, has gained greater product heterogeneity by acquiring Westab which had, at the time of merger, established a nationwide market for its products.

The impact upon Scott's product lines through its acquisition of the Soundview Pulp and Paper Co., the Detroit Sulphite Pulp and Paper Co., and Hollingsworth and Whitney Co. was significant. Thomas B. McCabe, the President of Scott Paper Company, in discussing these mergers wrote: "The recent additions of plants and timberlands represented the extension of a major plan that had its first important stimulus in 1951 through the acquisition of Soundview Pulp Company's pulp mill... . the site was ideal construction of a paper mill which is now operating with four modern

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[21]Drexel Harriman Ripley, op. cit., p. 22.

[22]Ibid.

[23]Annual Report: 1966, The Mead Corporation, p. 17.

paper machines."[24] The underlying motivation for Scott's plan for product integration was: "For better control of costs, improved customer services and more efficient operations. . .," and "The strategic locations of the newly added plants provide the opportunity not only for improving the efficiency of the Company's operations but for its further development and growth."[25] Scott, through its acquisition of the Detroit Sulphite Pulp and Paper Company, gained entrance into another new product area. In this case, it not only gained additional pulp and paper facilities, but more importantly, it now became a producer of wax paper, a product line in which it had no previous production capabilities.

Though not within the scope of this study, a recent merger agreement between Scott and the S. D. Warren Co., a maker of high grade specialty costed papers, is a good example of product heterogeneity. "It was not so much Warren's size that made the merger noteworthy. . . Rather, it was the strategic implication of Scott's entry into a paper area that it had so far studiously avoided."[26] Furthermore, the president of Scott, noting that even though the company's sales were increasing at 5 percent each year, these sales were being seriously challenged by the aggressive entrance of Procter and Gamble and Georgia-Pacific into the tissue market, Scott's traditionally strong market area. "The Warren acquisition marks a major move for Scott into a fast growing segment of the high-quality printing-paper business. . . which provide about 80% of Warren's total sales."[27] The significance is, according to Forbes, that Scott has ceased

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[24]Annual Report: 1955, The Scott Paper Company, p. 2.

[25]Ibid.

[26]"Losing Its Purity," Forbes, April 1, 1967, p. 35.

[27]Ibid.

to be one of the last true specialists in American industry. Scott, finding its traditional territories invaded, moved into other product areas in order to preserve its corporate profits--the yardstick by which successful management is judged. An underlying motivation for mergers becomes apparent--self-preservation. Scott, by remaining relatively specialized, was faced with a choice of either a price war to retain its existing markets, or diversification into other areas. It appears, however, that the latter afforded the company more latitude in its marketing decisions.

St. Regis, one of the most active acquisitors, has enhanced its product density by means of consolidation. Through the early 1950's, the company was primarily engaged in the manufacture of paper, multi-wall bags, and laminated plastics. "Today, St. Regis is one of the most diversified packaging producers in the world. . . it has 76 converting plants making corrugated boxes, folding cartons, multi-wall bags, plastic bags, flexible packaging, envelopes, gummed tape, reinforced papers, protective papers, specialty coated papers, paper plateware, school supplies, and a variety of special packaging materials. . . Entry into the manufacture of all these converted products gave the company a new stability, neutralizing adverse effects of cyclical swings in individual markets."[28] In addition, growth in converting has lead to further integration of the manufacturing process; the company provides the starting materials as well as those needed to provide the final product, adding value throughout the process. An important facet of this growth is directly attributable to the numerous acquisitions which the company has completed over the last decade and a half.

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[28] Annual Report: 1965, St. Regis Paper Co., p. 17.

The merger of St. Regis with the American Sisalkraft Corporation is a good example of how a company increased its product diversification. The principal products of the new addition are reinforced kraft paper consisting of sheets of kraft paper bonded together by asphalt or a non-staining adhesive, with fibers of sisal or glass embedded in the bonding material for reinforcement. "A promising new development of this division is Pyro-Kure, a permanent and non-corrosive adhesive that imparts flameproofing properties to barrier papers."[29] The importance of the merger to St. Regis is that it not only added diversification to the domestic market but extended as well the company's scope in its international operations. A similar merger was completed in the same year when St. Regis acquired Howard Paper Mills, Inc. through an exchange of stock. The principal products of Howard are printing and fine business papers, offset, envelope and map papers. Howard, at the time of merger, had begun to manufacture check base stock adapted to the special requirements of automated check sorting in banks.[30] The merger added another important converter as well as adding depth to its product line. Other examples of how St. Regis further diversified its activities, especially in converted products, were the acquisitions of the Pollock Paper Company and the General Container Corporation in 1955. At the same time St. Regis had completed negotiations for three other companies--The Ajax Box Company, the Gummed Products Company, and The Chester Packaging Products Corporation. The combined sales of the five companies would, at the time of their acquisition, add in the neighborhood of $60 million to the annual

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[29] Annual Report: 1960, St. Regis Paper Co., p. 18.

[30] Ibid., p. 11.

sales of the parent company. A few of the products the companies produced are: corrugated fiber boxes, corrugated and embossed wrapping and display materials, box tape, kraft sealing tape, printing papers, and bread wrappers. The Pollock Paper Corporation derives the major part of its business from waxed paper products, namely bread wrappers. The company also has a paper mill, a research laboratory, and a special machinery manufacturing shop. In addition, it conducts a substantial paper distributing business in the Southwest.[31] Overall, it becomes apparent that the acquisition route which St. Regis pursued enabled it to add greater product heterogeneity. "St. Regis has more than doubled in size since 1954 when it undertook a major expansion and diversification program aimed at broadening its product base. . . The rapid growth which has been brought about through acquisition of other companies. . . has resulted in fuller integration of both production and marketing operations."[32]

The growth of Kimberly-Clark has somewhat paralleled that of St. Regis. Kimberly-Clark also experienced its greatest expansion during the 1950's with acquisitions playing an important role. It began its acquisition program in 1951 by acquiring the Munising Paper Company, makers of specialty papers.[33] Since that time, it has merged with the International Cellucotton Products Company, which has become the marketer of the company's consumer products; the Peter J. Schweitzer Company, the world's

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[31] Annual Report: 1955, St. Regis Paper Co., pp. 8-11.

[32] St. Regis Paper Company, St. Regis in Brief, New York, 1964. (Mimeographed.)

[33] Kimberly-Clark Corporation, A Brief History (Neenah: Kimberly-Clark Corporation, 1966), p. 4.

leading producer of precision thin papers; and the paper wholesaling firm of Blaker, Moffit and Towne, adding not only diversification to the parent company's product line, but providing entrance into a new market area--the western states. Later, the American Envelope Company and the Neenah Paper Company, a cotton fiber business paper producer were acquired.[34] The sum total of the new additions to the corporate structure has played a major role in helping Kimberly-Clark become one of the most diversified manufacturers of paper and forest products.

At one time the Union Bag-Camp Paper Company, Union-Camp, was basically a bag and paper company. Today it markets a diversity of forest and paper products. Here again mergers played a significant role in the change. In fact, the Union-Camp Corporation was the result of a 1956 merger between Union Bag and Paper Corporation and the Camp Manufacturing Company. The latter began as a lumber manufacturer and did not enter the paper products field until 1936. The combination was quite a natural consolidation, with Camp providing the background in forestry and forest products and Union Bag providing broad knowledge of the paper products field. Moreover, Union was not without extensive land holdings at the time of the merger. In fact, in 1955 the company had nearly one million acres.[35] Four years after the merger, Union-Camp further broadened its product line by acquiring the River Raisin Paper Company which produces solid fibre board and specialty corrugated boxes and now operates as a separate division.[36] "This acquisition added to our [illegible]

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[34]Kimberly-Clark Corporation, <u>Information: 1967</u> (Neenah: Kimberly-Clark Corporation, 1967), p. 14.

[35]<u>Annual Report: 1955</u>, Union Bag and Paper Company, p. 10.

[36]<u>Annual Report: 1960</u>, Union Bag-Camp Paper Corporation, p. 7.

resources a northern mill producing corrugated and solid fibre boxboard entirely from reclaimed fibre. Also included were box converting plants in six important industrial markets in which we previously did not have producing facilities."[37] Another acquisition the company completed was that of the W. T. Smith Lumber Company which was announced first in September of 1965. This enhanced product diversification in that it expanded the company's capacity and enabled it to convert primary mill products into final products used by the ultimate consumer. In addition, the acquisition provided the company with nearly 220,000 acres of prime timberlands, which will be used for the purpose of entering the plywood field. "Technological strides which have made it possible to produce high-quality plywood from Southern pine open up a rapidly growing new market for us."[38] The acquisition enabled Union-Camp to broaden the market base for its Lumber Division.

Throughout the discussion of diversification, the concern was primarily with the concept of product heterogeneity by which the acquiring companies were able to broaden their product mix. Companies which had been characterized as operating primarily in one sector of the industry now found themselves moving into production areas closer to the supplier. The companies were doing this by gaining increased manufacturing capabilities in the area of forest products. It would appear that the companies were not so much trying to effect economies to scale as much as they were trying to overcome the vicissitudes of the markets faced by their products. Perhaps the term "spreading the risk" might better describe one of the most significant reasons for these mergers. In other

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[37]*Ibid.*, p. 6.

[38]*Annual Report: 1966*, Union-Camp Corporation, p. 18.

words, the corporations found themselves in an industry which often as not was faced with capacity outrunning the demand for their products. Thus, prices were in general kept fairly constant. Faced with increasing costs of production, it would seem that one way to overcome these increasing costs would be through the acquisition of the sources of supply. Apparently, this has played an important role as a motivating force behind those mergers just discussed.

Not only have these companies become active in all areas of forest products, but forward integration has enabled them to become active as merchants. The Mead Corporation is an example with its merchant sales representing approximately one-third of the corporation's total sales.[39] The role of merchants has become significant only in the last decade or so. Until say the early 1950's, the function of the merchant was handled primarily by independent paper companies and, in general, the major manufacturers were not significantly involved at this level. On the other hand, as was cited in the case of Scott Paper, though not necessarily unique, the company found its traditional markets being invaded by vigorous new entrants. The competition by the newcomers was of both price and non-price. Thus, the diversity these new entrants enjoyed in their product lines provided them with the ability to shift into those areas which current consumer demand appeared strong. This ability to change has in itself become another strong motivating force behind the merger movement within the industry. The ubiquitous nature that the firms within the industry have assumed has been a most important factor underlying the acquisition of one firm by another in order to achieve greater product heterogeneity.

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[39] Annual Report: 1966, The Mead Corporation, p. 2.

d. Market or Geographical Extension of Production

The preponderance of the mergers covered by this study can be broadly classified as "breadth" mergers. In a merger of this type, the acquiring company is already producing the same products as those being produced by the acquired company. A merger brings about no change in product heterogeneity. However, the emphasis here will concentrate on determining the impact of mergers on market heterogeneity. "In economic theory, it is usual to propose cross-elasticity of demand as a basis for identifying separate markets . . . If cross-elasticity is high, the products are close substitutes and, hence, belong to the same market; if it is low, the products belong to separate market."[40] As a result, mergers are a means of ingress to new market areas when cross-elasticity of demand is high.

The importance of market extension mergers appeared in the 1940's and continues to appear in the sixties. "In the case of paper, the dominant form of acquisition has been the extension of operations into allied fields such as kraft paper and paperboard."[41] This FTC report further states that of the 67 mergers studied in the paper and allied products industry, 71 percent were classified as being horizontal.[42]

Of the mergers studied, the majority were either market or geographical extension. Robert M. Allan states:

> The probability of a successful acquisition diminishes as management moves farther from what it knows best. This suggests that it is appropriate to require that a prospective acquisition "fit" the

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[40]Gort, loc. cit.

[41]Federal Trade Commission, Corporate Mergers and Acquisitions (Washington, D. C.: Government Printing Office, 1947), p. 22.

[42]Ibid., p. 13.

> acquirer, that the acquired and the acquirer have many things in common. This criterion may be satisfied by a similarity in customers, so that skills in marketing and distribution carry over, or by similarities in production technology or in research and engineering.[43]

Thus, it would seem understandable that market extension or geographical mergers would enable the management team of the acquiring firm to better comprehend the operation of an acquired firm which produces similar products.

Merchants play an ever-increasing role in the contribution to the overall growth of a number of corporations. This is especially true of Mead. Mead has utilized mergers to obtain inroads into this area as well as to gain wider geographic outlets for its products. In 1961, the Corporation acquired Beecher Peck and Lewis Papers, Inc. which handles both fine and coarse papers and related items. The significance of this merger was that the acquired firm had been a long-time distributor of Mead grades with a sales force and warehouse facilities in Detroit and Flint. Thereby, Mead gained a direct outlet in this geographic market area. At the same time a half-interest was acquired in the Nolan Paper Company, which handled products identical to those of Beecher, but its products were sold throughout Southern California. The acquisition enabled Mead to construct "A large, highly functionalized warehouse. . . on a strategic industrial location in Los Angeles, to provide West Coast customers the same swift and efficient service as our Jersey City warehouse has been offering East Coast customers since early 1963."[44]

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[43]Robert M. Allan, Jr., "Expansion by Merger," William W. Alberts and Joel E. Segall, eds., The Corporate Merger (Chicago: University of Chicago Press, 1966), p. 104.

[44]Annual Report: 1963, The Mead Corporation, p. 4.

Again, an acquisition was utilized by the company to gain access to a new market area.

The year 1961 illustrates how effective mergers can be in gaining wide geographical distribution of markets. In February of that year, Mead acquired the Chatfield and Woods Company and its subsidiaries. Its eleven locations serve important markets in a region from Nashville to Buffalo. The Dixon Paper Company was added in October with its nine branches serving the Rocky Mountain states. Then, in September, three Iowa companies were acquired.[45] These acquisitions illustrate important trends in the growth of Mead. A statement, establishing such mergers in the pattern of the company's operations and their significance to the future of the corporation readsas follows:

> For 25 years a swelling proportion of our fine paper production has been devoted to "merchant grades," paper for commercial printing, business papers, and similar grades sold through independent paper merchants. These merchants, enfranchised to handle the grades of the Corporation and two of its subsidiaries, Chillicothe Paper Company (acquired in 1955) and Gilbert Paper Co., now number in the hundreds. They represent many other suppliers besides Mead. The loyalty and cooperation of these merchants play an essential role in our fine paper distribution, since about a fourth of the Corporation's total sales are merchant sales. The report states further the role of the other acquisitions: The two Iowa container plants add a significant new dimension to our pattern of container production and distribution. With the exception of the container plant at Fort Smith, Arkansas, . . . Waterloo and Fort Dodge are Mead's only container operations west of the Mississippi.[46]

As a result, these acquisitions helped Mead obtain greater market heterogeneity.

Another company which has turned to mergers as a means of gaining access to new geographical markets is Champion Paper. This company

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[45] Annual Report: 1961, The Mead Corporation, p. 4.

[46] Ibid., p. 5.

has only recently turned to mergers when nearly all such mergers came about during the sixties. As in the case of Mead, merchant sales have become an important aspect of Champion's development. In 1960 two converting companies were added: Buffalo Envelope Company and Montag, Inc., located in Buffalo, New York and Atlanta, Georgia, respectively. "Montag, one of the largest and finest companies in its field, manufactures and markets a line of tablets and stationery, including the BLUE HORSE brand of school supplies so well known in the southwest."[47] Thus, the company gained both diversification of product and markets through acquisition. The relationship with the companies provided Champion with a greater insight into the needs and requirements of this segment of paper converting. This helped the company serve more effectively all of its envelope and tablet customers. Nevertheless, the company sold Montag to Western Tablet and Stationery Corporation within a year. Soon after, the company noted, "Already substantial improvement in the Company's relations with tablet converting customers and consequent increases in tonnage sales of tablet paper have been experienced."[48] It is assumed that the company faced reluctance on the part of other converters to purchase Champion's products as long as Champion was a competitor in the tablet field. A quick exit proved to be a way of regaining the lost sales.

One of Champion's largest acquisitions was completed in 1961 when negotiations with the Whitaker Paper Company were concluded. "Whitaker, one of the oldest and most successful paper merchant distributors in the United States, with sales of about $48,000,000, has its headquarters in

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[47] Annual Report: 1960, The Champion Paper Company, p. 8.

[48] Annual Report: 1961, The Champion Paper Company, p. 4.

Cincinnati, Ohio. It warehouses and distributes a broad range of fine and coarse papers and many other products to printers and other users in the Eastern section of the United States. Whitaker will continue to market paper and other products of diverse manufacturers."[49] The distribution capabilities of the company were greatly enhanced by Whitaker. This is especially significant when coordinated with the distribution capability of the rest of the company, including the Carpenter Paper Company, which was added but a few months earlier. "The acquisition of Carpenter Paper Company, one of the largest and most successful paper merchandising organizations in the world, shifted the Company's balance heavily in the direction of the marketplace."[50] As a result of the two mergers, not only did the company find itself operating over a larger geographical area, but found its corporate function greatly changed. The Distribution Division was soon established as the company's nationwide wholesale paper distribution system consisting of the Carpenter Paper Company in the West, the Whitaker Paper Company in the East, and seven midwest paper merchants companies. The division soon encompassed major wholesale distribution centers in 48 cities, each operating on a regional basis.[51]

Another company gaining a greater density of market penetrations through mergers was the St. Regis Paper Company. In June, 1955, St. Regis acquired all outstanding stock of Pollock Paper Corporation. The company has twelve plants, with sales approximating $35 million a year.

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[49]<u>Ibid</u>., p. 5.

[50]<u>Annual Report: 1961</u>, Champion Paper Company, p. 4.

[51]<u>Annual Report: 1962</u>, Champion Paper Company, p. 6.

This acquisition not only increased product heterogeneity, but resulted in greater market heterogeneity. During the same period, St. Regis added the General Container Corporation and its subsidiaries, having nine plants spread through the northern industrial area from Dubuque, Iowa to Cohoes, New York. Coincidently, the company added new facilities in Chicago and Troy, Ohio. In 1960, through the purchase of Schmidt and Ault, the company gained better access to converters and merchants in the middle Atlantic and northeastern states. The acquisition of modern, well-equipped corrugated box plants in Minneapolis, Minnesota, Jersey City, New Jersey, and Jacksonville, Florida, have broadened the national coverage of St. Regis--adding plants in new areas as well as strengthening the company's position in many market centers of primary importance.[52] Early the same year, the Sherman Paper Products Corporation of Newton, Massachusetts, with plants located in Chicago and Los Angeles, and the Central Waxed Paper Company, a Chicago based firm, were acquired. In general, the majority of the acquisitions which St. Regis completed during the period covered were basically market extension mergers.

Through a number of mergers, each corporation in this study was able to significantly add to its market heterogeneity. On the surface, it is difficult to differentiate between geographical (market extension) and diversification mergers. Frequently the two are inseparable, Nevertheless, certain facets of a merger tend to suggest that one broad category, say market extension, would be more applicable than product extension. Consider a few acquisitions which West Virginia Pulp and Paper Company completed in the late fifties. The company had developed a new

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[52] Annual Report: 1960, St. Regis Paper Company, p. 13.

product, trade marked CLUPAK, and using this product as a base, an extension of the company's converting operations was undertaken and a new department was created to establish a distribution system. To broaden the line of production, the Fulton Bag and Products Company, with factories in New Orleans and St. Louis, along with the factories of Arkell and Smiths, at Mobile and Wellsburg, West Virginia, were acquired. In addition, a factory in Torrance, California was leased for twenty years. This was the company's first actual operation on the West Coast. Virginia Folding Box Company, added earlier in the fiscal year, was already extending its distribution into wider markets. These mergers denote that West Virginia was already producing the product at the time of the merger, and that geography was a paramount issue.

e. Research and Development

Another motivation for acquisition is the desire to gain technical know-how. A large corporation with substantial financial resources may acquire a smaller company which has developed new techniques. Or, the desire may be to bring the research staff of a company into the parent organization. There were a number of these types of mergers within the paper industry. They are considered "negative space" mergers and carry the parent company into areas of production in which it had not previously ventured. Moreover, the operation of the newly acquired firm is unique--there is no comparable activity within the parent company which provides management with anything but limited experience with the new product line.

The best example of a research and development merger is that of Scott Paper Company. In 1965 Scott acquired the Plastic Coating Corporation and the Tecnifax Corporation and its affiliates. "The addition of these companies, with their talented and imaginative staffs, has given added zest to our respective research and scientific programs and has contributed materially to Scott's plans for product diversification."[53] The importance of these acquisitions is the simple fact that these companies make products and serve markets which are entirely new to Scott. "With increased knowledge of these companies gained in the intervening months, we now see even greater promise in their futures than we did at the time of acquisition . . . We are particularly pleased with the number of new product possibilities which they have in various stages of development."[54] Consequently, Scott was able to enter new areas as well as acquire new product lines which were better exploited through the vast resources made available to the parent company.

This represented a unique move on the part of Scott. Scott was characterized as a specialist until the 1960's, and this was truly an unprecedent event. Through the acquisition, Scott became important to the reprographics industry. Along with its subsidiary companies, the acquired corporations possess " . . . a base of technical knowledge and production skills matched by few companies."[55] They make a full range of reprographic products--photographic film bases, a variety of engineering reproduction materials and equipment, office copy paper, offset plate-making systems, and data recording materials. Tecnifax, an acknowledged leader in the diazo field, produces diazofilm, a chemically-sensitized transparent film. It is used with information storage and retrieval

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[53] Annual Report: 1965, Scott Paper Company, p. 1.

[54] Ibid., p. 5.

[55] Annual Report: 1966, Scott Paper Company, p. 5.

systems which makes it possible to condense a truckload of paperwork into a shoebox.[56] Since the company also makes diazo reproduction equipment, overhead projectors and complementary visual aids, Tecnifax serves, as well as creates, markets which are beneficial to Scott's growth.

Through the continuous strengthening of its research and production capabilities, Plastic Coating has become an important producer of photo-electrostatic copying material. A pioneer in the development of photo-electrostatic office copying techniques, the company is a supplier to the convenience copying market. It has also designed and developed one of the most efficient systems now in use for producing electrostatic office offset masters, and has developed a unique covering material known as Kivar which is extensively used on books. The photographic industry provides another rapidly expanding market for its products. Nearly every domestic manufacturer of amateur, commercial and industrial photographic products is a customer--Polaroid Corporation is one of the most important.[57] Thus, it is not difficult to see that mergers based upon research and development are noteworthy in corporate development. Obviously, Scott has entered a growing field which should prove profitable in both the short and long run.

West Virginia also increased its research facilities when it acquired Hinde and Dauch. From this merger several new techniques have evolved; one is the development of improved surface liner board. St. Regis gained a foothold in molded plastics by acquiring all the capital stock of Michigan Panelyte Molded Plastics. Over the intervening years,

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[56]*Ibid.*

[57]*Ibid.*, p. 7.

the new markets served by the acquired company have grown as the utilization of plastics has increased. Champion's packaging division received a tremendous boost in 1962 when the company acquired Dairy Pak Inc., one of the nation's largest producers of milk cartons and packages for dairy foods. The acquisition was motivated partly in order to produce plastic-coated instead of wax-coated milk cartons. Another venture of the company was in 1960 when it assumed partial ownership of the Vaculite Corporation. Some stock is owned by National Research Corporation which, originally, developed the Vaculite process. Technical problems were complex, especially those in the development of a base paper suitable for vacuum metallizing. These were eventually solved by Champion's research efforts. Here the basis of the acquisition was to complement technical know-how, and to enable the company to gain promising future markets.

f. Other Motives for Merging

There are a number of reasons for mergers which fall into categories other than those already mentioned. In addition to domestic market extension mergers, the role played by consolidations in international markets has provided the industry with perhaps its brightest potential. In many cases, paper products enjoyed in America are either unknown or extremely scarce throughout the rest of the world. Unfortunately, many countries look unfavorably on the development of domestic markets by outside interests. Sometimes this problem is alleviated by the acquisition of a domestic producer. The acquiring company gains a valuable asset when local personnel are working for the enterprise. In addition, the channels of distribution already exist. The market is not a totally unknown quantity. And, in many instances, there is less pressure from the host country when existing facilities are acquired, since, for all practical purposes, the status quo appears unchanged.

At one time or another all the companies in this study acquired the facilities of a foreign based paper products company, either directly or through an acquisition completed by a subsidiary. The importance of international marketing is becoming increasingly more significant in overall corporate growth. In discussing Scott's international interests in the 1966 Annual Report, it was noted that the Company's growing involvement in the international market is one of the most exciting new directions which the Company has pursued in recent years. "Since its first investment in an overseas affiliate twelve years ago, the Company's foreign interests have expanded at a rate about three times as fast as its domestic operations."[58] Scott affiliates are located in 13 countries having a market potential of 400 million people. Whereas per capita paper consumption in the United States is well over 500 pounds a year, foreign consumption is only a fraction of that amount, illustrating the potential for growth in these markets. The report also describes the sales growth of these affiliates:

> Last year's sales (1965) by Scott affiliates totaled approximately $100 million, an increase of more than 50 percent in two years. Scott's affiliates, producing more than 200 different paper products, operate 28 paper machines at 18 locations. In nearly all cases Scott shares ownership of the affiliates on a 50-50 basis with nationals of the countries involved.[59]

Scott has built its international activities on the basis of partnership with members of the host country. To understand how Scott developed

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[58] Annual Report: 1966, The Scott Paper Company, p. 13.

[59] Ibid.

these markets, it would be of benefit to review the company's philosophy when it initiated its first foreign association.

Scott's foreign investment program, including the acquisition of foreign companies which would produce and sell products under their trademark, was initiated to enable the company to control quality and trademark usage. The program was started, like the programs of so many other companies, in the mid-fifties when Scott invested in Westminister Paper Company, Ltd., of British Columbia, and in Comparria Industrial de San Cristobal, S. A., of Mexico. "We believe that an effective means of establishing the harmonious and successful operation of a business in a foreign country is by sharing ownership with its citizens. Their own special skills and abilities in the development of local resources and market potential will effectively supplement Scott's experience in research, manufacturing and distribution."[60] This approach is highly commendable; of all the foreign companies with which Scott has become affiliated through 1965, only three were owned entirely by Scott, two of which are in Canada.

Partnerships formed between American business firms and foreign manufacturers have made technical and manufacturing knowledge, developed in the United States, available to countries throughout the world. For instance, St. Regis held several international meetings in Europe for the management, technical, and marketing personnel of their licensee companies. St. Regis also has wholly or partially owned affiliates in 18 countries, with the Republic of South Africa alone having nine such plants. These firms significantly reduce the United States' unfavorable

[60]Annual Report: 1955, Scott Paper Company, p. 2.

balance of international payments. St. Regis is carrying out its program of new investments by its overseas financial reserves, and by borrowing in several foreign capital markets. In addition, the overseas converting companies are large users of St. Regis kraft paper and paperboard (their purchases further aid the international payments program).[61] Moreover, the company has concentrated its foreign development in paper converting and packaging operations, thus adding strength to U. S. exports.

A recent venture of the Mead Corporation affords insight into how a given partnership works. In 1964, Mead joined with Societe Industrielle et Agricole de la Somme (SIAS) to launch a new packaging plant in Paris. It is now Mead-Habermacher, and it is based upon the acquisition of a carton manufacturing firm of long standing in France. "Progress so far has justified our confidence in the new venture, which blends the technology and market techniques learned throughout the years in the United States with the specialized knowledge of the European market contributed by SIAS and our own marketing office in Paris."[62]

Foreign affiliations can smooth entrance into new markets. Kimberly-Clark's venture into Australia demonstrates: a major barrier to expansion in that country was removed when Kimberly-Clark entered into a working agreement with the Australian Paper Manufacturers, Ltd. The agreement allows the company's subsidiary access to an assured supply of the quality materials which it needs to operate. At the same time, the company acquired a controlling interest in Societe Sopalin,

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[61] Annual Report: 1966, St. Regis Paper Company, p. 20.

[62] Annual Report: 1964, The Mead Corporation, p. 10.

a converter of tissue and paper products in France and North Africa. Co-shareholder in this venture is Societe Anonyme de Papeteries Darblay, an established manufacturer of a wide range of paper products. The association further illustrates a typical method employed to enable an American corporation to gain admittance to a foreign market. By combining with another company, usually from the host country, a merger is completed. As in the case of Sopalin, the firm was utilized as a platform from which the acquiring company could launch the sale of its trademarked consumer goods. Thus, Kimberly-Clark was able to gain a foothold in France and Central Europe.

In addition to joint ventures with foreign companies, there were a number of affiliations undertaken as domestic joint ventures. An example is the Georgia based Brunswick Pulp and Paper Company of which Scott and Mead are coequal owners. With the joint control of the two owners, Brunswick has gained access to large sums of capital to refinance its former indebtedness as well as to add to its production capabilities. Thus, the availabilities of Scott and Mead to financial resources has enhanced the future of Brunswick. Another such venture involved the formation of a jointly owned subsidiary by Kimberly-Clark Corporation and J. P. Stevens and Company, Inc., to develop, produce, and market nonwoven materials. Here, though short run returns were not expected to be significant, the combination of Kimberly-Clark's paper making experience with the textile skills and marketing experience of J. P. Stevens and Company, should ultimately make the new company an important factor in the nonwoven field.[63] The joint venture enabled a combination

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[63] Annual Report: 1960, Kimberly-Clark Corporation, p. 16.

of skills to be merged; a new area could be better developed than if the two firms were to act individually.

A joint venture of International Paper Company and the American Cyanamid Company gave International an outlet for its by-products which could be used in the manufacture of a number of products. This provided International with increased knowledge in the area of chemicals. Contributions were made by the research facilities of American Cyanamid as well as by the Arizona Chemical Company, which it jointly owned. The Southern Kraft Division mills, owned by International, are the principal source of supply of the pulp mill by-products which Arizona uses in refining fatty acids, rosin and turpentine as well as a variety of organic chemicals for industrial use.[64] Thus, through the joint venture, a complementary product line was established by International.

Another type of merger is that of two companies whose sole motivation is "good business." In other words, there is a "synergistic effect" when, as a combined unit, the development possibilities seem to be enhanced significantly. It appears that a number of future mergers will follow along these lines. An example is the merger of U S. Plywood and Champion Paper. Although outside the scope of this study, the basic premises underlying the consolidation explain the future path the industry may follow. The two companies were of almost equal stature. Each contributed nearly half of the total pro rata sales. Gene Brewer, one of the chief executives, said, "This is about as close to a 50-50 merger as you can get in corporate life."[65] The reason cited for the

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[64] Annual Report: 1966, International Paper Company, p. 18.

[65] "The Merger That Wasn't Made in Heaven," Forbes, March 15, 1967, p. 46.

merger was that the opportunity was just too good for either company to pass up.[66] During the sixties, both companies had undertaken significant moves to integrate their operations. USP's integration backward into manufacturing and timber propelled it forward toward the paper industry as well. At the same time Champion, having made a number of similar moves, found itself at a point in which it could expand only with the market--the paper market. Thus, both companies began looking for a major merger. "No matter how you looked at it, the two companies seemed made for each other. Their products, though derived from a single raw material, were not competitive and served radically different markets; thus there was no problem with the Justice Department."[67] In addition, Champion had wanted to expand to the West Coast, but could not find the timber base to support its operations. U. S. Plywood's timberlands are concentrated on the West Coast. Since there will be less dependence upon a single market, the newly formed company will reduce varying responses to cyclical influences. And lastly, there will be a greater utilization of the company's timber resources. Since the company can now move into a number of higher value-added processes, such as sawmill operations, the overall economic prospects of the company have been improved. "A basic purpose of the merger is seeing that each tree in the forest is converted to its highest value."[68]

As a result of the merger, the combined assets are $798 million and net sales are $1,036 million, both of which would rank the new

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[66] Ibid.

[67] Ibid., p. 48.

[68] Annual Report: 1966, U. S. Plywood-Champion Papers, Inc., p. 10.

enterprise among the industrial giants. Within the industry, only International Paper would rank ahead of it. In terms of product diversification, there are few companies which could boast of such variety. The importance of the merger, in terms of this study, is the fact that two companies had, so to speak, reached the limit within their own industry. In order to satisfy continued corporate growth, both companies sought out a merger. This move is important--important because it suggests that other companies within the industry will pursue similar mergers.

Truly, mergers have played a significant role in the development of the paper and allied products industry. The reasons underlying the transactions have been numerous. Many times the primary motives seemed to overlap. Nevertheless, the underlying motives of various mergers seemed to emerge which could then be considered as a means of achieving corporate goals. Even though merger activity among the 10 most active acquisitors appears to be waning during the sixties, it would seem that in light of such mergers as Scott Paper with S. D. Warren Company, and U. S. Plywood with Champion Paper that the magnitude of future mergers will be impressive.

CHAPTER V

FORCES RESTRAINING MERGER ACTIVITY

Several forces have served as a restraint upon the merger activity within the paper and allied products industry; even though, it would appear from the earlier discussion that little stands in the way of a proposed merger. Despite the flurry of mergers, there were a number of acquisitions which were ultimately terminated. It has already been noted that Champion Paper acquired Montag in 1960 and voluntarily divested itself of the same company one year later. The result was a brash of sales to other converters.[1] Other such examples of voluntary divestiture of acquired companies will be discussed in this chapter.

On the other hand, the impact of government regulation must be considered to completely grasp the concept of merger restraint. Without a doubt, the role played by governmental regulation has proved to be the major obstacle to unabated merger activity. Regulation together with interpretations by the courts creates a formidable obstacle when one company desires to acquire another within the same industry. The analysis to follow will view various legislative regulations and applicable court cases from the standpoint of their impact upon the paper and allied products industry. The remaining sections of the chapter will deal with other phenomena, such as risk, which have served to either block a given merger, or led to the eventual dissolution of a completed acquisition.

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[1]See p. 110.

Antitrust Legislation

During the economy's development, there have been three periods generally accepted as the most active for merger movements. The first great merger movement occurred during the late 19th century, 1885-1905. The next significant period occurred during the latter part of the 1920's. And the mid-fifties to the present encompasses the last important merger period. Two interesting notes should be made at this point. One: each period of increasing merger activity was prefaced by a new antitrust law with, perhaps, the exception of the first merger era. Second: a depression followed immediately on the heels of these waves of merger activity. With these points in mind, it would be well to turn to a discussion of the development of antitrust legislation which, of late, has become a significant obstacle in the path of mergers.

Antitrust laws were not always considered as an obstacle to growth. Even today, considering the continuous dialogue of the Subcommittee on Antitrust and Monopoly, the relevance of antitrust laws is still widely debated. The Sherman Antitrust Act of 1890 was the first act of this nature passed by Congress. The importance of the Act was that government had reacted to the development of industrial concentration within the private sector of economy; <u>laissez-faire</u> economics was being tempered when the government made one of its first truly significant inroads to the business community.

A brief discussion of some of the sections of the Act will be of value to the analysis. To begin, a few comments from the preface of a study made by Professor William Letwin will be helpful. He states:

> Contrary to its premises, the public does not easily recognize wrongs. Especially in the domain of economic policy, what people eventually come to regard as wrong is often an inevitable by-product

> of arrangements they regard as good and desirable. Contrary to its premises, the legislature does not always execute the will of the people...because it cannot...translate that will into statutes. And finally, statutes do not eliminate all problems.[2]

Professor Letwin points out what many economists will readily admit. The public is often unaware of any problem, and more importantly, the problems associated with legislative doctrine are often such that the cure is often assumed to be worse than the disease. This was exemplified by the Sherman Act. At the time of the Act's passage, the economy was on the upswing; the populace was concerned with a multitude of problems of everyday living, not trusts. Consider briefly the conditions in the meat packing industry which Upton Sinclair presented in his book, The Jungle.[3] Even though the worker might have considered trusts as unsatisfactory business arrangements, there was little that could be done to change the situation. Fortunately, Congress recognized the problem, not because of its impact upon the workingman, but because of the impact on the business community itself. Through cut-throat price competition, the trusts were able to monopolize their markets for their own economic advantage.

Even though there is no unanimity of the interpretations rendered by the Courts involving the Sherman Act, there is, in general, the acceptance of the fundamental premises underlying the Act. First, the statute was written to prevent the exercise and growth of monopoly power. Second, the purpose of the Act was to retain and restore the business

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[2]William Letwin, Law and Economic Policy in America (New York: Random House, 1965), pp. v-xi.

[3]See Upton Sinclair, The Jungle (New York: New American Library, 1960).

practice of free entry and price competition to all industries.[4] In order to achieve these ends, the various sections of the Act were specifically designed to eliminate a number of techniques which are used to restrict and limit competition. Such techniques include trusts and the acquisition of the stock of competing companies. Of the eight sections, the first two were the most significant.

Section 1. "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal."

Section 2. "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and on conviction thereof, shall be punished by a fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."[5]

The courts did little to stop the wave of mergers which continued to sweep the country after the passage of the Act. Given the lack of precise definition of the terms of the Act, the courts moved slowly to forestall corporate acquisitions. In essence, the Sherman Act proved to be inadequate in curbing restrictive business practices. Nevertheless, the foundation for antitrust control had been laid. But the inadequacies were such that by the time of the presidential campaign of 1912, the

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[4]Vernon A. Mund, Government and Business (4th ed.; New York: Harper & Row Publishers, 1965), p. 101.

[5]Committee on the Judiciary, The Antitrust Laws, A Staff Report to the Antitrust Subcommittee, H. R., 88th Cong., 2d Sess., 1965, pp. 1-2.

leading candidates recognized the need for new legislation. Soon after the election of Woodrow Wilson, and under this leadership, Congress passed the Clayton and Federal Trade Commission Acts.[6] There were a number of important sections in the Act, but for the purpose of this study the primary concern was with only one: section 7.

Section 7. "That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in commerce where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition or to restrain such commerce in any section or community or tend to create a monopoly of any line of commerce. No corporation shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of two or more corporations where the effect...may be to substantially lessen competition...or to restrain such commerce... or tend to create a monopoly of any line of commerce."[7] This section further states that the Act does not apply to corporations purchasing stock for investment purposes. Nor will the Act prevent a corporation from creating subsidiary corporations in order to carry out lawful business endeavors.

The purpose of section 7 was to thwart mergers in their utilization of the acquisition of stock. The Sherman Act was basically punitive; the government could proceed against mergers only if a restraint of trade or monopoly was evident. Since a typical merger, prior to 1914, was

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[6]Asher Isaacs and Reuben E. Slesinger, Business, Government and Public Policy (Princeton: D. Van Nostrand Company, Inc., 1964), p. 133.

[7]The Antitrust Laws, p. 6.

completed by acquiring the stock of a competitor, section 7, on the surface, should have proved to be a formidable obstacle to this technique of acquisition. The Act spells out in detail that one corporation may not acquire the stock of another corporation if the effect of the acquisition"...may be to substantially lessen competition...or to restrain such commerce...or tend to create a monopoly..." by such action. Unfortunately, as John Maynard Keynes would say, "There is many a slip between cup and lip." Indeed, this seemed to be the case of section 7, at least until the 1950's.

The corporate minds, particularly the corporate lawyers, noted that the Act said nothing about the acquisition of a firm's <u>assets</u>. Thus, a situation comparable to the opening of Pandora's Box was thrust upon the world of mergers. Problems arose and abounded. There was no exact wording which would eliminate the acquisition of assets of one firm by another, even though the acquisition of stock, prohibited by law in cases where competition would be reduced, had been employed as part of the acquisition. "In the first thirty-six years after 1914, decisions under the Clayton Act appear to have blocked only two industrial mergers."[8]

Numerous reports by the FTC had noted how its activities were hampered in policing mergers. The Temporary National Economic Committee recommended that legislation be inacted to include direct physical asset acquisition as one of the illegal merger techniques.[9] During the late

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[8]Donald Dewey, <u>Monopoly in Economics and Law</u> (Chicago: Rand McNally & Company, 1959), p. 219.

[9]Isaacs and Slesinger, <u>op. cit</u>., p. 143.

1940's the Subcommittee on the Study of Monopoly Power held hearings on antitrust laws. "Armed with subpoena power, this subcommittee has been directed to make a searching inquiry into the present antitrust laws and to report the results of its studies and investigations with such recommendations for legislation as may be deemed desirable," was written as part of the introductory statement made by the Chairman, Emanuel Celler.[10] A witness, Dr. John M. Blair of the Federal Trade Commission, in discussing the monopolization problem, noted that the use of the Sherman Act had been quite ineffective in curtailing monopoly control over the market which results from the concentration of power, through great size, through great power, through the consolidation of the different independent firms into one or a few large corporations.[11] He commented further:

> Today, most of the antitrust cases of the Department of Justice, are cases against this form of action (collusion) by independent producers. There are relatively few actions against the problem of size and power, against the problem of combine....The Federal Trade Commission has absolutely no legal basis whatsoever to support an action against the problem of existing size. And because of the loophole (discussed above), it cannot take effective action against the problem of the increased size through acquisition and mergers... Throughout the years, corporations, by increasing their size and power, have been able to achieve that which was specifically and categorically denied when it accomplished by collusive action among independent producers...the decisions of the Supreme Court in the U. S. Steel case and in the International Harvester case, stating in effect that size and power in and of itself, no matter how great, did not constitute a violation of the law, effectively blocked off vigorous effective dissolution actions.[12]

Thus, the temper of the times was such that, in 1950, Congress amended section 7 with the Cellar-Kefauver Act. The new section reads as follows:

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[10] Study of Monopoly Power, Hearings before the Subcommittee on Study of Monopoly Power, 81st Cong., 1st Sess., pt. 1, 1949, p. 1.

[11] Ibid., p. 193.

[12] Ibid., pp. 194-195.

"Section 7. That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."[13]

The Celler Amendment has further extended the coverage of the Act to bring under its jurisdiction all types of mergers--vertical, market extension, conglomerate--instead of the basically horizontal types, just so long as the effects of the merger lessen competition in any market: product or geographic.[14] Nevertheless, the issue remains clear that in order to challenge any merger or proposed merger, the government needs only to show that the "probable" effect of such a combination will tend to lessen competition substantially. The courts, it is evident, will have to decide on a case-to-case basis whether the merger or proposed merger will result in the claimed probable effect.

No matter how arbitrary it may appear, there are certain factors which usually exist before a merger is challenged. Professor Sumner Marcus notes that the Department of Justice, charged with the responsibility for enforcing the merger law, has used, at one time or another, the following criteria in determining whether or not to challenge a merger:

1. The market share of the firms involved in the merger.
2. The level of concentration in the market--before and after the merger.
3. Whether the merger will give the resultant firm "some competitive advantage which may be decisive."

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[13]The Antitrust Laws, pp. 6-7.

[14]Isaacs and Slesinger, op. cit., p. 144.

4. Whether the firm being eliminated is a "particularly vigorous competitor."
5. Whether there has been a recent trend of mergers on the part of the firm or its industry.
6. Whether there is substantial danger that the merger will trigger others.
7. The economic power of the merged companies.
8. Whether entry into a market is difficult.
9. Whether demand for the industry's product is increasing.[15]

However, the Justice Department does not frequently challenge mergers. But the concern here is more with how a given merger will be regarded by the Federal Trade Commission since, as noted earlier, the complaints instituted by the FTC far out-weighed those brought by the Justice Department.

Mergers Challenged by Government Agencies

"Here, as under the Sherman Act, the relevant market must be defined. And here, as elsewhere under the Clayton Act, the impact of the law depends upon the meaning given by the enforcement agencies and the courts to the words 'may,' 'substantially,' and 'tend.'"[16]

Relevant Market

In Chapter III, the acquisitions which were challenged by the Federal Trade Commission and the Department of Justice were listed.[17] In fact, there were 6 and 2 acquisitions challenged respectively by these agencies. The majority of the FTC complaints came during the mid-1950's. The Justice Department complaints involved a merger by Kimberly-Clark in 1962, and one by West Virginia in 1960, which apparently would lessen competition within the relevant markets served by the merger.

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[15] Sumner Marcus, Competition and the Law (Belmont: Wadsworth Publishing Company, Inc., 1967), p. 33.

[16] Clair Wilcox, Public Policies Towards Business (rev. ed.; Homewood: Richard D. Irwin, Inc., 1960), p. 154.

[17] See pp. 89-93.

It should be noted here that the utilization of the consent decree, or consent order, has gained in acceptance; as a consequence, the need for carrying the complaint through a number of courts is often eliminated. The business community has apparently realized that section 7 has truly become a powerful antitrust weapon which can be used effectively against mergers. As a result, more companies are turning to appropriate governmental agencies prior to the formal merger agreement in order to determine the acceptability of the proposed merger as viewed through the eyes of the regulating agencies. One factor that has encouraged this approach is the courts themselves. For instance, a series of court litigations may well take a decade, perhaps longer, before the case is ultimately settled by the Supreme Court. If the complaint could be nipped in the bud by asking for an opinion prior to the completion of the merger, lengthy litigations could possibly be reduced. Consider the case involving Crown Zellerbach. The FTC complaint was issued in the early part of 1954, with the Supreme Court denying <u>certiorari</u> in 1962. By this time, the acquired facilities had, in a sense, become an integral part of the acquiring company. "Since St. Helens was bought in 1953 and fully merged into Crown Zellerbach by 1955, the question arises whether or not the assets of the two companies can be unscrambled to make divestiture feasible."[18] This problem was such that even the FTC was trying to avoid the complicated unscrambling process by asking Congress for the authority to seek court injunctions against those mergers pending the FTC's determination of their legality.[19]

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[18] <u>Paper Sales</u>, April, 1957, p. 10.

[19] <u>Ibid</u>.

It was mentioned above that the FTC challenged the merger between Crown Zellerbach and St. Helens. The case was one of the first mergers to be challenged under the amended section 7. Furthermore, it was not settled by a consent order, but rather it was one of the few litigated cases involving alleged antitrust violations. In fact, the case was the first anti-merger case involving the paper industry, which was to reach an appeals court.[20]

The complaint was issued on February 15, 1954. The decision by the FTC was rendered December 26, 1957, nearly four years after the initial complaint had been filed. The hearing examiner had found that the acquisition of St. Helens by Crown Zellerbach had the effect of substantially lessening competition and tended to create a monopoly in the relevant line of commerce. This was in violation of section 7 of the Clayton Act, as amended.[21] At the time of the merger Crown Zellerbach's net sales were $253 million, and St. Helens had net sales of approximately $9 million. The merger was completed through an exchange of stock which was valued at approximately $9.6 million. Since the hearing examiner had found against the merger, Crown Zellerbach (sometimes referred to as Crown) cited three primary arguments in the appeal which were as follows:

1. That the line of commerce is trade coarse paper rather than census coarse paper as determined by the hearing examiner;
2. That the appropriate section of the country is the Nation, or at least the area west of the Mississippi River rather than the 11 Western States as determined by the hearing examiner; and

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[20] Paper Sales, August, 1959, p. 9.

[21] 54 F.T.C. 769.

3. That the acquisition of St. Helens does not have the potentiality of adverse competitive consequences prohibited by section 7.[22]

Thus, two basic issues must be resolved: the relevant market and the competitive aspects of the consolidation. As to the first issue--relevant market--the Commission found:

> In 1952, 85 percent of St. Helen's domestic sales were in the 11 Western States. The Pacific Coast States alone accounted for 88.7 percent of its sales within the 11 Western States and 75.4 percent of its sales in the United States. Respondent also sold 80 to 85 percent of its products comparable to those produced by St. Helens in the 11 Western States with the greater portion being sold in the Pacific Coast States.[23]

The Commission noted that factors such as the preferences of purchasers and the high cost of shipping over long distances resulted in the effective separation of the Western States from the rest of the country. "The relevant market here is a substantial market."[24] The industry's total production of coarse papers in the West was 455,934 tons which was shared among the various western producers as shown in Table 28. Crown Zellerbach was by far the most significant producer with St. Helens ranking as the fourth largest producer at the time of the acquisition. The Commission considered that a combined total of 62.5 percent of western production constituted a predominant share of the market, in spite of its relative isolation. On the other hand, the Commission noted that Crown, St. Helens, Longview, and St. Regis, in combination, produced 93.9 percent of the total in 1954. "Of the four, only Crown, St. Helens and Longview Fibre Company sold a relatively broad line of wrapping papers,

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[22] *Ibid.*, p. 799.

[23] *Ibid.*, p. 802.

[24] *Ibid.*, p. 803.

TABLE 28

COARSE PAPER PRODUCTION,
IN THE WEST, BY COMPANY
1954

Company	Production (Tons)	Percent of Total
Crown Zellerbach Corp.	242,539	53.2
Former St. Helens	49,317	10.8
Longview Fibre Co.	80,108	17.6
St. Regis Paper Co.	6,068	12.3
Oregon Pulp & Paper Co. and Columbia River Paper Co.	14,540	3.2
Publishers Paper Co.	6,929	1.5
Potlatch Forests, Inc.	4,990	1.1
Inland Empire Paper Co.	681	.1
Fibreboard Products Co.	81	
Simpson Paper Co.	377	.1
Weyerhaeuser Timber Co.	304	.1
Total	455,934	100.0

Source: 54 F.T.C. 769, p. 802.

bag papers and allied papers which was of particular importance to the jobber trade...Longview Fibre Co., while it produced and sold a relatively broad line, converted a substantial portion of its production and sold jobbing papers to only three jobbers."[25] Thus, the FTC concluded that there were two immediate results from the acquisition. First, a fully integrated competitor having its own timber reserves, pulp manufacturing and converting facilities as well as having fully developed trade outlets was eliminated. Secondly, the size of Crown Zellerbach was significantly increased in the relevant line of commerce in which it already had a commanding lead. It was further noted in the opinion that jobbers must

[25] _Ibid_.

have a dependable source of supply of a wide range of papers in the relevant line, to be competitive.

> Very few producers in the West supplied a substantially broad line of such papers, and supplies outside the West were generally unreliable sources, particularly in times of paper shortages. Clearly, with the elimination of St. Helens, western jobbers generally have been severely restricted as to sources from which the relevant papers may be purchased. It likewise appears that many converters which formerly could look to St. Helens for purchases of the relevant papers must now depend upon Crown as a primary source of supply, a company which is a major competitor since Crown converts a substantial share of its production.[26]

The Commission added that there was little evidence that the competition which St. Helens had provided would be effectively replaced in the foreseeable future. Nor would possible entrants produce the broad line of papers needed to supply the jobbers and converters, nor would they provide the extra services that had become customary from St. Helen's mills. "Under the circumstances, it does not appear that new entrants will measurably offset the lessening of competition apparent in this record."[27] Thus, the opinion of FTC was ". . . that the effect of this acquisition may be substantially to lessen competition or tend to create a monopoly in the relevant line of commerce. . ."[28]

The last issue involved in the case was the respondent's argument that the order of divestiture cited by the examiner was unreasonable. It was argued by Crown that new machinery was added and that improvements to St. Helens' property were completed, totaling approximately $14 million. Therefore, since the property had been substantially added to or improved, it would be unreasonable to attempt to disjoin the two companies. The

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[26]*Ibid.*, p. 804.

[27]*Ibid.*

[28]*Ibid.*

Commission rejected this line of reasoning by noting that ". . . clearly, the broad purpose of the statute cannot be thwarted merely because respondent has commingled its own assets with those of the acquired firm."[29]

In essence, the Commission supported the hearing examiner, and the stage was set for judicial review. The decision was appealed, and reached the circuit court in 1961. The Court again was asked to consider the acquisition as one which would substantially lessen competition, or tend to create a monopoly in the lines of commerce. The relevant market was accepted as a three-state area in which Crown's market share was determined to be about 51 percent in production, as well as sales, in dollar values. St. Helens accounted for 12 percent of the production and 11 percent of the sales. To decide the relevancy of these figures the Court turned to the Interstate Commerce Commission, which showed nearly 90 percent of wrapping paper and bags were shipped from Pacific Coast mills. It was noted that Longview, the second largest producer, sold 85 percent of its products to Blake, Moffitt, and Towne, which was to be acquired by Kimberly-Clark in 1961. The Court found that prior to the merger Crown produced 57.2 percent of the total tonnage of wrapping paper in the West, whereas St. Helens produced 21.3 percent. After the merger the combination produced 77.6 percent of the total. Such a predominance of production appears to be not only a threat to possible competition, but as the Court noted, the situation would appear to approach monopoly proportions. But, the issue was not the mere possibility of lessening competition. It was the indication that competitors would be hurt. Furthermore, although the merger might be intended to increase efficiencies, the Court considered

[29]Ibid.

the design of the law to be to avoid an increase in the relative size of the market of the acquiring firm, if such an increase would threaten its competitors. It is noteworthy that the Court's concern was with competitors, not consumers. Since the jobbers now had to turn to Crown, the inference was that competition was threatened because no contradictory testimony was cited.[30]

On the other hand, Crown argued that potential new entrants should be taken into consideration when a comparison of Crown's position with other competitors was made. The court rejected this argument because it could not allow a merger which would ordinarily be prohibited, just because there might exist prospective entrants to the market that would offset the consequences of the merger.[31] It is interesting to note that earlier both the Court and Commission stated that the merger would probably substantially lessen competition. Yet the probability that entrants would provide competition was rejected as a defensive argument for the merger.

The Circuit Court upheld the Commission. After the merger, the relevant market share was considered as being too large; it would probably be a potential threat to the other competitors. Crown Zellerbach appealed to a higher court, but as noted earlier, the Supreme Court denied _certiorari_. Divestiture was completed in 1964, and the commingled assets were divided.

Impact on Competitors

At the time that the original complaint against Crown Zellerbach was being decided by the FTC, the stockholders of International Paper,

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[30] 296 F2d 800.

[31] _Ibid_.

Long-Bell Lumber Corporation and Long-Bell Lumber Company approved a plan to merge. This was November 5, 1956. The next day the FTC filed a complaint charging that the acquisition by International was in violation of section 7 of the Clayton Act. The FTC turned to a Circuit Court, asking for an injunction to stop the acquisition. The injunction was necessary because the Commission considered it impossible to separate assets of the companies if, after a formal hearing, it is found that there has been a violation of the Clayton Act. Here, the issue was initially whether or not the FTC was entitled to an injunction.[32]

The Court noted that there is a dual scheme of enforcement of the Clayton Act. One is enforcement by a cease and desist order of the FTC, and the other is enforcement by suits in equity which are instituted by several district attorneys in their districts. These specific provisions as to who may seek injunctive relief, and in what court, implies that the Commission itself is not authorized to do so. The Court implied that this Court--Circuit Court--acquires jurisdiction to review only after there has been a formal hearing on the charges. The Clayton Act clearly recognizes that this Court has no fact finding powers; thus, if the FTC desires an injunction, it must go to a District Court. In addition, the opinion of the Circuit Court noted that the Act did not allow the Commission to ask for an injunction to maintain the <u>status quo</u> during the proceedings of the Commission. And if the Commission had no authority to seek an injunction, it is clear--in the opinion of the Court--that it had no power to grant the Commission such relief.[33]

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[32] 241 F2d 372.

[33] <u>Ibid</u>.

Once more the Commission had challenged an acquisition which, over a period of time, would pose serious problems of divestiture if there should be an antitrust violation. Since the Commission's request for an injunction was refused, the FTC pursued its complaint--issued November 6, 1956. At the time of the merger, International ranked as the world's largest paper company.

> Its capacity to produce paper and paperboard is more than three times as great as its largest competitor. It is now and for many years has been the price leader of the paper and paperboard industry. It is the leading producer of kraft board and ranks as a leading manufacturer in newsprint, dissolving pulp, book and bond papers, kraft papers, ground wood and towel papers...is also one of the largest owners of forest-land in the United States.[34]

The company is a fully integrated paper company, having mills in 20 states which are utilized in the manufacture of its various products. During the six-year period from 1950 to 1955, its net sales increased from $498 million to $796 million, an increase of 59.8 percent.

> Prior to and since November 5, 1956, respondent has been and is now engaged in substantially every facet of the paper and paperboard industry; it has produced and is now producing virtually all types of pulp, paper and paperboard, and also converted products from paper and paperboard.[35]

The Long-Bell Lumber Corporation was a holding corporation whose assets consisted of cash and 51 percent of the stock of the Long-Bell Lumber Company. Both had their main offices in Kansas City, Missouri. Long-Bell Lumber Company (which will be referred to as Long-Bell) and its subsidiaries substantially operated in every phase of the lumber industry from ownership of standing timber, to the operation of retail building supply yards. It also ranked as the second largest producer of

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[34]53 F.T.C. 1192.

[35]*Ibid.*, p. 1194.

lumber in the Pacific Northwest as well as being one of the leading producers of plywood. It owned and operated 100 retail lumber yards and 6 jobbing establishments. The company's sales for the six-year period, 1950 to 1955, grew from $102 million to $106 million.[36]

The terms of the above merger called for an exchange of stock in which Long-Bell would receive 900,000 shares of International. The approximate value of the International stock to be exchanged was $117 million. International proposed to build additional facilities to produce pulp, paper and paper products which would primarily utilize the timber assets of Long-Bell. The proposed construction of a kraft mill in Oregon would be International's first facility for the production of paper and paperboard in this western market.

The Commission considered that the effect of the acquisition might substantially lessen competition, or tend to create a monopoly in the lines of commerce in which the companies were engaged. Specifically, the complaint stated these possible or actual effects:

1. May substantially lessen competition in the western states by foreclosing the probable entry of Long-Bell, as well as other potential entrants into the paper industry and also lessen the opportunities for existing paper companies to expand.

2. May substantially lessen competition in the western states by reason of leverage which may be excited by the utilization of the large natural and financial resources and the extensive operations now has in other markets.

3. May substantially lessen competition in the western states by resulting in the entry into that market of a seller which is unlikely to engage in price competition.

4. May substantially lessen competition or tend to create a monopoly by the increase of International's share of the country's production for various paper products and thereby substantially lessen the proportion held by competitors.

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[36] Ibid., pp. 1194-1195.

5. May substantially lessen competition or tend to create a monopoly in the nation as a whole by the increase of the present dominant position of International in the paper and paperboard industry.[37]

These were the contentions of the Commission, charging International with increasing its present dominant position in the paper and paperboard industry by the acquisition of Long-Bell, which would tend to substantially lessen competition or to create a monopoly in commerce, violating the antimerger provision of section 7 of the Clayton Act.[38]

Approximately six months after the complaint was issued, "Respondent, its counsel, and counsel supporting the complaint entered into an Agreement Containing Consent Order to Divest and to Cease and Desist, which was approved by the Director and the Assistant Director of the Commission's Bureau of Litigation, and thereafter submitted to the Hearing Examiner for consideration."[39]

International, in essence, admitted all the jurisdictional facts alleged, and agreed that the record might be construed to mean that jurisdictional facts had been duly made in accordance with these allegations.

> The order contained in the agreement does not require the Respondent, International Paper Company, to divest itself of the assets of the Long-Bell Lumber Corporation or the Long-Bell Lumber Company, which it acquired in 1956. It does, however, require Respondent to divest itself of all the stock in the Longview Fibre Company, which it acquired through the acquisition of the Long-Bell Lumber Company.
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> In support of the proposed order submitted in the agreement, counsel in support of the complaint state that in the light of all the circumstances of which they are aware, the order will afford the public immediate and adequate relief, and competition will be well served thereby.[40]

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[37] _Ibid._, p. 1196.

[38] _Ibid._

[39] _Ibid._

[40] _Ibid._, p. 1198.

The Counsel for International also pointed out that the order which would prohibit future acquisitions would assure a source of supply for smaller non-integrated converters and wholesalers. Moreover, this would allow competitors at various levels ample time to reappraise the market and to plan their future development. The hearing examiner accepted the terms of the Consent Order and found that the proceedings were in the public interest. The hearing examiner, thus, ordered divestiture of all the stock in Longview Fibre Company, and for a period of ten years, International was not to acquire any interest in any paper or paperboard mill located in any present state of the United States which competed with any of International's mills. Nor could International acquire interest in any plant located in any state which produced products either made or converted from paper or paperboard, or which competed with any plant owned by International. In addition, International was required to sell 40 percent of the paperboard tonnage produced at the mill to non-integrated converters, non-integrated wholesalers, and other non-integrated purchasers in the 11 Western state areas. The same restriction was placed upon the proposed mill in the Pacific Coast area. The Commission stated that the decision of the hearing examiner would become the decision of the FTC.[41]

There are a number of observations which are relevant to the above case. Initially, it provides an insight into the workings of a consent order which is characteristic of the handling of the majority of cases by the FTC, involving the paper industry. Moreover, International was required to divest itself of Longview Fibre Company. During the

[41] Ibid., p. 1200.

previous discussion of the Crown Zellerbach acquisition of St. Helens, it was noted that the potential entrance of new firms was not significant enough to allow increased competition. Now it is realized that at the time the third largest paper producer--St. Helens--was being acquired by Crown, International was picking off the second largest producer. At the same time there developed the very interesting possibility with Crown taking over St. Helens, and International gaining access to the Western market through its acquisition of Long-Bell, that there would be substantial competition for Crown Zellerbach. Nonetheless, the Commission, by approving International's acquisition of Long-Bell, opened new sources of supply to the western states. Still, the question of size becomes evident when the Commission, noting Longview was a competitor of International, disallowed this aspect of the consolidation.

Lastly, it would be well to point out that the opinion rendered here has definitely affected the role of merger activity on the part of International. In Chapter III it was observed that International completed 16 mergers during the period 1950-1965. More importantly, the preponderance of these acquisitions were brought about by International's foreign subsidiaries. Tentatively, it may be considered that the Commission views an acquisition by International as tending to lessen competition in any area in which International has any manufacturing facilities. Since International must have such mergers approved beforehand, it is not surprising to find that the role which mergers have taken by the company is that of placing the emphasis on foreign ventures. In summary, the decision rendered in this case did influence the acquisitive spirit of the corporation. Perhaps the entire industry gained an insight into the fact that divestiture would not be ordered solely because integration of facilities had been achieved.

The case involving the acquisition of three companies by Scott Paper was significant in that it provided further knowledge concerning the impact of a merger on competitors. After issuing the complaint, the FTC turned the case over to a hearing examiner. The hearing examiner found that there was insufficient evidence to support the alleged violations, and he ordered the case dismissed. However, the counsel supporting the complaint appealed to the Commissioner by requesting an order to vacate the initial decision to be issued. In reviewing the initial decision, the Commission noted that the hearing examiner failed to consider a number of significant points. As a result, the decision was vacatdd, and the case was remanded to another examiner.[42] Commenting on the case, Paper Sales reported that the dismissal of antitrust chargers filed against Scott Paper Company were recommended for the second time by the hearing examiner. Several months before, an examiner had ruled that the FTC had no case; overruled by the Commission, another examiner again found that the case had not been proven. "Attorneys in charge of the complaint said that the acquisition resulted in Scott's increasing its share of the national paper market. The examiner held, however, that there is no such thing as a national market, only many local markets in which Scott has strong competition from local manufacturers and distributors."[43] Once again the issue of relevant market becomes important. In the Crown Zellerbach case, for instance, the

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[42] 56 F.T.C. 2050.

[43] Paper Sales, March, 1960, p. 5.

definition of relevant market as being the United States, in general, was rejected by the court. Here, the case involving Scott differs from the others in the fact that the Commission based its complaint of Scott's acquisition on the fact that the tendency to monopolize the lines of commerce, and substantially lessen competition, involved national markets.

Scott's first acquisition, in 1951, was that of Soundview Pulp Company, a producer of bleached sulphite pulp. It did not produce any paper products. However, the pulp mill was the largest mill of its kind in the world. "Immediately following the acquisition, Scott was able to obtain pulp at a manufacturing cost of $77.50 per ton in contrast to Soundview's market price of $139.77 per ton."[44] This would represent a potential savings of $12 million per year based upon 1951 costs and selling prices. Moreover, after the acquisition Scott made extensive capital improvements. In fact, the capital additions and improvements at Soundview from the time of acquisition through 1958 amounted to nearly $50 million. Considering the aggregate merger value was approximately $60 million, the capital improvements Scott made were substantial.

In 1953, the second firm, Detroit Sulphite Pulp and Paper Company, was acquired for an aggregate market value of approximately $11 million. The company primarily manufactured paper stock, but no consumer products. Prior to the merger, Scott had purchased Detroit's entire output of wax base stock--the only product made by both companies. In all, Scott, the year before the merger, purchased 53 percent of Detroit's overall production. Again, after the merger, Scott made substantial capital improvements--valued at over $11 million from the time of the merger through

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[44] 57 F.T.C. 1417.

1958. The total expenditures were approximately equal to the purchase price.[45]

The third acquisition was Hollingsworth & Whitney Company which was acquired by the issuance of 770,000 common shares of Scott, valued at $38 million. Of the products Hollingsworth produced, none of the finished products were sold by Scott; nor did Scott produce or sell any of the products made by Hollingsworth. Here, too, Scott made extensive improvements and additions, the total cost of which was approximately $48 million.[46]

"The section of the country in which the effects of the acquisitions should be measured is the entire United States, that is, the national market. The industry's products are used in all sections of the country."[47] Scott sold its products nationwide as well as conducting national advertising. However, the fact that Scott's competitors confined their sales to one or more areas did not signify that an effective nationwide area of competition was nonexistent.

To illustrate Scott's dominant position, the Commission noted that Scott did not make paper napkins in 1953; yet by 1955, the company was the second largest producer of napkins. "The respondent's ability to successfully penetrate the paper napkin market in such a relatively short time attests to the high degree of market control which it had achieved."[48] The Commission added that in 1950 Scott was the dominant

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[45] *Ibid.*, p. 1420.

[46] *Ibid.*, p. 1421.

[47] *Ibid.*, p. 1422.

[48] *Ibid.*, p. 1423.

producer in the sanitary paper products industry, a position which the company has since enhanced. Having purportedly established Scott's dominant position, the Commission then turned to pricing policies. Being the dominant firm, it was very interesting to note that Scott had maintained relatively stable prices over the period in question. It seemed that Scott was the antithesis of what would be expected from a company enjoying such status. By this, it seemed that Scott was causing the marginal or less efficient firms to maintain prices at lower levels than would exist, had Scott not entered the market. It was especially interesting that the Commission seemed to be concerned, not with the consumer, but with other competitors.[49] The inference here appeared to be that had Scott allowed the price of sanitary paper products to increase, the Commission would have favorably viewed its merger program. Whether or not market power, attributable to size, was utilized was no longer the problem. Rather, the mere enjoyment of the dominant market position became relevant in terms of having the potential ability to exercise such power. The regulatory agencies as well as the courts seemed to

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[49]The following excerpts from certain documentary exhibits were used by the commission to illustrate Scott's pricing program. Quoting a Scott official, the statement on p. 1424 of the decision read:

We are extremely proud of our record in maintaining the general level of prices of Scott trade-marked products in the fact of rising costs. Our selling prices are based primarily on manufacturing costs, with due allowance for promotional expenses, dividends to our shareholders and the retention of reasonable amounts of earnings for expansion purposes.

Our prices have not moved up since 1951--more than 4 years ago--despite ever higher wages and material prices.

You could logically ask why don't we do something about it--why not move prices up, since other arms of the paper industry have? Well, our efforts to broaden our markets, to sell all the new capacity we have developed, we feel a price increase would be a deterrent--not a help. There would be no point to higher prices which slowed down sales and piled up inventory, or conversely required additional promotional dollars which would offset the price increase.

have turned their emphasis toward the implication of the potential ability to control the market situation, regardless of the fact that the actual use of these economic powers were never employed by the companies involved. Or, as in this instance, these economic powers were used in a way favoring the consumer, not competitors.

Here, the Commission emphasized the fact that since the time of the acquisitions Scott had enhanced its market position. Also it was noted that more and more of the total production of the acquired firms went into Scott's trade-marked products. However, this seemed logical, given the capital improvements that were discussed earlier. "The acquisition also afforded production and marketing economies and other advantages which could be reflected by the respondent in price, advertising, promotion or profit."[50] Again the Commission is suggesting that the economies gained will lead to a lessening of competition between Scott and its competitors.

> As a result of the acquisitions, the respondent's market shares have increased substantially over their prior high levels. In short, the challenged acquisitions have decisively strengthened the respondent's ability to compete and each has compounded its capacity to exert the power inherent in its dominant position in the line of commerce for sanitary paper products and household wax paper.[51]

The Commission stated that the effects of the challenged acquisitions may be to substantially lessen competition, and thus, ordered divestitures of the acquired properties.

Lastly, there were other allegations against Scott for having violated the Federal Trade Commission Act, which were:

> They allege that the respondent's constant and continuous acquisition of companies engaged in the pulp and paper manufacturing

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[50] _Ibid._, p. 1427.

[51] _Ibid._, p. 1433.

> industry, together with their conversion to the manufacture of sanitary paper products by Scott as the dominant producer of such products, has been to the prejudice and injury of the public and constitutes an unfair method of competition...[52]

However, this aspect of the complaint was dismissed because the Commission noted that there was not adequate support in the record. Once again, the question was one of emphasis--the consumer, the public, or the competitor. Economic theory, in general, strongly emphasizes the role of the consumer as being the most vital factor; yet the regulatory bodies dwell at great length on the role of the competitor.

Scott appealed the decision, and in 1962 the lower court decided the issue of whether or not Scott had violated section 7.[53] The Court found that the Commission had based much of its argument on a survey showing Scott's shipments of various product lines in 1950 and again in 1955, noting the percent of the market these shares represented. The Commission said that the acquisitions resulted in Scott being able to increase its market share in all but one of the markets cited. Scott contended that the survey did not support the contension that the increased market share was a result of the acquisitions. The Court sided with Scott. The case was remanded once again to a hearing examiner for additional evidence. The issue was resolved in 1964 by a consent order in which Scott had to divest itself of some paper making machines.[54] In general, the case provided another opportunity to gain an insight into the ambiguities of determining how competitors in the relevant market were affected by specific mergers.

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[52]Ibid.

[53]301 F2d 579.

[54]See Figure 3.

There was one other section 7 violation which will serve as an illustration of a violation involving purchases of large shares of stock in a competing company. The case involved Union Bag and Paper Company when it purchased a substantial block of the common stock of the Hankins Container Corporation. Coupled with the shares that Union had previously acquired, Union would now control two-thirds of the authorized and outstanding stock of Hankins.[55] Both firms manufactured corrugated boxes and sheets. "For many years, respondents Union and Hankins, by virtue of their business and location of operation, have been, and now are, competitors, so that the elimination of competition by agreement between them would constitute a violation of a provision of the antitrust laws."[56] The agreement entered into by the two firms briefly set forth the following conditions:

"1. Union would not acquire the stock, or any part of the stock, of a box manufacture in Hankins market area;

"2. Container board sales by Union had definite minimum and maximum quantities of liner board and corrugating medium which could be sold for a 15-year period;

"3. Each agreed to buy certain products from bhe other, and limited similar purchases from other suppliers at fixed maximum quantities; and

"4. Prices paid by Hankins for container board were not to be higher than in effect of the largest suppliers in the domestic market.[57]

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[55]52 F.T.C. 1278. ([illegible]).

[56]Ibid., p. 1287.

[57]Ibid., pp. 1282-1284.

In essence, these were tying arrangements between the companies. When challenged by the FTC, the respondents admitted all the jurisdictional facts alleged, and agreed to a consent order which was issued approximately one year after the complaint. In brief, it was ordered: "... forthwith the companies must cease and desist from any planned common course of action. And Union must limit its control of Hankins to only a 9 percent stock interest. Also, Union could not vote its stock, or have a director on Hankins board."[58] Thus, the presence of directors serving on both boards would be ended.

These cases have traced the important development of antitrust laws and its pertinence to mergers in regard to the paper industry between 1950 and 1965. From which two important factors keep appearing in each merger case: the definition of the relevant market, and the impact on competitors within that merger. It was significant that Crown Zellerbach could not use the entire domestic market, providing potential competitors, in its defense. But rather the market area was defined as the Western states. On the other hand, Scott's dominance in the national market was the basis for the complaint brought against it. When the issue was discussed in terms of regional markets, the issue of competition was far from lacking. Lastly, it was noted that the relationship of a merger with regard to the ultimate consumer was not relevant (as in the acquisitions of Scott Paper). It would now appear that section 7 of the Clayton Act, as amended, has become an important obstacle to be overcome given the acquisitive spirit which seems to prevail among the firms in this study.

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[58] Ibid., p. 1285.

Possible Effects of Pending Antitrust Cases

The cases discussed in the preceding section have been settled by either consent orders or judicial review. However, there are a number of cases pending in which no decision has been rendered by the end of 1965. These cases are important in that they may well suggest the manner in which future acquisitions may be controlled by the regulatory agencies. An example of one such case which has yet to be decided involves an FTC complaint against St. Regis.[59] The importance of the case rests upon the fact that the Commission does not challenge one, two, or even three acquisitions, but rather that the complaint is lodged on the basis of 15 acquisitions dating from 1954 through 1960. The total sales of the 15 companies prior to their acquisition is approximately $150 million.[60] The firms all produce paperboard and converted paperboard products in varying degrees. The significance of the complaint is not so much a question of relevant market, or even the percentage share of the relevant market controlled by St. Regis. Rather, the issues are the number of acquisitions and the time period. The case involves an eleven-year period between the time the first merger was completed and the complaint issued. Assuming the case is ultimately resolved by the Supreme Court, twenty years may have elapsed. Attempting to achieve dissolution may indeed be a formidable task.

As to the issue of the number of acquisitions encompassed by a complaint, the Commission, apparently given encouragement by the courts, seemed to be approaching various types of mergers *en masse*. For example,

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[59]Betty Bock, *Mergers and Markets: An Economic Analysis of the First Fifteen Years Under the Merger Act of 1950* (New York: National Industrial Conference Board, 1966), p. 243.

[60]*Ibid.*, p. 244.

there were six new merger complaints issued by the FTC in 1965 in which the acquiring firm had merged with three or more companies, all of which were cited in the complaint.[61] Moreover, of the six complaints, three were against paper companies--St. Regis, Mead and Champion. The complaint against Mead cited 14 acquisitions; acquisitions which, for the most part, involved producers of container board, corrugated and solid fibre products. Even though the Commission was challenging only three of the acquisitions made by Champion, the combined sales of these three acquisitions was approximately $150 million.[62] Consequently, in three complaints, 32 acquisitions representing approximately 18 percent of the mergers and acquisitions covered by this study, were challenged. The final disposition of these cases will have a definite bearing on the future merger direction to be taken by members of the industry.

The relative market in two of the above complaints is the production of container board and the shipment of corrugated products in the United States. It is interesting to note that prior to the series of mergers undertaken by Mead and St. Regis that each has controlled 6 percent of the container board market and 5 percent of the shipments of corrugated products.[63] Thus, the Commission views competition in the relevant line of commerce as being substantially lessened because of these acquisitions.

Hence, it may be safe to assume that any and all mergers completed from 1950 to date could be lumped together and challenged by the FTC.

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[61] *Ibid*. See also pp. 245-255.

[62] *Ibid*., p. 247.

[63] *Ibid*., p. 249, 253.

As time passes, the issue becomes more ominous because a given acquisition, as far as the Commission is concerned, will be viewed in concert with previous mergers as well as the base for future mergers. However, this philosophy may not be without substance. If the net sales of the companies covered by this study are considered, a single merger involving, say $1 million in net sales, is perhaps inconsequential taken singly. If a series of such mergers are considered in toto, perhaps a different conclusion may be drawn. In brief, it appears that the impact of the regulatory agencies may have important consequences on lump sum acquisitions.

Other Forces Thwarting Merger Activity

There are a number of other forces which serve to dampen the acquisitive spirit of the companies in the paper and allied products industry. Many of these factors lead, or have led, to the dissolution of acquired companies. These same factors may possibly prevent the acquisition in the first place. Already an instance has been noted where an acquisition of a paper merchant has caused the acquiring firm to lose some of its pre-merger customers. Dissolution has allowed the company to regain its lost market. On the other hand, an acquired company may not develop as the acquiring company has estimated, and again, divestiture may resolve the problem. There is another factor which seems to be paramount: historical development. Aside from the apparent impact of antitrust laws, the historical development of the industry seems to be one of the most relevant aspects when the factors thwarting merger activity are considered. Historical development can be defined as that merger activity within the industry which is reflected by the behavior of the 10 companies in this study during the period 1950-1965. It appears that the activity of the firms themselves reflects a significant drop-off in the number of mergers undertaken by the 10 companies in the 1960's. This trend, instead of moving in the same direction as the general economy, has taken on an inverse relationship. As far as merger activity is concerned--with reference to manufacturing and mining for all firms in the United States--the number has, in general, moved along in the same direction as the economy.[64] Thus, the acquisitive spirit of the paper industry is non-representative of the manufacturing sector of the economy.

When the impact of the antitrust laws upon the industry is coupled with the potential results of the numerous decisions pending, the ultimate control of vertical and horizontal mergers within the industry seems imminent. This is significant considering the industry has been characterized as one in which vertical and horizontal mergers are the prevalent types of acquisitions. The courts and the regulatory agencies are becoming more effective in thwarting these kinds of mergers. As a consequence, the traditional merger movement within the industry may well be grinding to a halt. Unless there is a significant change in the direction of mergers,on the part of the firms comprising this study, the merger activity within the industry may become a moot question.

Most of the FTC complaints seem to currently revolve around the percentage share of the relevant market. Therefore, any increase in market share appears to be a per se violation of section 7 of the Clayton Act, as amended. It further appears that the only type of merger activity

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[64]See p. 53.

which might possibly circumvent the amended act is "negative space" mergers. However, these mergers are relatively inconsequential for the industry as a whole. Though, as in the case of Scott acquiring the Technifax Company, it may be significant to a particular company. Nevertheless, the extensive use of "negative space" mergers appears dubious at this time. Considering the historical trend of merger activity in the industry, it appears to emphasize once more, that the attitude of management toward mergers will have to change in order for the merger movement to gain new impetus.

Other problem areas associated with mergers are usually those dealing with financial and accounting practices and principles, assuming antitrust consequences have been overcome.[65] Nevertheless, this overlooks an important aspect of any merger--the problems associated with people. Louis W. Matusiak writes, "Inattention to the personnel area can reduce materially the profitability of a seemingly 'perfect-fit' merger or, in some cases, actually prevent a proposed merger from becoming a reality."[66] Matusiak goes on to point out that problems can often be avoided by the right approach to the merger. For example, a merger should not be viewed as an impersonal occurrence. Many supervisory people especially are worried about the future role which they will play in the new organization--the U. S. Plywood-Champion Paper merger is a prime example. A fear of loss of identity, title and/or prestige could lead to the termination of a proposed merger. "Rarely do subordinates question

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[65]See Arthur R. Wyatt, A Critical Study of Accounting for Business Combinations (New York: American Institute of Certified Public Accountants, 1963).

[66]Louis W. Matusiak, "Overcoming Obstacles to Merger," The Journal of Accountancy, September, 1967, p. 52.

the wisdom of the merger. What they do question--and judge rather harshly--is how the merger is accomplished, how it affects the predecessor firm, their jobs and themselves. Therefore, it is imperative that the program for assimilation be well conceived and executed."[67] As a corollary, not only is the "people problem" important in a proposed merger, but the same analysis would equally apply to the case of divestiture.

Having earlier touched upon the subject, it is well to reconsider another factor which thwarts merger activity--risk. The risk of the failure of the merger that is involved in any acquisition seems to grow geometrically as the acquiring firm moves away from its primary production area. According to a recent study John Kitching noted that top executives were uneasy about their companies' acquisition activities. "The executives were uneasy about the relatively high degree of risk associated with investment in an acquisition compared with an equivalent investment in, say, a new plant."[68] He also noted that these executives "...wished to know what the 'track record' of other companies had been, before attempting to undertake or expand their own acquisition program."[69] Kitching concluded that there were several factors in the case of a merger failure: (1) the merger was a relative high risk combination--conglomerate type; (2) size mismatch was relevant in which the acquired firm's sales were less than 2 percent of the acquiring firm's sales volume; (3) the change in organizational format after the merger was completed was significant in over 80 percent of the failures; and

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[67] Ibid., p. 56.

[68] John Kitching, "Why Do Mergers Miscarry?" The Harvard Business Review, November-December, 1967, p. 86.

[69] Ibid.

(4) synergy is most difficult to achieve where production facilities are combined.[70] Still, the overall conclusion of Kitching's article seemed to be that mergers failed because of management's failure, or lack of ability, to cope with the new task. In essence, he supports Matusiak's "people problems" thesis. Kitching concludes his article with "Finally, if the acquiring corporation is new to the game, why not tap the skills and experience of the sophisticated acquirers, especially their knowledge in the area of risk reduction at negotiation time?"[71] In the end, overcoming the numerous problems mentioned earlier, the primary obstacle which will stand in the way of a merger in the paper industry is the element of risk.

This chapter has been devoted to the analysis of some of the forces which restrict merger activity.for the purpose of establishing significance to each of these forces as an obstacle to mergers. The most important factor was the application of section 7 of the Clayton Act, as amended. Pursuant to this analysis, the historical development of merger activity within the industry was discussed; the "people problem" was presented; and lastly, the risk element was examined. All of these factors have had a definite bearing on the trend of merger activity in the paper industry.

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[70] Ibid.

[71] Ibid., p. 101.

CHAPTER VI

POSSIBLE RESULTS OF THE MERGER MOVEMENT IN THE PAPER AND ALLIED PRODUCTS INDUSTRY

Noting the number of mergers, those factors were discussed earlier which seemed to serve as a catalyst for the merger movement. Persuant to this it was viewed, at some length, the countervailing factors which seemed to serve as potential, or actual, obstacles to the acquisitive spirit of these companies.

Nonetheless, the industry may well be in a period of readjustment. Within the industry there appears to exist a significant change in the magnitude and direction of the merger movement, such as the merger of U. S. Plywood with Champion Paper and Scott Paper's acquisition of S. D. Warren. In the case of Scott, to reiterate, the consolidation with S. D. Warren represented an acquisition of a company whose annual sales are over $100 million. In contrast with the $143 million in sales of the 15 acquisitions by St. Regis, it appears that current mergers seem to be moving in the direction of larger-scale consolidations. Moreover, acquisitions seem to be moving away from horizontal and increasingly toward vertical and conglomerate consolidations. In the U. S. Plywood-Champion Paper merger, the consolidation appears to be such that a violation of the amended section 7 is not evident. Thus, it may well be that the industry is now entering a new threshold of merger activity. Still, there are a number of other possible results springing from the merger movement in paper and allied products industry.

COMPETITION

Gene C. Brewer, President of U. S. Plywood-Champion Papers, noted that 30 years ago the industry produced one product--lumber. "Today, we are a multiproduct industry, and the end is nowhere in sight."[1] In the same article which dealt with the forest products industry, he noted the following about the industry:

1. Now, in a new, deeper phase of backward integration, many a company is on the way to building a chemical business founded in the basic chemistry of the tree;

2. Managements are market-oriented to an unusual degree, when just ten years ago management was still production oriented;

3. Today, the companies of the forest products industry market 5,000 products; and

4. They used to use only 50 percent of a log whereas 85 percent of a log is now used.[2]

Although this paper is not concerned solely with forest products, the transition experienced by this segment of the industry serves as an example of what is taking place throughout all segments of the paper and forest products industry. Since all of the companies in this study are characterized as being fully-integrated paper companies, the turn of events in regard to forest products industries makes them relevant as well to this study.

One of the most significant aspects of mergers is the impact on the competitive spirit of the industry. In economic theory,

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[1]Christopher Elias, "The Forest Products Industry," The Exchange, April, 1967, p. 1.

[2]*Ibid.*, pp. 1-5.

competition is usually denoted by price competition. Any vicissitudes in the market are a result of price changes, brought about by shifts in the industry supply and/or demand curves. Clearly, the paper and allied products industry does not fit the model of pure competition; yet reading about the industry, especially in the trade publication, Paper Sales, the term competition is extensively used to characterize it. How, then, is the term applied?

To answer this question, consider the development of the market conditions associated with Chamberlain's small numbers case--oligopoly.[3] There are certain characteristics which are used to describe the theoretical aspects of this model; particularly the factor of uncertainty. In other words, what will other sellers do in a given situation? Since the antitrust laws do not allow sellers to act in concert, the element of uncertainty is paramount in this case. In general, certain characteristics prevail in such a market: (1) relatively few firms control a significant share of the market; (2) there exists a heterogeneity of products--differentiation may be real or imaginary; (3) entry or exit may be relatively easy or very difficult; and (4) the price may be set by the industry, or by, perhaps, a dominant firm or price leader. The interaction between firms is very significant since the pricing policy pursued by any firm can affect the pricing policy of all firms. Chamberlain stated further that differentiation exists if there is any basis for distinguishing the goods of one seller from those of another.

> Such a basis may be real or fancied, so long as it is of any importance whatever to buyers, and leads to a preference for one variety of the product over another. Where such differentiation

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[3]See Edward Hastings Chamberlain's, The Theory of Monopolistic Competition (8th ed.; Cambridge, Mass.: Harvard University Press, 1962).

exists, even though it be slight, buyers will be paired with sellers, not by chance and at random (as under pure competition), but according to their preferences.[4]

Differentiation may be based upon characteristics of product. However, it may also exist, as Chamberlain noted, with the conditions which surround the sale.

In retail trade, to take only one instance, these conditions include such factors as the convenience of the seller's location, the general tone or character of his establishment, his way of doing business, his reputation for fair dealing, courtesy, efficiency, and all the personal links which attach his customers either to himself or to those employed by him. In so far as these and other intangible factors vary from seller to seller, the "product" in each case is different, for buyers take them into account, more or less, and may be regarded as purchasing them along with the commodity itself.[5]

This last statement is the keystone because in dealing with "non-price" competition the above mentioned factors play a more important role than price. This does not mean that price has no influence, but since prices throughout the industry have remained relatively stable, the role of prices has been overshadowed by other factors. Therefore, when speaking of competition in the paper and allied products industry, it involves all the relevant factors surrounding the sale, and price is only <u>one</u> of the factors.

"Everything about the product sounds good--except the price."[6] The increasing role of non-price competition, in part, is helpful in overcoming a price obstacle. <u>Paper Sales</u> prescribes 21 ways to prove your price is right or to show that you are the firm from which to buy, even though the prices charged for your products are higher than those

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[4]<u>Ibid</u>., p. 56.

[5]<u>Ibid</u>.

[6]"21 Ways to Prove Your Price Is Right," <u>Paper Sales</u>, May, 1966, pp. 36-37.

charged by competitors. For example, such things as sell ALL the features of your product, sell quality, point out hidden savings, make prospects impatient to enjoy benefits of products you're selling, and so forth, are essential in overcoming competition--price competition.[7] By developing the art of salesmanship, a firm moves away from price competition to non-price competition.

In an interview Roger Arnold, President of Paper Service Supply Company, a local paper merchant says: "Price is often not the key factor, but rather it is the IDEA (underlining for emphasis) that sells."[8] In other words, service has become all-important. The paper merchant has had to sell his products by showing the customer how they will do a given job better than the products he is now using. "The key is hard work, long hours, and the financial rewards will take care of themselves."[9] The element of service is crucial at the local level. Arnold notes that "Typically a manufacturer's representative will come into your office, shake your hand, buy you a lunch, and expect an order. However, if you ask him to go out and help your salesmen, the manufacturer's representative does not have the time."[10] It can also be said that about 10 years ago this same situation would be indicative of the attitude of the local paper merchant in his approach to customers. During the intervening years, there has been a tremendous change within the industry. The mills

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[7] *Ibid.*

[8] Interview with Mr. Roger Arnold, President of Paper Service Supply Co., Wichita Falls, Texas, March 2, 1967.

[9] *Ibid.*

[10] *Ibid.*

or converters have started to deal directly with the customer, say a retail grocery chain, and thus the wholesaler is by-passed. The wholesaler, in order to retain his sales, has had to adjust his entire approach. He has become extremely conscious of service. The traditional markets which have been the bailiwick of paper distributors have been successfully invaded by the mills. New markets, new sales techniques, and so forth have had to be developed. "Ninety-five percent of the sales of local distributors were made to grocery stores in years past. Today, the reverse is true; five percent or less of their sales are accounted for by sales to grocery stores."[11] Therefore, it has become apparent that new approaches are vital in order to prevent the complete usurpation of the local markets by the mills. The nature of competition within the industry has definitely shifted toward an increasing role being played by non-price competition. Increased non-price competition is provided by the entrance of new firms, in the form of the mills, into the markets traditionally served by the paper distributor.

Direct Mill Competition

Nearly every issue of Paper Sales contains one article about competition. Again, non-price competition is the basic concern. The article is often directed toward the paper merchant and usually points out that the wholesaler is not an anachronism. The inference is that the wholesaler need not, through default, yield his business to the mills. One such approach is seen in an article written by Saul Herman--a wholesale paper merchant. He says that he can usually outsell the mills. "The major reason is simple; he provides the kind of service

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[11] Ibid.

that no mill could possibly hope to match."[12] Herman adds, "A good house must be willing to carry in stock all the paper items used by a prospect...also delivery must be prompt.... Another thing is top quality lines...these buyers want the best."[13] One thing that has been a door-opener for him is that his firm has the ability to make quick deliveries from its own inventory. Even though his prices might be no lower, or even somewhat higher, than those offered by mill competitors, his recommendations sometimes reduce costs for customers. "More essential than anything, however, is the salesman's know-how...he must know his business and know it well."[14] Herman's forte, and the forte of any successful merchant, lies in the fact that he provides far greater service than could be rendered to a customer by a direct mill supplier.

> He can guarantee immediate delivery when supplies are needed; less money must be tied up in inventories; smaller warehouse space is needed when buying is done in smaller lots from a local paper house; he is constantly available for assistance, whereas mill men may not be in the city for days at a time; and by selling the lines of several mills, he is able to provide the best item for every use, without having to substitute a less adequate item instead.[15]

To summarize, the paper merchant of today, finding his markets encroached upon by direct mill selling, has had to change his philosophy toward the amount of service offered before, at the time of, and after the sale.

The mills have indeed played a role in the price policy of the paper distributors. In general, the mills have been responsible to a great degree for holding down prices charged by paper distributors.

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[12] Saul Herman, "Don't Be Afraid of Direct Mill Competition," Paper Sales, December, 1957, p. 22.

[13] Ibid.

[14] Ibid.

[15] Ibid., p. 23.

As a consequence, many paper distributors have employed extensive price cutting in order to maintain their sales market. This may account for the numerous articles found in the same trade journal decrying the use of extensive discounting by merchants. In 1961, "the FTC said it was drafting legislation to go to Congress requiring mills to sell paper distributors at lower prices than to chains and direct-buying retailers."[16] The need for such legislation is an indication that the merchant has been hard pressed by the mills. When the pressure of the mills is coupled with an industry often faced with excess capacity, the merchant is frequently confronted with the need to cut prices. Given increased sales and even greater increased operating costs, "some operators continue meeting this problem with price cutting, though this was proving, again and again, a short-sighted approach, leading at times to bankruptcy."[17] Dick Reinhardt, publisher of Paper Sales, counselled in November, 1960, "The safest way for a paper merchant to operate, whether in industrial or printing papers, is to publish a price list and then sell every customer on exactly the same basis."[18] Lastly, Stephen Bolling, commenting on developments over the last 25 years, noted: "Merchants have always been accused of price cutting but mills seem even worse, in the face of excellent demand, even shortages."[19] Therefore, it may be concluded that prices are often the major competitive

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[16]"Printing Papers: The Fabulous Years," Paper Sales, January, 1966, p. 64.

[17]"Industrial Papers: Epic Era," Paper Sales, January, 1966, p. 47.

[18]Ibid., p. 48.

[19]Ibid., p. 52.

weapon used by both merchants and mills. At any rate, the fact that price wars erupt from time to time seem to indicate that monopolization does not exist at the local level.

The role of direct selling by the mills has been twofold. First: it has served as a means of maintaining relatively stable prices in the local markets. Second: the price competition provided by the mills has been counteracted by vigorous non-price competition, encompassing all the aspects surrounding the sale of paper and allied products.

Product Diversification

The one characteristic which best summarizes the industry is "change."[20] After reviewing the impact of direct mill sales on the paper distributor, it has been noted that the merchant has turned to providing the customer with better service as a means of retaining his market. However, service alone is not enough, but rather the merchant has become a knowledgable specialist who often is more knowledgable about a customer's needs than the customer himself. "Product knowledge has become a most important asset, especially in industrial packaging service. This, of course, has separated the order taken from the professional salesman."[21] The new competition has, therefore, resulted in the placing of a greater demand upon the merchant's sales force. However, interest lies not only in the need for better salesmen but also in the development of new products which necessitate the emergence of technically knowledgable salesmen.

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[20] See p. 22.

[21] "Industrial Papers," p. 53.

Using a phrase from the 25th Anniversary Issue of Paper Sales, "1941-1965 The Incredible Paper Products Revolution," may succinctly denote the change in the industry. Consider the number of carton sizes produced by Kimberly-Clark: "Ninety-six new standard carton sizes have been added for a total of 2,100."[22] This serves as a typical example from the industry, and represents the greater variety of existing products being offered. Moreover, it points up once again the importance of well-trained salesmen to help customers select the products best suited for their needs.

The product revolution has gained added impetus as paper proved to be an ideal substitute for glass, tin, steel, burlap, canvas, cloth, rubber, leather and many other products. Not all of the applications have proved themselves in the long-run, but others have found wide scale market acceptance. During the discussion of the many types of diversification mergers, numerous examples have been cited of new products being served by the paper industry. Since paper is an ideal substitute for numerous products, there is a high degree of cross-elasticity of demand between paper and other materials, especially those materials used in packaging. Much of the product development is directly attributable to this interindustry competition for the packaging market. One example is that of paper milk cartons replacing glass containers. In addition, the product proliferation within the industry is readily apparent in the Source of Supply Directory of paper and allied lines.[23]

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[22] Paper Sales, February, 1966, p. 42.

[23] See Source of Supply Directory (Park Ridge: Peacock Business Press, Inc., 1965).

This annual publication not only provides a complete listing of paper and allied products, but also cites the numerous suppliers of these products. It is of interest that few products have but one or two sources of supply. Typically, there are at least a dozen or more manufacturers of the products. The paper merchant does have a broad source of supply, and in light of the merger activity which is characteristic of the industry, the sources appear to be increasing rather than decreasing.

Lastly, the merger activity of the 10 most active acquisitors has added to the deepening of product mix. In a number of cases, mergers have been utilized to gain access to a new market. By providing ingress, additional sources of supply have been added which have enabled the merchant to keep pace with the product proliferation. A survey reported in Printers Ink illustrates the significance of new products at the retail level. The survey includes those items carried by a chain of food stores in Minneapolis in 1967, and compares them with those found in a comparable survey conducted in 1957. The new items account for 55 percent of the items now handled. Moreover, these items contribute 52 percent of unit sales, represent 52 percent of dollar sales, and earn 57 percent of dollar margins.[24] The following table denotes those products experiencing marked growth. Paper products have increased 66 percent, representing a 72 percent gain in sales of these products. It may be noted further that by 1957 the industry entered into a significant merger period. By 1967 the effect of these mergers reflects a greater product mix. With retail paper product sales, the introduction

[24]"Product Categories Showing Marked Growth," Printers' Ink, August 25, 1967, p. 8.

TABLE 29

PRODUCT CATEGORIES SHOWING MARKED GROWTH FROM 1957 TO 1967
(In Percent)

Item	New Item As Percent of Total Items	Sales Gain	Margin Gain[1]
Paper products	66	72	96
Prepared canned foods	73	120	138
Laundry detergents	53	67	162
Pet foods	81	85	99
Refrigerated doughs	85	111	160
Snacks	71	154	177
Frozen dinners	72	88	140
Candy	53	101	112

[1]Profit gain from selling these products.

Source: "Product Categories Showing Marked Growth," Printers' Ink, August 25, 1967, p. 8.

of a new product is not strictly a single product line, but rather the new product is offered in a multi-line sequence. For instance, if a new line of tissue paper is introduced, it comes in a series of different sized packages as well as a number of colors. According to some sources, the introduction of a single product line is usually unsuccessful. Therefore, paper products especially, as the above mentioned data suggest, have been widely expanded. Not all of the heterogeneity is attributable to merger activity; however, it appears that mergers did play an important role in this area.

The Effects of Integration

Mergers and acquisitions have resulted in a new era of marketing techniques, but what effect has the waves of mergers had upon the industry? The initial wave of mergers resulted from the fact that during the early 1950's, the quantity of paper products demanded has acceeded the quantity supplied. The results have been high prices, high profits, and acquisitions. Paper manufacturers have become fully integrated companies, moving from acquisitions of forest resources to the acquisitions of paper houses. However, many companies have found the operation of wholesale establishments not to their liking. For example, Scott Paper took over the operation of an Eastern paper house, and after one year, divested itself of the operation. Scott dropped the paper house because of the following reasons:

1. the problem of maintaining adequate warehouse stocks;

2. the problem of billing hundreds of customers in a given local market;

3. the fact that many local companies preferred to deal with local merchants rather than with branch warehouses of national organizations; and

4. the necessity for handling the thousands of local problems that require the immediate attention of a local representative with an intimate knowledge of customer needs.[25]

In spite of this, the acquisition wave has continued.

In 1960, Champion Paper acquired Carpenter Paper Company which had acquired numerous paper distributors prior to 1960. "The trade took immediate notice, as this leading manufacturer of many paper lines became owner of a sizeable distributor complex."[26] Another significant

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[25]Paper Sales, February, 1966, p. 66.

[26]Ibid., p. 67.

mill-merchant acquisition which occurred around the same time was Kimberly-Clark's purchase of Blake, Moffitt & Towne. There were a number of similar mergers which have been noted. The importance of these mergers lay in the fact that the sources of supply for many merchants were affected. Also, the "demonstration effect" seemed to prevail as one after another of the major paper manufacturers began acquiring merchant houses.

All in all, the impact of these mergers has provided a "Lester Effect" or "Shock Effect."[27] As increased wages have resulted in stimulating improvements in management and labor performance, so too have mergers stimulated the entire industry. New products, new techniques, better utilization of resources, all have become common practices within the industry. The growth of non-price competition, as well as price competition, has definitely carried service to the forefront in the industry. Lastly, the industry has found itself on the crest, perhaps, of a new and more complex merger wave of activity. It seems that the industry is now at a point where extensive vertical and conglomerate types of mergers may occur. The bulk of conglomerate mergers may take the form of primarily market extension mergers. They should continue to provide the means of gaining access to new market areas rapidly.

The emphasis on geographical markets, as well as the development of product lines, is reflected by the data in an annual report. Of interest is the evolution in the annual report from the early 1950's

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[27]Richard A. Lester, Economics of Labor (2nd ed.; New York: MacMillan Company, 1964), p. 517.

through the mid-sixties. At the outset of this study, the basic product lines for each company have usually been cited by geographical region. Using St. Regis as an example, its annual report lists each plant and the product produced at that site. In 1955, the company has had 43 domestic plants and 9 foreign-owned affiliates described in the report.[28] By 1965, the annual report has incorporated a new format. In this report, each major product is cited individually, and under each heading is listed all the various plant locations where the product is produced. For example, where St. Regis has had 8 corrugated box plants in 1955, the 1965 report cites 26 such manufacturing plants.[29] Obviously, not all of these new plants are attributable to mergers. But, the point is: it appears that the 10 most active acquisitors have become engaged in a numbers game. "Keep up via merger" seems to be the theme song for these firms. It is difficult not to be impressed by the Annual Reports of the Mead Corporation. Each report presents a map of the United States on which their plant sites have been located. It is indeed impressive to note the manner in which the map is being covered with more dots, stars, and lines with each successive annual report. As a consequence, the manifestation of merger activity may, in part, be attributable to corporate annual reports--the "demonstration effect" manifestation.

The Consumer

Under the model of pure competition, the products are homogeneous--identical. The consumer is thus afforded no choice other than the choice to purchase, or not to purchase, the item. As denoted in

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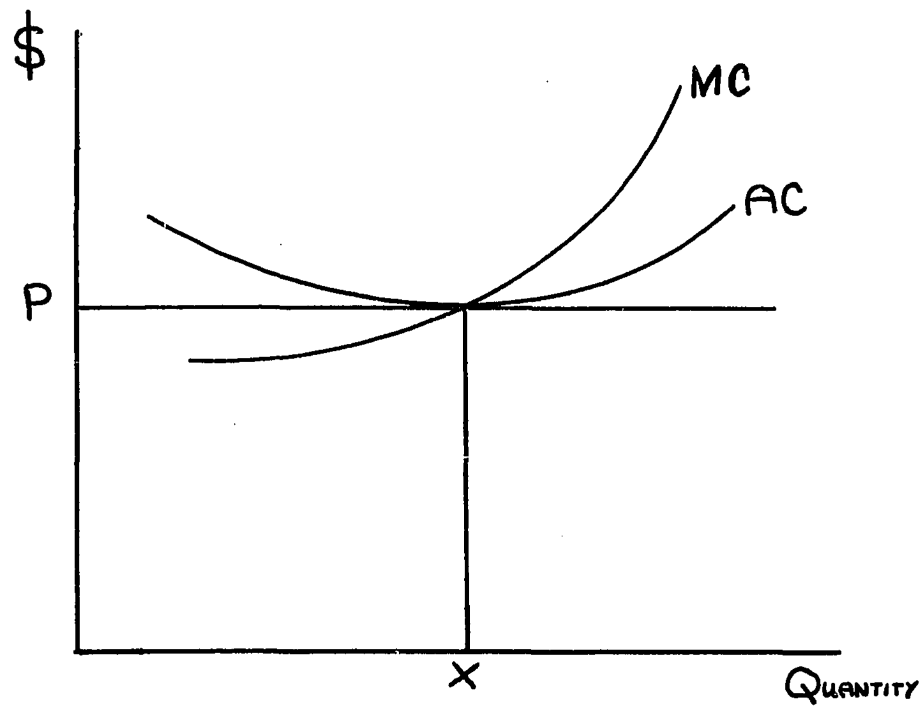
[28] Annual Report: 1955, St. Regis Paper Company, p. 11.

[29] Annual Report: 1965, St. Regis Paper Company, p. 26.

FIGURE 5

COMPETITIVE OUTPUT

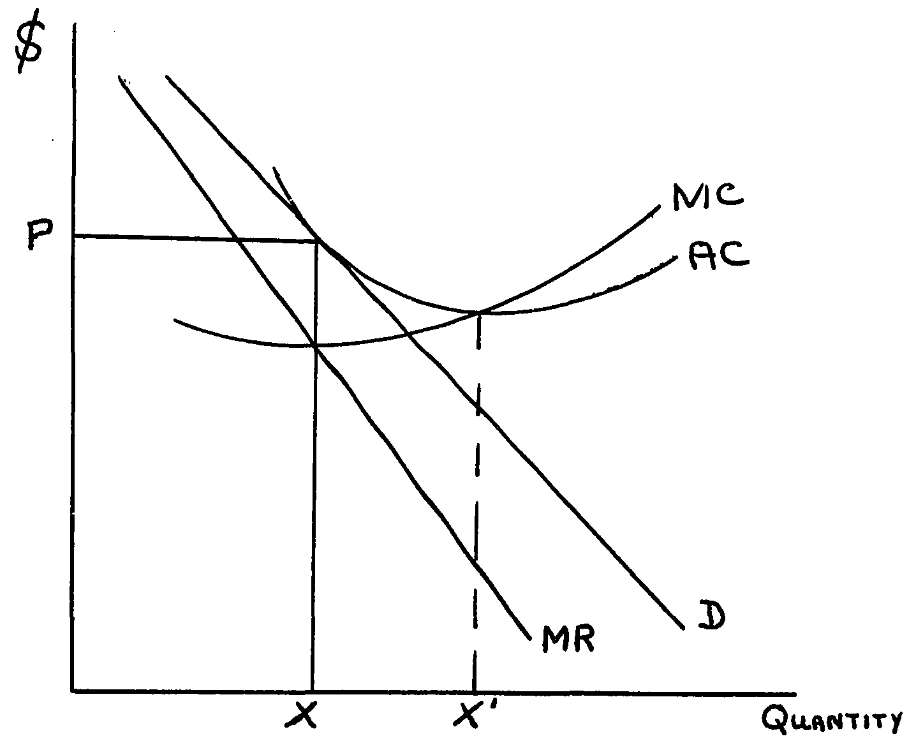


Chapter III, mergers are often undertaken as a means of adding to the product heterogeneity of a company. Therefore, the effect which mergers have had upon the consumer has been beneficial. The obvious question is: in what way has the consumer benefited?

Again using the model of competition, the model is cited as desirable because society is thus offered products at their lowest cost. In other words, given a perfectly elastic demand curve, horizontal line, the equilibrium position for the firm is attained when price is equal to average cost, P = AC. At this output, average revenue is equal to average cost, AR = AC, which means the firm is realizing normal returns. The significance, though, is that average cost is at a minimum. Graphically, it is shown in Figure 5. The price, P, is equal to average cost, marginal cost, average revenue, and marginal revenue. Thus, the firm is

FIGURE 6

NONCOMPETITIVE OUTPUT



operating at the point of profit maximization, as well as at the lowest point of its average cost curve. However, the products distributed in the paper industry are differentiated--heterogeneous. Hence, the demand curve faced by any firm would be negatively sloped, indicating that given a price change, different quantities are demanded. The significance of this becomes apparent when examining Figure 6. The firm would operate where MR = MC, but at this output, X, the average cost is equal to average revenue, but the price, P, is above the lowest point on the firm's AC curve. The point of tangency of a downward-sloping demand curve is obviously above the minimum cost of production output, denoted by X'. The consumer, as a result, is confronted with a higher price and fewer units than may be the case under competition.

Theory suggests that if there is a movement away from product homogeneity and the model of competition, the result is that the consumer is penalized by being confronted with higher prices and fewer units. But theory also provides the tools to refute such an analysis--the bugaboo of economies of scale. Briefly, since economics recognizes a curvelinear average cost curve, it can be argued that internal economies are relevant factors. Assume a number of competitive firms is joined into one large-scale firm, definite economies may be generated. As a result, the average cost curve may fall, reflecting a lower per unit cost for producing a given unit of output. Assuming this to be the case, the consolidated firm may now be willing to provide more units at a lower price. In fact, a number of mergers has been discussed in which a greater quantity of goods has been sold at lower prices after a merger (see below).

The question which immediately arises is whether the consumer, or the competitor, is in need of protection. Economic theory suggests that if a firm is unable to cover its average cost of production in the short-run, the firm should exit the industry in the long-run. However, the courts and the regulatory bodies have muddied these waters by minimizing the question of prices. Still it should be noted that the courts are apparently concerned, not with short-run, but rather with long-run consequences of mergers. In other words, the lower prices resulting from a given merger are often construed as being only temporary. Once a monopolistic position is established, prices may be pushed ever upward. It is the potential ability to control prices through the domination of the market that has been one of the major obstacles confronting the merger movement. Citing Scott's acquisition of Soundview Pulp Co., Detroit Sulphite Pulp and Paper Co., and Hollingsworth & Whitney Co. as an example, it has been noted that the FTC apparently minimized prevailing market prices after the merger.[30] The concern is apparently the probable effect on existing competitors. Does the mere existence of a large number of firms benefit society?

"Economics is the study of how men and society choose, with or without the use of money, to employ scarce productive resources, which could have alternative uses, to produce various commodities over time and distribute them for consumption, now and in the future, among various people and groups in society."[31] The emphasis is placed on allocation of resources for consumption. Thus it would seem that economics serves consumption, not necessarily competitors. Competition, or the model of competition, is merely a means to an end. Suppose that a merger does result in the realization of lower per unit costs; it would seem that economics is serving the purpose for which it is purported to serve--the consumer, if that merger is allowed to stand.

Immediately, the counter argument arises. What about monopolization? Given the stage of development of the paper and allied products industry at this time, monopolization is not a serious issue. In fact, the merger movement seems to have enhanced the competitive situation. Extensive geographic penetration has been accomplished by mergers. As additional companies move into new markets, the situation changes. Though perhaps unfortunate, the marginal merchant may, in some cases, be driven out in the process. But economics is not directly concerned with

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[30]See p. 151.

[31]Paul A. Samuelson, Economics (7th ed.; New York: McGraw-Hill Book Company, 1967), p. 5.

the perpetuation of the marginal firm. Economics strives for the most efficient, lowest cost-operation with, hopefully, the lowest possible prices being charged. In addition, alluding to indifference curve analysis, the consumer may derive a much higher level of satisfaction, _ceteris paribus_, if the prices of the goods consumed are lowered. The consumer's increased real income as reflected by lower prices increases the total satisfaction of society. Since much of the theoretical analysis involving the consumer is phrased in terms of maximizing the level of consumer satisfaction, it would seem that to deny the consumer lower prices would be to come in direct conflict with the role of consumer economics. The consumer may benefit from mergers either by realizing lower prices, or by experiencing constant prices. On the other hand, the consumer should not be faced with increased prices in order to protect the marginal producer or paper merchant.

There is another aspect of mergers which needs elaboration at this point: the deepening product heterogeneity which has resulted from numerous mergers in the industry. How does this affect the consumer? The issue revolves around consumer choice. It would be erroneous to assume that mergers alone have contributed to the product proliferation experienced by the industry. Nevertheless, it appears that mergers have contributed to the wide scale availability of these product lines. The acquiring firm, with large financial resources available, is often in a better position to develop far wider markets which are gained through the acquisition of new facilities and then to expand internally into these same areas. The result is broader product selection being made available to the consumer.

Lastly, there is one other factor which is pertinent to the consumer. It has been noted that paper products are easily substitutable for numerous types of packaging material. Obviously, then, the materials for which paper is a substitute can also be substituted for paper. It is this interindustry competition that serves as a good, perhaps even better, check on the pricing activities of the paper industry, than the mere presence of a few additional paper producers in a given market. The innovational processes which prevail in the economy are highly competitive.[11] Moreover, no market is without possible entrants, and in many cases, these entrants represent firms from other industries. For example, Proctor & Gambel has begun to acquire a number of paper producers. It is this type of entrant which protects the consumer from the effects of possible monopolization which numerous mergers may afford an acquiring company. Briefly, the consumer has been spared any significant price increases in the short run after the numerous mergers discussed above, and in the long run the prices charged the consumer should be held in check by the forces of competitive products--interindustry competition. Thus it would seem that the regulatory bodies, when considering the impact on the consumer, have, in essence, inferred a non-probable result.

Impact of Mergers on Society

Has society benefited from the merger activity of the paper and allied products industry? Again, it would appear that society has definitely gained from such merger activity.

Since antitrust cases are resolved on the basis of "probable" effects on competition, the issue of intent is paramount. If intent is based upon monopolization of a market, most observers would agree that a merger transpired under such circumstances should be disallowed. However, it seems that the evolutionary spirit underlying today's corporate enterprise may be to gain as large a share of a given market as possible. The question arises: what is an acceptable technique which can be utilized to gain a larger share of the market being served? Natural growth--however that may be defined--is considered an acceptable technique. Legally, if a company evolves as the dominant firm in a market, the antitrust laws condone such behavior. Unfortunately, any attempt by a corporation to add to its size is often construed to be an attempt to monopolize. Natural means are acceptable; unnatural means--mergers--are not acceptable, especially horizontal mergers. Hence the question of intent concerning monopolization is, perhaps, a foredrawn conclusion of the modus operandi of the business community. Yet, a more relevant stand on intent is needed.

Based upon the nature of the majority of mergers undertaken in the paper and allied products industry, it appears that the primary intent has been to expand corporate markets. As noted in Chapter IV, market extension mergers have accounted for the majority of mergers completed by the companies in this study. Moreover, if monopolization has, in truth, been the major objective, it seems reasonable to expect that prices would have tended to move upward throughout the period of the study. Besides, these companies have made large capital expenditures in order to create additional corporate, as well as industry, capacity. A number of mergers have afforded the acquiring company a new base from which expansion could take place. The intent seems to be expanded capacity. This in itself would further seem to run counter to the usual argument set forth under the concept of monopolization.

Assuming monopolization is achieved, price is expected to increase, and as is further assumed, output is reduced. Contrarily, it appears that the paper and allied products industry has done little to thwart increased output. In fact, many analysts suggest that this increased output is the major cause of depressed prices in the industry. To wit, if monopolization is the primary purpose underlying the merger movement, it would seem that the companies themselves have failed to recognize their motives.

Nevertheless, the laws which have been written to protect society from anticompetitive actions have provided a number of exceptions which would render mergers acceptable. Mergers may be allowed because:

1. Owners desired to liquidate their holdings;
2. The free transferability of capital assets tends to put them in the hands of those who will use them to their utmost economic advantage;
3. Growth by merger may lead to economies of scale;
4. Entry by merger may stimulate improved economic performance, for example, an industry characterized by oligopolistic lethergy; and
5. Diversification may mean economic stability.[32]

In essence, as Donald F. Turner has noted, Congress has pointed out that mergers can very well be procompetitive. Therefore, assuming that a given merger is established as procompetitive, society will benefit from the consolidation.

Another area improved by mergers has been the basic attitudes of the local paper merchant. The lethergy, characteristic of the paper

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[32] Donald F. Turner, "Conglomerate Mergers and Section 7 of the Clayton Act," Harvard Law Review, LXXXIII, May, 1965, 1317-1318.

merchant in the past, has been significantly overcome. Moreover, new entrants using the merger route have challenged traditional markets. In addition, the acquiring company, supported by large capital resources, was able to expand greatly the existing facilities, affording the consumer a wider choice of products. This reinforces the conclusion that society has greatly benefited from merger activities of the industry. In fact, there have been no instances where the ultimate consumer has been placed at a disadvantage. However, there are some examples where converters or wholesalers have found themselves at a competitive disadvantage. Nonetheless, the issue here is not the impact on competitors, but on society. Society, unfortunately, is not the issue in many of the cases discussed in Chapter V. Although cruel, perhaps, the marginal firm, marginal in the sense that costs are higher, should not be protected at the expense of society in general.

When discussing the purpose of antitrust statutes, Judge Learned Hand, in the Alcoa Case of 1945, stated:

> It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few.... We have been speaking only of the economic reasons which forbid monopoly; but, as we have already implied, there are others, based upon the belief that great industrial consolidations are inherently undesirable, regardless of their economic results. In the debates in Congress Senator Sherman, himself...showed that among the purposes of Congress in 1890 was a desire to put an end to great aggregations of capital because of the helplessness of the individual before them.... Throughout this history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other.[33]

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[33] 148 F2d 416.

Judge Hand's opinion in this case is basically from the viewpoint of the number of competitors, regardless of the economic consequences. It could be argued that the best way to encourage competition is to allow the firms to drive prices upward, thus attracting new firms to enter the industry. Such an approach, though favorable to the producer, would likely result in a loss of real income for the consumer. Moreover, the pursuit of numbers by the statutes and regulatory bodies cannot serve the best interests of society. Protection is afforded the producer and not the consumer. Again, the paramount question is emphasis. Which group--consumer or competitor--needs to be protected?

On the other hand, Turner has noted: "... there seem to be overpowering reasons against using cost savings as a basis for invalidating conglomerate or other mergers."[34] He cites three reasons why economies, _per se_, should be grounds to validate mergers.

> 1. There is the enormous social interest in progress and efficiency, which has represented one of the primary bases for the policy of promoting competition as it has in fact evolved.
>
> 2. To forbid mergers that would or might produce substantial efficiencies would narrow substantially the category of acceptable mergers, thereby drastically weakening the market for capital assets and seriously depreciating the price which entrepreneurs could get for their businesses when they wish to liquidate...
>
> 3. The protection that this policy would afford to small business, except in the short run, is at best highly conjectural and probably negligible.[35]

To which, Turner adds that there are a number of more effective techniques which are available to aid small business entrepreneurship. The government has already made available loans and loan guarantees to small

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[34]Turner, _op. cit._, p. 1326.

[35]_Ibid._, p. 1327.

businesses. Further, the Small Business Administration has been established to serve this segment of the economy. Nevertheless, protection, be it through tariffs or antitrust statutes, serves the marginal firm, and it is typically a short-run phenomenon. If efficiencies are germane, it is only a question of time until such efficiencies are realized through internal growth. In the paper and allied products industry, there are several instances where internal economies are coincidental with the growth of the firm.

In summary, it appears that society has fallen victim to the zealous protection of the competitor, at the expense of the consumer. To deny a merger simply because it reduces by one or more the number of competitors, is to fail to take into consideration the reasons, theoretical reasons especially, why competition is a desirable characteristic. Succinctly put, competition tends to equate price with the lowest point on the average cost curve. Price is equal, or approximately equal, to the average cost of production. Moreover, if a merger affords the manufacturer an opportunity to realize a reduced average cost curve, then society apparently will realize a greater output at a lower price, increasing the real income of society. The issue, however, becomes clouded for one apparent reason--the role of the entrepreneur.

The Role of the Entrepreneur

Profit, normal profit, is the return for entrepreneurial skill--enterprise. It is assumed that the entrepreneur's purpose is to maximize the profits of the company which is served by his skill. Based upon this assumption, a merger becomes a useful managerial weapon since it may well lead to the monopolization of the market. Inherent to this may be a broader attempt of the entrepreneur to maximize the firm's profits, perhaps resulting in a higher price and lower output. If the firm is afforded the opportunity of realizing economies to scale, the consolidation may still yield a lower price and greater output than existed prior to the merger. This leads to the question which much be resolved--what is the role of the entrepreneur? Monopolization is undesirable because, given the opportunity, it is assumed that the entrepreneur will raise his prices in order to enhance his profit picture.

Economic theory, however, would allow for several factors to come into play. First, the law of demand states that an increased price will result in a decline in the quantity demanded, ceteris paribus. Assuming an elastic demand curve, the entrepreneur will find that not only sales, but total revenue, will diminish if price is increased. The assumption of an elastic demand curve is appropriate because lowered prices have led to increased revenues. Since the products are close substitutes, this in itself suggests a high degree of cross-elasticity of demand, which would serve to check any price increases. In addition, the importance of interindustry competition may, for the most part, tend in the long-run to give rise to a more elastic demand curve. These factors may well explain the overall development of fairly stable prices throughout the industry, especially when coupled with excess capacity. Therefore, if merger activity has led to the monopolization of the industry, and the entrepreneur's purpose has been to maximize profits, the general price levels as well as the profit levels which exist throughout the industry do not support such assumptions.

Briefly, what are the alternatives to the profit maximization assumption? Baumol writes: "Perhaps the most remarkable failure of modern value theory is its inability to explain the pricing, output and other related decisions of the large, not quite monopolistic firms which account for so large a proportion of our output."[36] In his study, Baumol is struck with the importance which management placed upon the level of corporate sales. This has led him to develop the revenue maximization hypothesis.[37]

Weintraub adds that, in general, economic analyses have relied upon the assumption of maximization of profits for their solution. "Although it is probably accurate as a general principle of business conduct and as an indicator of the ultimate results, the shortcomings of this assumption are commonly acknowledged; no one will deny that it fails to describe _all_ the facts."[38] He further notes that public utilities are prohibited by law from applying this formula, and other practices which may tend to violate the maximization rule would be retail mark-ups and full-cost pricing.

> It is surprising and ironical, that, to judge by what businessmen often _say_, one would think that they, too, agree that the nature of business corporations is exactly and precistly what critics say it is; namely, that the corporation has no other purpose, and recognizes no other criterion of decision except profits, and that it pursues these profits just as single-mindedly and irresponsibly as it can.[39]

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[36] Baumol, _op. cit_., p. 13.

[37] _Ibid_., also see Chapter VI.

[38] Weintraub, _op. cit_., p. 189.

[39] Robert N. Anthony, "The Trouble with Profit Maximization," _Harvard Business Review_, XXXVIII, November-December, 1960, 127.

Professor Anthony, then, sets forth to show why in the real world of the practicing business community this assumption is invalid. It should be pointed out that Anthony places the blame on the perpetuation of this assumption squarely on the teaching of profit maximization economics. He adds that "Although we find leaders of the business community stressing the importance of a <u>satisfactory</u> profit, we also find them discussing business responsibilities, the need for a fair division of income among the parties involved in a business, and other subjects that are incompatible with the profit maximization goal."[40] He adds, "If profit maximization is the governing objective of business, such a statement is nonsense."[41] To illustrate the lack of consistency of profit maximization with management practice, Anthony poses a few questions; some of which are:

> Why give an employee a separation payment when he is discharged?
> Why don't executives spend all their waking hours at work?
> Why have a lawn around the plant, and why spend money to mow it?
> If prices are always as high as possible, how can a wage or material cost increase lead to a price increase?[42]

There are other questions raised which may serve to show the line of reasoning Anthony uses to support his nonmaximization thesis. In brief, the assumption of profit maximization is unrealistic, according to Anthony, because: "(1) profit maximization is too difficult, and (2) it is immoral."[43] With reference to the ethical problem, he states that "profit maximization requires the businessman to use every trick he can

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[40] <u>Ibid</u>.

[41] <u>Ibid</u>., p. 129.

[42] <u>Ibid</u>., p. 130.

[43] <u>Ibid</u>., p. 134.

think of to keep wages and fringe benefits down, to extract the last possible dollar from the consumer, to sell as low quality merchandise as he can legally hoodwink the customer into buying, to use income solely for the benefits of the stockholder, to disclaim any responsibility to the community, to finagle the lowest possible price from his vendors regardless of its effect on them, and so on."[44] In other words, "A businessman is a human being, and it is completely unrealistic to assume that he should act in an ethical vacuum."[45] Moreover, there is little evidence to support the concept that most active acquisitors in the paper and allied products industry are profit maximizers. Nor has the merger movement, per se, significantly enhanced the ability of the corporations to approximate such a position.

Other assumptions put forth in lieu of profit maximization are: the number of employees, the market areas served (which seems very relevant to this study), the company's rate of growth over a period of time, and maintenance of the firm's corporate image.

Workable Competition

Most textbooks which are related to the general area of government and business refer to the concept of workable competition. Indirect mention has been made of this concept, but it demands a more detailed development. Wilcox regards a market as workably competitive when it is characterized by conditions in which neither buyers nor sellers have the upper hand. The conditions which would give rise to such a market are:

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[44] Ibid., p. 132.

[45] Ibid., p. 133.

1. It need not involve the standardization of commodities; it does require the availability of products so closely related that they may be readily substituted...(and) that they differ so little that sellers will not hesitate to shift from one to another.

2. It does not require that markets be formally organized, ... it does require that information be ... (granted) to some traders and withheld from others.

3. It does require that traders be sufficiently numerous to offer to buyers and to sellers, respectively, a considerable number of genuine alternatives in sources of supply and demand, so that, by shifting their purchases or sales, they can substantially influence quality, service, and price.

4. Each trader must be free to adopt his own policy governing output, purchases, and price; ... power must not be so distributed that lack of resources or fear of retaliation prevent one trader from encroaching on the sales or the purchases of another.

5. It does require that transference and entry be unobstructed by artificial barriers and that no preferences be accorded or handicaps imposed.[46]

Workable competition involves the development of conditions which prevent the curtailment of market activity associated with monopolization. These characteristics are applicable to the paper and allied products industry, because there exists: a high degree of cross-elasticity of demand; a choice of supply; independent action on the part of sellers; and the possibility of new entrants prevails in the markets served by the industry.

In general, competition can be said to be effective as long as:

1. The consumer is afforded a choice as to the number of suppliers which act independently, and who vigorously attempt to satisfy the consumer's demands.

2. Prices as well as the availability of products are publicly made available to all consumers--potential or actual purchasers.

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[46]Wilcox, op. cit., p. 307.

3. The products themselves are good substitutes and the quality is the same for the products being supplied by these firms.

Drawing upon a popular political phrase, the consumer should be afforded a "choice," not an echo. The merger movement has been beneficial to the consumer by affording him additional sources of supply through the multiplicity of products being offered by the industry. Mention has been made of the fact that prices are relatively stable; if not declining throughout the industry. Consequently, it would seem that the industry is effectively competitive. Competition is effective, in the sense that there is little, if any, evidence to support the contention that prices have increased or that output has been reduced after these mergers were completed.

If these conditions prevail, the consumer and society are benefited. Since price competition exists within the paper industry, the consumer has also benefited from vigorous nonprice competition. However, nonprice competition has not circumvented price competition. Rather, nonprice competition has been coupled with strong price competition to provide the consumer with a true choice as to products, to the number of suppliers of these products, and to constant prices being charged for these products.

The Demonstration Effect

Another phenomenon which has emerged is the "demonstration effect." William B. Harris said: "Since 1946, interest in mergers has been so broad that practically every corporation in the U. S. with a net worth of $1 million has been approached with a merger proposition, or has itself approached another company with a deal."[47] Although Harris is commenting on the early fifties, the comment is important and relevant throughout this study. It seems as if the "demonstration effect" has, in truth, played an important role.

The function of business enterprise seems to be to serve growth. One way to achieve growth is through mergers.[48] "In the 20 years since World War II, the managements of a lot of U. S. companies, perhaps all major companies, have operated as though growth were their real raison d'etre."[49] Continuing, Business Week also notes that growth exerts its own dynamism, and certain paradoxical propositions emerge:

> 1. A growth company needs very high caliber men to run it--but it also attracts these men where a slow-growing or declining industry, say a railroad, never would.
>
> 2. A growth company in the high technology, high-investment area requires endless amounts of money and credit--but it is likely to have a reputation that generates both earnings and Wall Street backing.
>
> 3. A growth company inevitably involves risks--big risks--whether in making mergers, developing new products or new markets, or applying new techniques to old businesses.[50]

Moreover, growth can quickly catch the eye of Wall Street as well as by other companies. This recognition, especially by other companies, has contributed significantly to the merger movement.

Underlying the merger movement is the basic fact of economic life--"grow or die." Growth is often a slow process as evidenced by

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[47] William B. Harris, "The Urge to Merge," Fortune, November, 1954, p. 102.

[48] See p. 65.

[49] "Corporations: Where the Game is Growth," A Special Report, Business Week, September 30, 1967, p. 99.

[50] Ibid., p. 102.

the case of Container Corporation of America. Known as a packaging company, the company is one of the least active acquisitors in the study. A recent article in Business Week, reports how Container has concentrated on vertical integration tapered to the rear. The pursuit of such a policy has resulted in a very enviable position for Container because the company has performed well. Container's uniqueness lies in the fact that it has been able to enjoy growth without having to venture from converting paperboard into packaging. However, the company has become increasingly interested in diversification as a defensive move. As in the case of Scott, Container has found its baliwick being encroached upon by other companies, such as St. Regis, International Paper, Crown Zellerbach and Union Camp as well as American Can and Continental Can.[51] The significance here is that Container is faced with an ever increasing number of competitors. Therefore, in order to maintain its current level of growth, new markets have to be established because the above mentioned entrants assuredly will gain a share of this segment of the packaging market.

There are a number of other indicators which seem to favor the demonstration thesis. First, there are an increasing number of ads being placed by large diversified companies--conglomerate companies--which alluded to their diversification. Examples are:

> "We're bigger than 90% of the companies on the Big Board. But nobody knows us from Adam."[52]

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[51] "Container Seeks a Bigger Package," Business Week, October 21, 1967, p. 186.

[52] Ad by North American Rockwell, Wall Street Journal, September 21, 1967, p. 5.

"Forbes Magazine said the acquisition of Kern County Land Company would give Tenneco, Inc. 'as much diversity as any major company around.'"[53]

These are but two ads along the same line--diversification. However, the recurring theme is that diversification has come so fast by means of the merger route, that the general public is often unaware of the magnitude of these growth companies. Currently it seems that corporations, instead of fearing size, have gained status through size. Bigness now seems to be an end in itself. Putting together a large scale, well diversified corporation has become the paragon to which many businessmen aspire. Second, there appears to be an increasing number of seminars held on acquisitions and mergers. A description of one such seminar began:

> IN TODAY'S COMPETITIVE CORPORATE CLIMATE, no chief executive responsible for guiding his company's growth can afford to be uninformed about what aggressive, capably-managed corporations are doing to build earnings and assets through acquisitions and mergers. As new corporate strategies and tactics emerge that could out-perform or engulf you, practical planning, proven policies, and tested methods are musts if you are to excel or even survive.
>
> A small variation in method of acquisition can make a difference of millions of dollars. Or it may save hundreds of thousands--or <u>millions</u>--of dollars that otherwise would be paid out in taxes. Maximizing benefits and avoiding pitfalls can mean such substantial sums of money that this vital area of corporate activity deserves the closest attention of your most competent executive officers.[54]

More and more members of the stock exchange are conducting this type of seminar throughout the country. In addition, a number of companies are

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[53]Ad by Tenneco,Inc., <u>Business Week</u>, September 23, 1967, pp. 70-71.

[54]"Special Seminar on Acquisitions and Mergers," Ad by D. H. Blair & Co., <u>Wall Street Journal</u>, September 28, 1967, p. 17.

being created to serve the specialized needs of corporations merging, being merged, or seeking mergers. One such company offering special two-day workshops on acquisitions and mergers is Corporate Seminars, Inc., in New York. Part of their program includes a simulated exercise in which participants simulate the negotiations for a merger.[55] The origin of the program itself is interesting. William Colvin, who was employed by Olivetti-Underwood Corporation, where he was involved in efforts to acquire new companies, has decided to teach others how to make mergers. Thus, he has created his traveling school--Corporate Seminars. Though only about one year old, it has graduated approximately 700 students. Enrollment is expected to reach 2000 per year in the future. Tuition can run as high as $500 for a two to five day course. Colvin expects a profit of $100,000 this year.[56] This suggests a new adage--"It may well be better to instruct in the act of mergering than to practice such an act."

Third, there are a number of new publications which are devoted solely to merger and acquisition activities. There are additional publications, such as Financial Executive and Dun's Review, which devote space to merger activities. The fact that publications dealing exclusively with mergers and acquisitions exist, reflects the increased role of this segment of business. One such publication, Mergers and Acquisitions, is a series of monthly lists which cover acquisitions where the acquiring, or the acquired unit is engaged in

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[55]Ad by Corporate Seminars, Inc., Wall Street Journal, October 31, 1967, p. 16.

[56]"Mergers," Time, November 24, 1967, p. 104.

manufacturing, mining, wholesale or retail trade, or one of the service industries.[57] Although the lists do not purport to be complete, they are fairly well representative of larger acquisitions; small acquisitions are seriously underrepresented, according to the Announcement. Another publication by the NICB, already cited, is Mergers and Markets. This is an annual series which has been published since 1960. The emphasis of the studies is on the economic factors taken into account in the case-by-case enforcement of the merger act. The most recent edition "... is designed as a guide to the critical company and market facts taken into account by the courts in appraising the competitive consequences of different forms of acquisitions, and the implications of these appraisals for merger planning."[58] The series points up the fact that mergers and acquisitions are an important facet of the business community.

Lastly, the growth of the conglomerate form of business entrepreneurship has served as the training ground for numerous business leaders. For example, as noted above, Colvin, the founder of Corporate Seminars, has received his training in merger planning with Olivetti. However, Olivetti is not unique. Other companies are vigorously pursuing mergers and acquisitions. Consequently, the executives who are trained in the process often leave for other companies where their merger experience is utilized. Perhaps one of the fastest growing conglomerates is Ling-Tempco-Vaught. Its growth is achieved by means of product heterogeneity which is enhanced by mergers and acquisitions.

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[57] See Announcement of Mergers and Acquisitions (New York: National Industrial Conference Board, Inc., 1967).

[58] Ibid., p. 1.

This philosophy cannot fail to have some impact on the business community. Another training camp for corporate executives is Litton Industries. In fact, these executives who have dropped out of Litton refer to themselves as "Lidos." According to Business Week, "Each Lido has taken over one of the top three spots of other companies. Some started their own companies. Most of those who have been in their new jobs at least a year have gone a long way to upset the status quo of their companies."[59] The article also notes that the basic philosophy at Litton is entrepreneurship, opportunity sessions, and a strong appetite for growth through planning. "Litton believes in acquiring companies with a special knowledge as a means of attaining profitability in a new field, rather than taking the time to build from scratch."[60] Furthermore, Litton has recently moved toward public and social service. Litton has been active in both the Job and Peace Corps as well as working on the economic development of Crete and Western Peloponnesus in Greece.[61] As an aside, one cannot help but wonder whether Litton will start merging countries the way it has merged companies.

To reiterate, there does seem to exist a definite "demonstration effect" in terms of merger activity. Moreover, it appears that if the courts overturn the numerous horizontal mergers of Mead and St. Regis, it may necessitate that future acquisitions be along vertical or conglomerate lines. Also, one of the factors which serves as an obstacle to future merger activity in the paper and allied products industry,

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[59]"Litton: B-School for Conglomerates," Business Week, December 2, 1967, p. 88.

[60]Ibid., p. 90.

[61]Ibid.

is corporate attitude. However, it appears that the emerging executives within the industry are more cognizant of planned growth, utilizing mergers and acquisitions. Therefore, as stated earlier, perhaps, the industry is experiencing a period of readjustment, and is not in the doldrums of merger activity. Lastly, as noted in Chapter III, consolidations among all firms exist at approximately the same time in terms of activity. When one firm, say Mead, has been very active in acquiring new firms in the late 1950's, the other firms have also been busy acquiring new facilities. In essence, it seems that the industry is on the brink of a new merger wave. But if a pattern is developing, the new mergers may tend to involve larger scale acquisitions, such as the U. S. Plywood and Champion Paper consolidation. Similarly, these acquisitions may tend to involve interindustry consolidation. For example, there may be an increased number of mergers resembling the one in which Scott Paper acquired the Technifax Corporation and The Plastic Coating Corporation. As a result, Scott has entered and has become an important factor in the reprographics industry.

Foreign Acquisitions

Perhaps the most promising area in the development of new markets has been opened to the industry through the acquisition of numerous paper and forest products companies located outside of the United States. In Chapter IV, the discussion has shown where many of these acquisitions have initiated the foreign activities for a number of companies, though not until the mid to late 1950's. Nevertheless, the corporations have already realized the significance of such ventures to their overall corporate development. For the most part, International

Paper has acquired only foreign owned companies during the period covered by this study.[62] Consequently, a significant portion of International's growth can be traced to these mergers. However, since International is definitely the largest paper manufacturer, the company may well have turned to foreign operations in order to avoid antitrust regulations. Acquisitions on the domestic scene would, in all likelihood, be well screened by the Justice Department and the Federal Trade Commission.

Scott Paper Company considers the company's involvement in the international market as one of the most exciting new directions pursued in recent years. Quoting from the Company's 1966 Annual Report:

> Since its first investment in an overseas affiliate twelve years ago (1954), the Company's foreign interests have expanded at a rate of about three times as fast as its domestic operations. Scott affiliates, currently employing some 5,000 people, are located in 13 countries having a market potential of 400 million people.

The Report goes on to state:

> While the use of paper in the United States has reachdd a per person consumption level of 531 pounds a year, foreign use is only a fraction of that amount. The potential for growth is sizeable indeed.[63]

As in the case of Scott, St. Regis Paper Company has also pursued an extensive growth program through its foreign affiliates. The company has gained manufacturing and marketing facilities through both wholly-owned and partially-owned companies. Moreover, the company often has entered into patent license and technical aid agreements with foreign manufacturers. Overall, though, the situation faced by many of the

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[62]See Chapter III.

[63]Annual Report: 1966, The Scott Paper Company, 1967, p. 13.

companies is favorable in that the demand exceeds the supply of their paper products. Thus, the paper industry is faced with increasing markets, both domestic and international.

Another area of opportunity for the American companies to enrich their foreign markets is through the utilization of joint-ventures. Such agreements, perhaps, provide the best of two worlds in which American "know-how" can be coupled effectively with foreign "know-of." One such venture involved Crown Zellerbach--Crown-Van Gelder Papierfabrieken N. V., in Velsen, Holland, which was formed in 1963. Although only two years old, operating efficiencies and output have reached new peaks, and the quality of kraft grades produced have satisfactorily met customer demands.[64] The success of this venture may undoubtedly encourage the formation of other such endeavors. These facilities also provide the company with assured outlets for their products, especially pulp production, which may afford the companies an opportunity to reduce further excess pulp capacity.

Excess capacity helps explain, in part, why many companies had to turn to foreign markets in the mid to late fifties. During the early 1950's, the industry had found itself in the enviable position in which the quantity of its products demanded by the consumer--domestic consumer--could not be supplied by the industry. Prices were up, and capacity was being expanded to meet consumer demand. By the mid fifties, capacity exceeded the volume needed to fill customers' orders. The creation of new markets was important. Moreover, the Common Market was being created, reflecting the increasing potential of European markets

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[64] Annual Report: 1965, Crown Zellerbach Corp., 1966, p. 12.

which were to grow as the EEC grew. However, the paper and allied products did not limit itself to Europe. As noted in Chapter III, the companies serve markets throughout the world.

Another factor involving some of the non-domestic affiliates pertains to long-term purchase agreements. For example, Mead has agreed to purchase 50 per cent of the output of certain affiliates. The prices paid are to be "... sufficient to provide for all costs and expenses including interest on indebtedness, federal taxes on income, and adequate funds for the affiliates to pay current installments on their funded indebtedness."[65] Consequently, Mead has provided for the successful operation of these firms. Typically, the agreement also includes the stipulation that the remaining 50 percent be purchased under like terms by the other 50 percent owners.[66] A two-way street is the result. Mead has a market for its products; Mead also has a guaranteed source of supply for products which it needs. At some future date, this may become a problem because it is obvious that extensive arrangements of this nature could very well deny independent producers either sources of supply, or potential markets for their outputs.

Lastly, the importance of overseas markets can be briefly illustrated by an example involving the chemical sales of Union Bag Camp Paper Corporation. Union Camp's Chemical Division is the world's largest marketer of wood-derived chemicals among pulp and paper producers. The division has achieved varying degrees of market penetration

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[65] Annual Report: 1966, The Mead Corporation, 1967, p. 34.

[66] Ibid.

with shipments to 28 foreign countries. More significantly during 1965, these shipments accounted for more than 20 percent of the company's total chemical sales.[67]

To summarize this section it appears that the expansion of international markets may potentially serve as the area affording the greatest volume of growth. To compare the paper producing facilities of the United States with the rest of the world is to suggest that the latter lags in this facet of manufacturing. In order to illustrate this point, consider one company--Union Camp--and consider just one of its mills located in Savannah, Georgia. This mill is the largest and most fully integrated operation of its kind in the world. At the end of 1966, it has made an historic breakthrough by annually producing more than one million tons of brown (unbleached) grades of paper and paperboard. No other paper mill has achieved such a record. "And of all paper producing countries in the world, only fourteen turned out more paper in 1965 (the last year of available statistics) than did the Savannah mill alone in 1966."[68] True, the mill is unique, but its uniqueness points up the fact that the opportunity to provide the rest of the world with paper and allied products appears to be bright, indeed, for American companies.

After reviewing some areas which have emerged as a result of the merger activity within the industry, it appears that a readjustment period is under way, and the merger movement should regain its impetus

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[67] _Annual Report: 1965_, Union Bag Camp Paper Corporation, 1966, p. 18.

[68] _Annual Report: 1966_, Union Bag Camp Paper Corporation, 1967, p. 8.

as the 10 most active acquisitors move toward vertical and conglomerate type mergers. Competitive aspects which include both price and non-price competition have benefited the consumer and society. The benefits have included stability of prices, even lower prices in some sectors of the industry, greater availability of sources of supply, and increased potential entrants. Workable competition, the demonstration effect, and the significance of foreign acquisitions have been a development of merger activity.

CHAPTER VII

SUMMARY

There are a number of significant facets which have emerged from the investigation of the merger activities of the ten most active acquisitors in the paper and allied products industry from 1950 to 1965. However, if one factor seems to dominate, it is "CHANGE!" Throughout this paper, change seems to permeate nearly every fiber of the industry. Karl R. Bendetsen, while President of Champion Paper, Inc., has written:

> The predominant characteristic of life and of enterprise is change. The principal ingredient of growth itself is change, although change is not necessarily growth. It is axiomatic, of course, that change can be better or for worse. It follows then that of all futures for the paper industry, the single, predominant characteristic will be CHANGE--directed change for the better or misdirected change for the worse.[1]

Needless to say, Bendetsen is confident that the change would be for the better. It is interesting to note that the year this study commences approximately 50 percent of a felled tree is utilized. During the ensuing years this percentage has already been increased to approximately 85 percent.[2]

Moreover, change has appeared in a number of ways. For example, the volume of production has increased, meeting the ever increasing demands for paper and allied products. The additional products which are offered to the consumer, as well as the expansion of lines of

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[1]Karl R. Bendetsen, "Changing Characteristics of the Paper Industry," Financial Analysts Journal, XIV, January-February, 1967, 43.

[2]See p. 106.

existing products, further points up the changing character of the industry. Merger activity in itself represents change--especially product and market extension mergers. One example of product extension is Scott's acquisition of Tecnifax Corporation and The Plastic Coating Corporation. As a result, Scott has become an important factor in the reprographics industry. All of the companies have gained access to new markets through mergers, and as a consequence, many traditional markets are upset, necessitating even further change. Many of the traditional markets are being invaded by other paper companies. For example, Mead has gained new outlets from coast to coast, providing nation-wide distribution for their products.

Integration is another important area reflecting the changing character of the firms. Integration has been achieved, to a significant degree, through backward and forward acquisitions. These firms are usually classified as totally integrated paper companies.[3] In their standard stock reports, Standard and Poor's usually includes some mention of the fact that these paper companies are broadening their product lines, usually by acquisition. Another important aspect of integration, especially with reference to the local paper merchant, is direct mills sales. As the paper producers moved forward in their expansion and acquisition programs, more and more mills came into the area of merchant sales. Direct mill sales have had a major impact on the industry.[4] The Zellerbach Paper Company operates 25 distribution centers and 30 sales

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[3]See Standard & Poor's Corporation, Standard Listed Stock Reports. In their recommendation section, there are usually two terms mentioned: (1) leading integrated product, and/or (2) expanded product lines. Both terms signify change.

[4]See Chapter IV.

offices throughout the seven western states.[5] This is but one example of the increasing role being undertaken through direct paper merchandising sales. The companies are no longer dealing solely with wholesalers. In fact, this invasive action has necessitated a significant revision of the sales techniques employed by the local paper merchant.[6]

Before reviewing in detail some of these aspects of change, a mention of the basic process of paper making itself is in order. As Bendetsen has pointed out, "It is fair to say that there have been no basic innovations in the methods used to form paper and paper board since the invention of Louis Fourdrinier of the paper forming system which bears his name or since the advent of the less widely employed cylinder method."[7] However, another aspect of change comes to the fore in relation to paper making--planned obsolescence. Perhaps one of the best statements on plant obsolescence comes from West Virginia Pulp and Paper Company. Through an aggressive research program aimed at making the company's present equipment obsolete as rapidly as possible, Westvaco believes this is the best way to improve its competitive situation.[8] "One example of obsolescence induced by research is found in our large paper machines, which are as modern as we can make them. Even so, one research organization developed a distributor system for paper machine headboxes far superior to the system we were then using, which was the

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[5]<u>Annual Report: 1965</u>, Crown Zellerbach Corporation, 1966, p. 6.

[6]See pp. 163-168.

[7]Bendetsen, <u>op. cit</u>., p. 44.

[8]<u>Annual Report: 1965</u>, West Virginia Pulp & Paper Company, 1966, p. 7.

best available on the market. We installed this new component on six of our newest and largest machines at a cost of $200,000 a unit and scrapped the other equipment which was still quite new."[9] At the same time, the company is developing a new printing paper process bearing the trademark Accutrim. "If this development is as successful as we hope, it will make our existing equipment obsolete, but advance our competitive position in the process."[10]

The foregoing information points up a number of aspects of change pervading the industry. First, the development of new processes and techniques is extensively being pushed by all companies. Second, in order to achieve these new techniques, large sums of money are being allocated for research and development.[11] It is noteworthy that there is some mention of corporate research activity in the companies' annual reports. In fact, more and more space in the reports is being used to discuss the companies' research and development activities. When reading these annual reports written in the fifties, the dearth of data of any type on R & D is striking when compared to the annual reports of the same companies written in the sixties. Third, the competitive situation has truly undergone significant changes. Westvaco purportedly engaged in R & D to improve its competitive position.[12] At this point it is well to note that the spirit of dynamism seems to extrude change throughout all facets of the paper and allied products industry.

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[9] _Ibid_., p. 8.

[10] _Ibid_.

[11] See Chapter II.

[12] See Chapter VI, pp. 163-167.

The spirit of change perhaps serves as an indication that the merger movement has not contributed to a lethargic spirit. Just the opposite seems to be true. Purportedly, monopolization dampens the competitive spirit. If lethargy is a characteristic of monopoly--resting on one's laurels--then it would appear that the nearly two hundred mergers and acquisitions have significantly honed rather than dampened the competitive spirit of the industry.

Competition

In the last chapter, the transitory state of competition in the industry has been developed.[13] The industry has moved away from price competition to rigorous non-price competition. This does not mean that price competition is absent; quite the contrary is true. In spite of direct mill competition and excess production in some cases, prices have remained fairly stable. Some prices of product lines, however, have become depressed. Furthermore, there still is extensive discounting of established price lists, often resulting in a wholesaler or paper merchant absorbing a loss in order not to lose a preferred customer. Stephen Bolling of Mississippi Paper Co., commenting on the important changes over the last twenty-five years, has said, "Competition for business on the mill level has become especially important . . ." and "Merchants have always been accused of price cutting but mills seem even worse, in the face of excellent demand, even shortages."[14] However, the merchant faced with depressed prices has consequently turned increasingly to non-price competition.

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[13]See p. 163.

[14]Stephen Bolling quoted in "The 25th Anniversary Issue," Paper Sales, January, 1966, p. 52.

The trade publications usually have at least one article in each issue decrying the extensive practice of price cutting. For example, one such article has appeared in Paper Sales entitled, "21 Ways to Prove Your Price Is Right." The emphasis of the article is on ways in which the merchant may overcome the price objection--his price is higher than the ones for other comparable products. The fact that prices have tended to fluctuate has added greater depth to the local paper merchant. The latter, in order to overcome deteriorating prices, has become a specialist in those products he services. "Product knowledge has become a most important asset, especially in industrial packaging service."[15] Moreover, the local paper merchant has moved into the handling and distribution of other lines, such as sanitary supplies, film and equipment. These items are obviously not strictly paper products. This may be coincidental to the fact that the paper producers themselves are moving toward greater product heterogeneity. In essence, the paper merchant, faced with price competition from direct mill selling, has turned toward rigorous non-price competition, especially that of providing various types of service to his customers which, in general, are not provided by the mills. Besides, the paper merchant has become a specialist, gaining in a number of instances a greater knowledge of the needs of his customers than the customer realizes himself. Much of the development of extensive non-price competition can be attributed to the merger activity. By integrating their productive facilities, the paper companies have entered into the sphere of consumer distribution at an expanding rate. The paper merchant has had, for the most part, little choice but to change or be eliminated.

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[15]Ibid., p. 53.

This same spirit of survival has also become characteristic of the entire industry. Competition has been a contributing factor, interindustry competition. Perhaps one of the most significant aspects which has emerged from this paper is the growth of interindustry competition. The emergence of a multitude of good substitute products has changed the industry, particularly in packaging. Moreover, the introduction of new equipment has resulted in the obsolescence of existing equipment. This further reflects the competitive aspect of the industry. In other words, to gain a competitive edge by means of lower cost of production techniques, perfectly good but less efficient capital equipment is replaced.

The profit maximization thesis of traditional economic, microeco economic, theory suggests, as an industry moves toward monopolization, that prices may increase and output may diminish. After the wave of mergers which have been concluded by the ten most active acquisitors, neither of these conditions prevail. In fact, just the opposite seems to be true. The capacity of these firms is still being enlarged through capital expenditures as well as by acquisitions. This means that the capacity for the industry is growing, too. And as noted throughout the paper, prices in the paper industry have lagged other sectors of industrial community. One concluding note on interindustry competition needs elaboration. Often it is said that monopolization of profits becomes a long-run phenomenon. This means that even though the business firms may be unable or unwilling to maximize their profits in the short run, these firms will do so in the long run. Such a viewpoint seems to be further from the actual occurrences in the business community. It appears that the evolution of new products and new processes may become the most formidable obstacle to the attainment of monopolization in any one industry. In the business community of today, the innovational parade can easily pass by a company or even an industry. In brief, the role of the mills, new products, substitute materials, all have served in a significant way to maintain a strong competitive position within the industry. Competition here is two-fold: price and non-price. Since the maintenance of competition is stressed as a means of providing the consumer with the items desired at the most efficient rate, attention is directed toward the impact of mergers on the consumer.

Consumer

The consumer has benefited in a number of ways from the merger movement. Prices have remained relatively stable, and but for a few years the quantity of paper products demanded has exceeded the quantity supplied. Since numerous mergers have been classified as either geographical or market extensions, more products have been made available. These new distribution points also have provided a greater source of supply to paper merchants, as well as affording the merchant a greater variety of product lines which he, in turn, can offer his customers.

The merger movement has perhaps provided the greatest gain for the consumer in terms of new products. Due to increased intra-and inter-industry competition, the industry has truly experienced the emergence of product proliferation. Walden's Guide, a paper directory, cites numerous products of interest to the buyer of paper and related products. For example, under the heading Boxes, there are nearly ninety different types listed. This would be exclusive of various sizes, colors, and so forth.[16] A similar directory for 1961 listed less than thirty types

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[16]See Walden's ABC Guide and Paper Production Yearbook (Chicago: Walden, Sons and Mott, Inc., 1965).

under the same heading.[17] This approach--market orientation--is reflected in a report directed to Mead share owners in 1964.

> In a year which generated record production, sales, and profit totals, perhaps the most significant element for the future of the Corporation was an increased dedication to marketing as a way of corporate life. A number of dramatic steps were taken during the year to insure that all segments of the organization keep their energies directed toward satisfying customer requirements, rather than on production-oriented goals.[18]

The report goes on to discuss future planning with increased emphasis on the marketing scheme.

> We're dedicating ourselves anew to finding out how we can use our knowledge and capability to fulfill the needs of the customer to the fullest. . .[19]

Moreover, the corporation staged a number of marketing conferences with the explicit mission to develop more thorough marketing plans.

> Many activities formerly conducted separately--forecasts and plans, campaigns and needed research--were pulled together to unite all resources in the service of <u>what</u> the <u>customer wants</u>.[20]

A discussion of the Creative Consumer Packaging Division of International Paper is also illustrative of the increased emphasis on consumer choice. The company has established nine creative art centers to bring graphic and structural diversity to consumer packaging.[21] The applications, the company notes, are:

> In folding boxes the Lord Baltimore Press makes thousands of different styles and kinds of packages every year. Muirson Lable

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[17]See <u>Source of Supply</u>, Directory of Paper and Allied Products (Park Ridge: Peacock Business Press, Inc., 1961).

[18]<u>Annual Report: 1964</u>, The Mead Corporation, 1965, p. 4.

[19]<u>Ibid</u>., p. 27.

[20]<u>Ibid</u>., p. 28. Also see <u>Ibid</u>., pp. 29-32.

[21]<u>Annual Report: 1966</u>, International Paper Company, 1967, p. 2.

> Company, with the industry's largest library of food illustrations, produces millions of labels daily in more than thirty thousand different designs. Single service, which manufactures Pure-Pak plastic coated paper milk containers, maintains designs and plates for forty thousand individual items.[22]

The orientation is definitely toward serving the consumer.

In order to further enhance the industry's position, all the companies in this study have recently--mid 1960's--completed research facilities. New Ideas are paramount. "If necessity is the mother of invention, ideas are the father."[23] Union-Camp has created a full-time Ideation Group which is comprised of industrial designers who concentrate on identifying problems as well as opportunities in all areas germane to the company's operation.[24] Also, the company has set up an endowment at the Parsons School of Design where students probe the range of paper shapes and characteristics, adapting them to new uses in packaging and related areas.[25]

The establishment of new research facilities, the development of new products, the innovations achieved with better manufacturing techniques, coupled with relatively stable prices, all have served to provide the customer with new and imaginative materials which has definitely contributed to a better standard of living for the American people. One such example in the area of paper disposables is the development of a complete line of hospital products and paper dresses. In order to keep pace with changing consumer desires, it appears that the industry has

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[22] Ibid.

[23] Annual Report: 1965, Union-Camp Corporation, 1966, p. 17.

[24] Ibid.

[25] Ibid., p. 18.

developed more colors, designs and combinations to meet the changing temper of society.

Foreign Acquisitions

The most promising area in terms of potential as well as actual development of new markets has been afforded the industry through numerous acquisitions and joint ventures involving foreign paper and allied products companies.[26] A number of the mergers and acquisitions have been undertaken in order to initiate service to these foreign markets by the acquiring company.[27] In other words, the entrance to these markets apparently has become more accessible by means of mergers than by the creation of new facilities by American Paper companies. Moreover, the majority of these acquisitions are typically participating ownership agreements. The American company acquires a half interest, allowing local business interest to acquire the remaining stock interest. Moreover, a number of companies, St. Regis for instance, have also entered into a number of license and technical agreements with foreign manufacturers throughout the world. It should be further noted that the preponderance of these foreign acquisitions were undertaken in the late 1950's and early 1960's. For example, Scott Paper's first investment in an overseas affiliate had been rendered in 1954.

When per capita consumption is considered, it can readily be seen that the rest of the world is in need of additional paper and allied products.[28] Since the United States and only a few other countries

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[26] See p. 200.

[27] See Chapter III.

[28] See p. 10.

are paper exporters, and as the standard of living of the world increases, there will be greater demands placed upon the producers of paper products.[29] Typically, the volume of goods demanded runs well ahead of the volume of the paper and allied products produced. The growth potential of world markets is sizeable. The significance of these growth markets becomes more apparent each year as foreign-made sales account for an increasing share of the total sales of these companies. For example, in 1965, the chemical sales shipped by Union Camp's Chemical Division to 28 foreign countries represented approximately 20 percent of the Division's total sales.[30]

Lastly, foreign acquisitions can play an important role in the current balance of payments deficit of the United States. By developing numerous foreign affiliates, the American companies gain a two-fold advantage. First, they are assured of markets for their goods. And second, any profits generated by these foreign affiliates can be expropriated to this country. Both will favorably aid this country's payments positions. Moreover, since partially-owned affiliates are very common, this helps reduce the need for large outflows of American capital. In brief, the growth of foreign markets should, indeed, prove to be one of the most exciting developments for the paper and allied products industry, and when coupled with the evolution taking place domestically, it would appear that the potential growth of the industry is assured.

Antitrust Aspects of Mergers

The most relevant factor restricting merger activity is the role played by the regulatory agencies. This is illustrated by the fact that

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[29]See p. 35.

[30]See p. 203.

the preponderance of the cases have been settled by either consent orders or judicial review.[31] Moreover, the numerous cases discussed have substantiated the fact that it now appears section 7 of the Clayton Act, as amended, is truly a major obstacle to the merger movement within the industry. In general, the cases handled by the Justice Department and Federal Trade Commission have been primarily concerned with horizontal and vertical mergers. Since the relevant market served by acquired and acquiring firm is the keystone in every case, two factors have emerged--the number of firms and the percentage share of market. Under section 7 it appears that these two facets have proved to be insurmountable for the acquiring firm in the mergers challenged. In brief, horizontal and vertical mergers have been fairly well controlled. Conglomerate type--especially product extension--have remained unchallenged.

However, there is another aspect emerging, which appears to run counter to the basic philosophy as expounded by the proponents of a rigorous antitrust policy. Willard F. Mueller, Chief Economist and Director of the Bureau of Economics, Federal Trade Commission, in contrasting the current merger movement with earlier movements, notes that the antitrust agencies have been given a powerful tool--The Celler-Kefauver Act of 1950--with which to effectively deal with the most obvious anticompetitive mergers, i.e., horizontal, vertical, and geographical market extension mergers.[32] The Act, he notes further, has been passed in recognition of

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[31] See p. 185.

[32] Willard F. Mueller, "Merger Enforcement Policy," A Position Paper for the Professional Dialogue on Marketing and the Federal Trade Commission, Winter Meeting of the American Marketing Association, Washington, D. C., December 29, 1967, p. 1.

the failure to deal adequately with anticompetitive mergers between 1890 and 1950.[33] However, the main issue at this point is Mueller's statement: "The important point to grasp when interpreting this statute is that it is designed to strike at monopoly in its incipiency."[34]

It is the philosophy of striking at monopolization at its incipiency that is somewhat befuddled by the action of the regulatory commissions. There are still a number of significant merger cases pending, i.e., The Mead Corporation, and St. Regis Paper Company cases. These cases are significant in that they may well suggest the manner in which future acquisitions may be controlled by the regulatory agencies. Assuming that the basic philosophy of antitrust is to nip monopoly at its incipiency, one is made to wonder how the term incipiency applies to the mergers undertaken by firms in the paper and allied products industry. For example, the above mentioned St. Regis case involves an FTC complaint dated July 7, 1965. The Commission is not challenging one, two, or even three acquisitions, but rather the complaint lists 15 acquisitions which St. Regis completed between 1954 and 1960.[35] It does seem that eleven years after a merger has taken place is not attacking monopolization at its incipiency. Moreover, if the case goes against St. Regis, in all likelihood divestiture will be ordered. Obviously, these firms cannot be restored to their original market positions. Thus, it does appear even more likely that these firms may

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[33] *Ibid.*, p. 1. Also see Chapter V, this paper, for a detailed statement in support of this viewpoint.

[34] *Ibid.*, p. 2.

[35] Betty Bock, *op. cit.*, p. 243.

become part of another corporate giant, say Procter and Gamble. "Says one antitruster: 'Selling a company isn't all that easy. With so many companies joining together, many times the only buyer you can find is another giant like the one you're trying to cut back.'"[36] It appears further that the problems associated with divestiture grow more enormous as the time between the initial complaint and the settlement of the case grows more distant. Therefore, it seems that if long drawn-out cases are designed to nip monopolization at their incipiency, it does appear that the regulatory bodies are creating situations which apparently they are trying to avoid. The only possible justification may be that conglomerate mergers are more desirable than vertical or horizontal ones.

Thus, the role being played by the regulatory agencies has become a formidable obstacle to vertical, horizontal and geographical mergers. On the other hand, the "negative space" mergers have remained, for the most part, unchallenged. In general, the majority of mergers discussed in this paper did go unchallenged. Still, the historical nature of mergers within the industry has tended toward those types which are most susceptible to regulation under the amended section 7. As the industry moves away from this traditional approach, antitrust procedures may no longer hold in check the merger movement. However, this does not mean to imply that no new horizontal or vertical mergers may be completed. On the contrary, these types of mergers will exist, but they will be fewer in number. Since "negative space" mergers may remain relatively unchecked, it may be reasonable to expect future mergers to widely reflect

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[36]"Finding Homes for Merger Orphans," Business Week, December 9, 1967, p. 154.

this phenomenon. Mergers may, for the most part, be large scale--involve firms with annual sales in the $100 million or more category. In brief, horizontal, vertical, and/or geographical market extension mergers, though occurring, may become less significant to the ten most active acquisitors in the paper and allied products industry.

Other Emergent Factors From the Study

There are a number of other significant factors which became apparent upon investigation. One element is related to the so-called "Demonstration Effect" which seems to pervade the entire business community with reference to merger activity.[37] A number of factors have emerged in support of this viewpoint. For one, there are numerous publications which are related exclusively to merger activities that have recently (mid-sixties) come into existence, such as, "Growth and Acquisitions Guide" which is published each month by Predicasts, Inc., in Cleveland, Ohio.[38] Also, a new breed of management consultants is springing up in order to locate potential mergers. The finders' fee can be substantial. It often runs as high as 10 percent of the gross sales of the acquired company. In addition, the finder need not concern himself with the ultimate success of the venture; the fee is paid regardless of the amount of success or failure of the merger. Lastly, the number of mergers tends to suggest a "demonstration effect." This is analogous to keeping-up with the Jones' as a motivation for corporate

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[37]See pp. 193-200.

[38]The series is designed for the business community. Not only are mergers and acquisitions summarized, but an analysis of potential areas for mergers and acquisitions is also provided by Predicasts.

behavior. Though not easily shown by empirical data, it does appear to be a relevant factor, and one which seems to become more important with successive generations of business executives.

Concentration has presented surprising factors. Concentration did not fully emerge. When data relevant to the ten most active acquisitors (sales, assets, and so forth) are compared to industry totals, there is no clear pattern which reflects concentration. Even though these firms are the most active acquisitors, their overall relative market share has stayed fairly constant. Company growth records seem to parallel that of the industry. In brief, it appears difficult to show conclusively that these firms have gained a dominant position in the industry through their acquisitive spirit. In fact, this study tends to imply that these firms may have experienced a declining market share had they not pursued an active merger program.

Another facet which has emerged pertains to the role of profit maximization. A number of reasons which may invalidate such a premise has been discussed.[39] However, it is well to note the conclusion: profit maximization appears to be unfeasible in either the short run or the long run. In the short run, each of the companies has provided numerous public services which have the effect of raising the cost of production without gaining commensurate price increases; profits are not maximized. With reference to the long run, it seems that profit maximization is even less probable. Inter- and intraindustry competition serve to curb long-run gains. More specifically, technological advances have been coming at a greater pace each year. This means that the long run

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[39]See p. 189.

is even more tenuous since today's products may exist, but their composition may well be of a completely new material tomorrow (plastic instead of cardboard containers). Nonetheless, the findings suggest that the firms have neither maximized profits nor increased prices. The overall effect favors the consumer.

To summarize, there seems to be little indication that the merger trend within the paper and allied products industry may cease, especially the merger activities of the ten most active acquisitors. It does appear, however, that there may be a shift in direction, as these firms move into the area termed "negative space" mergers. It further appears that mergers are more likely to enhance product heterogeneity rather than market heterogeneity. This seems probable because the regulatory bodies have apparently concerned themselves more with vertical and horizontal mergers rather than with conglomerate mergers. In addition, as more firms find their traditional markets being encroached upon, there is a tendency to turn to diversification mergers. A good example is when Procter and Gamble and Boise Cascade entered the market areas served by Scott. Such encroachment by firms now in the industry as well as potential entrants suggest that many firms may turn to greater product diversification achieved through acquisition. Since the cost of mergers is often far less than building new facilities, the merger movement may be fanned as the investment capital markets tighten up as a consequence of the strong inflationary pressure which has existed these last few years. Moreover, it actually seems as if the merger movement implies a cause and effect relationship in itself. It appears that a true demonstration effect exists in regard to mergers, and once the momentum gets under way, the forces feed, as well as fan, themselves to greater heights. Unless a major economic downturn occurs, a new merger law written, or growth by merger can be shown to be an unsound business policy, it is reasonable to expect the movement to continue. Moreover, there seems to be little economic justification to suggest the movement should be thwarted. In fact, it further appears that the merger movement should be encouraged in this particular industry.

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