Conglomerate corporations

**Definition:** Conglomerate from *The AMA Dictionary of Business and Management*

Diverse and disparate group of companies under a common holding company. In most cases, the individual companies have unrelated businesses. Conglomerates often lack a clear strategic focus and the operating subsidiaries are thus unable to derive synergy from their combined operations.

**Summary Article: Conglomerates**

from *Encyclopedia of Social Problems*

A conglomerate is a company engaged in often seemingly unrelated types of business activity. Two major characteristics define a conglomerate firm. First, a conglomerate firm controls a span of activities in various industries that require different managerial skills. Second, a conglomerate achieves diversification primarily by external mergers and acquisitions rather than by internal development.

There are three types of conglomerate or diversifying mergers: (1) product extension mergers that broaden the product lines of firms, (2) geographic market extensions that result in nonoverlapping geographic areas, and (3) pure conglomerate mergers that involve combining unrelated enterprises. Common motives for conglomerate mergers include financial synergies, taxes, and managerial incentives.

Conglomerate mergers were popular in the 1960s because of low interest rates and favorable economic conditions. Small- or medium-size firms facing diminished prospects for growth and profits decided to diversify into more promising industries. Acquiring firms borrowed low-cost funds to buy businesses outside their traditional areas of interest. The overall return on investment of the conglomerate appeared to grow as long as the target company had profits greater than the interest on the loans. In practice, much of this growth was illusory and profits fell as interest rates rose. During this merger wave, about half of the firms considered as conglomerates were based in the defense and aerospace industries.

In 1968, Congress moved against conglomerate firms by passing hostile anti-trust policies and punitive tax laws. These factors plus declining stock prices brought an end to the conglomerate fad. Because of the lack of success of many conglomerate mergers, managers shifted their focus from diversification to a firm’s core competency.

Various arguments exist for and against the diversification achieved by conglomerates. Proponents argue that the conglomerate organizational form allows for allocation of capital in a more efficient way. Other potential advantages include stabilizing earnings, cost and revenue economies of scope, lower tax burdens, sharing of managerial “best practices,” and better monitoring and control of capital expenditures. Arguments against diversification include cross-subsidization across business lines, overinvestment in certain projects caused by excess free cash flow and unused borrowing capacity, and conflicts of interest among various activity areas.

An important issue is whether conglomerates create or destroy value. Although some mixed evidence exists, research suggests that diversification does not increase the firm’s value in most cases. That is, diversified firms are worth less than the sum of their individual parts. For example, empirical studies of financial conglomerates suggest the presence of a financial discount caused by diversification. Thus,
the impact of functional scope is predominantly value destroying. However, the benefits of geographic diversification appear to outweigh its costs and lead to value enhancement.

Today, examples of large conglomerates include Time Warner, AT&T, General Electric, News Corporation, and Walt Disney Company in the United States; Sony and Mitsubishi in Japan; and Siemens AG in Germany. For instance, Time Warner is a leading media and entertainment company, whose businesses include interactive services, cable systems, filmed entertainment, television networks, and publishing.

**See also**
- Economic Restructuring
- Global Economy
- Globalization
- Multinational Corporations

**Further Readings**

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