AMERICAN ECONOMIC LIBERTIES PROJECT

Executive Summary

The Roll-Up Economy: The Business of Consolidating Industries with Serial Acquisitions

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While large mergers in concentrated industries make national news and present a serious problem, the focus on headline-making mergers can ignore a potentially more concerning trend: the intentional consolidation of fragmented industries through small, “serial acquisitions.” Long a core aspect of the private equity business model, serial acquisitions are now endemic to American commerce. Whether it is magic mushrooms, youth addiction treatment centers, mobile home parks, nursing homes, comedy clubs, ad agencies, water bottles, local newspapers, or health care practices, many local businesses normally thought of as independent are being swept up in serial acquisition sprees. Today even publicly traded firms and start-ups use this consolidation strategy to pursue higher returns.

However, Section 7 of the Clayton Antitrust Act sought to prohibit such serial acquisitions with a standard for “incipient monopolization.” It stated that no firm can acquire the stock or assets of another “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.” The 1950 Celler-Kefauver Amendment bolstered the focus on curbing monopolization in its incipiency by removing loopholes and broadening the standard to block vertical and conglomerate mergers or acquisitions.

This incipiency standard of the Clayton Act — prohibiting acquisitions that might harm competition in the future — was initially interpreted very broadly to prohibit mergers large and small. As the Supreme Court interpreted it, the standard “requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future.” Small-scale mergers were not exempt, because “remaining [competitive] vigor cannot immunize a merger if the trend in that industry is towards a monopoly,” as is the case with many industries being consolidated through small acquisitions today.

Serial acquisitions were explicitly considered in both the legislative background of the 1950 Celler-Kefauver Act and in subsequent interpretations of it. The legislative history reveals a fear that companies would extend “their power by successive small acquisitions” which would “convert an industry from one of intense competition among many enterprises to one in which three or four large [companies] produce the entire supply.” The 1962 *Brown Shoe* and 1966 *Von's Grocery* decisions both blocked small mergers in unconcentrated markets, based on concerns about future threats to competition. When ruling to block a banking merger in 1963, the Supreme Court stated, “A fundamental purpose of amending § 7 was to arrest the trend toward concentration, the tendency of monopoly, before the consumer’s alternatives disappeared through merger, and that purpose would be ill-served if the law stayed its hand until 10, or 20, or 30” more firms were absorbed.

However, changes to the legal and regulatory landscape weakened incipiency enforcement since the 1970s, such that, despite their expanding prevalence in many industries, serial acquirers fly under the regulatory radar into an antitrust twilight zone. In addition to generally scaling back merger enforcement, merger filing thresholds under the Hart-Scott-Rodino Act (HSR) only require that companies report acquisitions to the FTC if they are valued at over $101 million, so serial acquirers rolling up industries with many small transactions are never seen or reviewed by antitrust enforcers. To give a sense of the potential scale of the problem, in 2021, there were 21,994 total merger transactions in the United States, yet under 20% — only 4,130 — were reported to the FTC. Similarly, in 2020, there was a total of 16,723 transactions, and only 1,637 — under 10% — were reported. While these legal changes primarily served to weaken enforcement against large mergers in concentrated industries, they also had the effect of limiting the scrutiny that smaller serial acquirers face.

As a result, companies have found many benefits in pursuing a strategy of serial acquisitions in the loose regulatory environment of the past 40 years. Multiple studies show strong, positive correlations between serial mergers and acquisitions and total shareholder returns (TSR) and enterprise value (EV). How serial acquirers turn acquisitions into shareholder value varies. Sometimes the value derives from increased efficiencies or valuation increases, but in other cases, it comes from exercising consolidated market power by raising prices or extracting concessions from stakeholders like workers or suppliers. As a result, companies that make serial acquisitions a core part of their corporate strategy are typically motivated by one or more of five commercial pursuits: lower-risk expansion, greater efficiency from scale, increased pricing power, stronger buyer power, and valuation arbitrage. Some of these motivating factors — like greater efficiency and lower-risk expansion — can genuinely enhance the quality of products, services, or supply chains. However, acquirers that seek to increase their market power and then leverage stronger pricing or buyer power can easily find themselves in anticompetitive territory or demonstrating monopolistic behavior.

In addition to some of these intrinsic commercial motivations and the permissive environment created by the nonenforcement of key areas of antitrust law, the growing trend of serial acquisitions has been amplified by several notable factors that converged in the aftermath of the financial crisis and, more recently, the COVID-19 pandemic. An increase in the number of acquirers, and their unprecedented access to capital, has coincided with the "silver tsunami" demographic change as more business owners look to retire. Approximately half of businesses are owned by Baby Boomers, and 60% are expected to sell within the next 10 years. These combined factors have produced record M&A activity across all segments of the market.

The rise of private equity is a significant contributor to the rise of serial acquisitions. Cheap debt from the Federal Reserve following the 2008 financial crisis helped balloon the private equity industry. At the same time, large institutional investors dramatically increased their

allocations to private equity. U.S. pension funds, as an example, have increased their private equity allocations almost 40% from 6.5% to almost 9% between 2010 and 2021, and now total approximately $480 billion. This translates to more industry consolidation, and less transparency in markets. There are now more than twice the number of private equity-owned companies as there are public companies — more than 8,000 nationwide.

As the industry grew, private equity investors went looking for less crowded deals, resorting to roll-up strategies in fragmented industries with lower acquisition costs. The investment structure of private equity creates strong incentives to pursue serial acquisitions, and in 2020, 71.1% of private equity deals in the U.S. were add-on acquisitions that consolidated the acquired companies. Many of these add-ons fall below the HSR reporting threshold, with the median buyout size now around $70 million, and over 50% of add-ons falling below $100 million.

Three case studies demonstrate the dynamics of serial acquisitions in different industries and its prevalence across different types of investors: private equity's roll-up of physician practices; EssilorLuxottica's eyewear monopoly gained through small, serial acquisitions; and the start-up Thrasio, which has raised significant venture capital investment to roll-up Amazon third-party sellers.

To address the anticompetitive harms of serial acquisitions, we make the following recommendations, with more detail in the full report:

Reinvigorate the Clayton Act's Incipiency Standard
Section 7 prohibits any acquisition or merger where "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." The FTC and DOJ already have the authority to act against these harmful serial acquisitions through reinvigorating and enforcing this law – particularly for mergers and serial acquisitions in similar or adjacent industries, or which draw from the same labor pool. This revived incipiency standard should be included in the new merger guidelines.

Consider Non-price Effects
Merger policy and enforcement has, for too long, had a near singular focus on efficiency through price, which has ignored many other substantial harms to stakeholders. In addition to price effects, regulators and enforcers should focus on additional harms such as monopsony effects on labor, quality of products and services, new firm exit and entry rates, effects on innovation, and disinvestment strategies by the acquiring firm.

Consider Role of Debt in Merger Analysis
Serial acquirers typically have access to and carry higher levels of debt, which provides them with a competitive advantage over other prospective acquirers such as local acquirers or

independent entrepreneurs. Additionally, high levels of debt, especially in a rising interest rate environment, can put pressure on serial acquirers to pursue price hikes or wage cuts. The FTC should investigate the role of bank and non-bank lenders in enabling consolidation through serial acquisitions, and also consider incorporating the amount of debt as an indicator for the anticompetitive intent of the merger.

Remove "Safe Harbor" Provisions From Merger Guidelines
Since 1982, merger guidelines have included general guidelines for a "safe harbor" — a level of industry-wide concentration below which the agencies will not challenge a merger. The FTC and DOJ should eliminate any such assurances in the new merger guidelines.

Transparency in Merger Notifications
The FTC should notify the public of the existence of all Hart-Scott-Rodino merger notifications the moment they are filed, even as the detailed filing will remain confidential.

FTC Exemption from the Paperwork Reduction Act (PRA)
The FTC should be completely exempted from the PRA, which currently requires Office of Management and Budget for the FTC to seek information from 10 or more market participants during a 6(b) study.

New Investigative Criteria for Serial Acquisitions
New investigative criteria should be developed to challenge serial acquisition strategies.

- First, this should include criteria about the size, number, and rate of acquisitions. The agencies should determine the appropriate levels based on further review.

- Second, complex legal or tax structuring can often convolute who the ultimate acquiring firm is in a transaction. In the case of private equity firms, beneficial ownership should be traced to their portfolio company, as is reported to their limited partners, as well as the private equity firm itself.

- Third, investigators should request information specific to serial acquisitions, including investment materials, such as private placement memorandums, management or lender presentations, documents prepared for the purposes of soliciting investment, and. commercial loan documentation to understand a company's acquisition plans and financing strategy.

Preapproval or Moratorium Requirements for Violations
Companies who have recently been found to have violated the antitrust laws or the terms of a consent decree should face a time-limited moratorium on future acquisitions for a period of three to five years following the violation. An alternative penalty would require the company

to seek preapproval from the FTC for any future acquisitions. The FTC should study whether a moratorium or preapproval would be a stronger and more practical deterrent to illegal behavior. Whichever approach the FTC prefers, we recommend that it apply to all of the portfolio company's future acquisitions within the specified time frame, as well as those by its majority shareholder (i.e., a private equity fund manager) within the same sector or market (including labor markets) for the same time period to get around beneficial ownership obfuscation schemes.

Review Enforcement of Regulations Against Corporate Ownership

In numerous industries in the U.S., particularly in healthcare, there are existing regulations that are intended to prohibit corporate ownership of businesses by non-licensed professionals. However, many of these regulations have been underenforced by the relevant state or industry regulators. The FTC and DOJ should work in collaboration with state regulators to review the lack of enforcement on restricted ownership and, where necessary, consider changes to enhance enforcement.

Statutory Changes to Merger Review

In addition to these immediate regulatory and enforcement actions, several possible statutory changes should be considered to improve merger review:

- Lower notification thresholds: Notification thresholds for Hart-Scott-Rodino filings should be lowered. Evidence indicates that the mere existence of notification requirements is an effective deterrent to many anticompetitive mergers.

- New notification threshold by number of transactions: Expand Hart-Scott-Rodino notification requirements to include the most rapidly acquisitive firms, regardless of their size. We recommend that firms that make more than six acquisitions in one calendar year — roughly one acquisition every other month — within the same sector or labor market, and in cases where the acquisition grants the acquiring firm a controlling interest, are required to report these acquisitions to the FTC on an annual basis.

- New Disclosure Requirements: Merger filing requirements should include new requests for naming the ultimate beneficial economic owners of the acquiring firm as well as the disclosure of any investment memoranda or investment summaries used to attract investment in the acquiring firm or its ultimate beneficial economic owners.

- Sharing of HSR Filings with States: The FTC should be given the authority to share HSR filings with state governments and attorneys general.

As the Federal Trade Commission and Department of Justice conduct a wholesale review of both the strength of current merger guidelines and agency enforcement practices, we believe serial acquisitions should be an area of particular attention. They cause substantial harms to consumers, suppliers, workers, and competition itself. The scale of the problem is still likely underappreciated, given that neither regulatory nor public attention has focused on the issue. The antitrust statute regarding mergers, the Clayton Act, was written specifically to prohibit monopolization "in its incipiency," well before dramatic harms were inflicted on stakeholders across the economy. Today, a similar strength of vision is needed to course-correct the roll-up economy threatening American workers, consumers, and prosperity.

AMERICAN ECONOMIC LIBERTIES PROJECT

The American Economic Liberties Project is a new, independent organization fighting against concentrated corporate power to realize economic liberty for all, in support of a secure, inclusive democratic society.

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