The Public Policy of Antitrust and Strategy: An Overview

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For more than a century, the United States has used antitrust law in an effort to control business behavior by forcing firms to compete. The same era that gave birth to antitrust law also witnessed the creation of the business school. In what must constitute one of the legal system's biggest ironies, however, antitrust law has largely ignored the insights of business theory and scholarship, choosing instead to focus on economics as a sister discipline. As the brand of economics used by antitrust law shifted from Harvard School industrial organization to Chicago School price theory, courts, policymakers, and antitrust legal scholars increasingly attempted to force the facts of actual business behavior to fit into a simplistic framework that explained all conduct as a rational attempt to maximize profits. During its first 85 years, antitrust law addressed three harms to competition: (1) the loss of a level playing field for competitors, (2) the exclusion of competitors from access to markets, and (3) the loss of consumer welfare (see Fox 2002). The hard form of price theory advocated by Chicago School adherents, however, refused to acknowledge any type of injury to competition other than consumer welfare losses. As the Chicago School influence reached its zenith during the Reagan Administration, concerns began to surface about the "Faustian Pact" of antitrust law and economics (Rowe 1984). Business scholarship has drawn increasing attention in the search for an alternative or, at least, a complementary approach to economics that could account for both the actual behavior of businesses and the harms to competition beyond consumer welfare loss (Waller 2001).

Business schools house a rich variety of disciplines. It is no more likely that any one discipline holds the key to antitrust law than it holds the key to successful business operations. Nonetheless, strategic management, similar to marketing, offers a particularly good source of insights for antitrust law because it focuses on the actual behavior of firms in markets. Thus, even Chicago School proponents such as Posner (1979, p. 939) have suggested that strategic management may yield important insights for antitrust law.

Some Antitrust Insights from Strategic Management

Even at this early stage into the potential uses of strategic management in antitrust law, two insights have emerged. First, strategic management provides a basis for challenging the Chicago School assumption that all business behavior can be explained as a rational effort to maximize profits.

Second, strategic management suggests the need for increased attention to the anticompetitive potential of vertical restraints.

A Challenge to Rational Profit Maximization

The narrow version of price theory that dominates antitrust law assumes, almost as a matter of faith, that firms act in a rational manner to maximize their profits (Bork 1978, p. 116). Occasionally, a firm may behave in an irrational manner or seek to attain some goal other than profit maximization, but the rational profit maximizing firms will quickly obliterate such aberrant firms, and therefore such firms should not concern antitrust law. From this vantage point, predicting the conduct of a firm becomes a simple matter of deductive logic; that is, what would a rational profit maximizing firm do? Strategic management, however, challenges this critical assumption in two respects. First, strategic management teaches that firms should seek sustainable competitive advantage, not maximum profits. Second, and more important, strategic management acknowledges that firms act on emotional as well as rational motives. For example, only Besanko, Dranove, and Shanley (2000) advocate profit maximization as an appropriate strategic goal or motive, and even they concede that it is not universally accepted in strategic management. More typically, strategic management rejects profit maximization as vague and overly broad (Hussey 1999, p. 25; Saloner, Shepard, and Podolny 2001, p. 21). Although strategic management teaches that a firm must earn profits or, more important, maintain profitability, profits may be perceived less as an overarching goal and more as a means to an end, such as survival or the satisfaction of multiple stakeholders, not just shareholders, claims on the firm (Barney 2002, p. 28; Hitt, Ireland, and Hoskisson 2001, p. 5; Thompson and Strickland 2001, pp. 42–45).

Sustainable competitive advantage, not profit maximization, constitutes the "holy grail" of strategic management (David 2001, p. 5; Saloner, Shepard, and Podolny 2001, p. 40; Thompson and Strickland 2001, p. 55). Operationally, sustainable competitive advantage is the ability to do something better than or different from the firm's rivals using resources or skills that its competitors lack (Barney 2002; Besanko, Dranove, and Shanley 2000, pp. 405–407). In economic or performance terms, sustainable competitive advantage enables a firm to enjoy consistently above average profits (Besanko, Dranove, and Shanley 2000, p. 389; Hitt, Ireland, and Hoskisson 2001, p. 5). Students of strategic management are not taught to seek or measure success against the maximum potential profits of the firm. Instead, they are taught simply to outperform rivals. This approach could result in the same end as profit maximization, because every attempt to beat the average could raise the average until every firm performs at its highest level of profitability (Barney 2002, pp. 26–27). Although this argument, which

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could bring analysis back into the Chicago framework, is not without merit, it still assumes that businesses rationally pursue sustainable competitive advantage.

This discussion suggests that the most striking thing about strategic management to an antitrust law scholar is not the substitution of sustainable competitive advantage, but the willingness of strategic management to consider emotional as well as financial motives in firm behavior. For example, according to Bourgeois, Duhaime, and Stimpert (1999, p. 27), "managerial decision making is typically anything but a rational and well-informed 'grand plan.'” Unlike the strict price theory of the Chicago School, strategic management acknowledges that a firm's culture influences its behavior (Saloner, Shepard, and Podolny 2001). Further research into strategic management's integration of psychological and economic factors may provide a way to explain actual firm behavior that stretches people’s faith in the rational profit maximizing firm to the limit (Ghemawat et al. 1999, pp. 79-81). Although the policy implications await further research, this insight suggests that courts should be reluctant to dismiss cases on the basis of only the deductive logic of what a rational profit maximizing firm would or would not do.

A New Method of Competitive Analysis

The Chicago School framework views competition in the only sense that price theory allows, the point at which marginal cost intersects demand (Bork 1978, p. 94). In a competitive market with perfectly elastic demand, a firm cannot increase profits by raising prices. Any attempt to raise prices would result in the firm’s buyers switching to competitors. However, in the absence of competition, a firm will increase price to the point where marginal cost intersects marginal revenue. These two insights are illustrated in Figure 1, where Pc is the competitive price and Pm is the monopoly price (Bork 1978, p. 100).

Figure 1. Monopoly

![Monopoly Diagram](image)

Within the confines of the Chicago School model of competition, researchers can debate whether, as Chicago theorists such as Bork (1978) suggest, the great evil of monopoly is that the monopolist fails to appropriate him- or herself all the wealth the consumer loses as price moves from Pc to Pm (the consumer welfare loss triangle in Figure 1) or whether, as post-Chicago scholars such as Lande (1982) suggest, the great harm is the loss of consumer wealth regardless of where the lost wealth ends up. Either way, the model successfully illustrates some of the cost imposed on society by lack of competition. The policy consequences from this view require condemnation of conduct that clearly causes a firm's demand to curve from elasticity to inelasticity (e.g., agreements among competitors to fix prices). Because the model suggests that a firm in a competitive market can increase profits only by lowering marginal costs, conduct that reduces marginal costs should be legal, even if undertaken by monopolists and regardless of its ability to create harm to competition in the level playing field or the exclusionary sense.

Problems with the Chicago model emerge when people begin to consider conduct such as a merger between actual or potential rivals that may reduce marginal costs even as it decreases competition. Chicagoans argue that the conduct's legality depends on whether it increases the size of the consumer welfare loss triangle, even as they concede that “accurate measurement of the actual situation is not even a theoretical possibility” (Bork 1978, p. 125). The model does not provide guidance as to what factors give a particular demand curve its particular slope, other than the commonsense intuition that buyers will consume more if prices decrease and less if prices increase. The model also does not provide a basis for explaining how the factors that dictate the slope of the demand curve interact with each other and change over time. In short, the model provides some useful theoretical and general insights into the outcomes of the competitive process, but it cannot serve as a practical tool for analysis of the process itself or the actual competitive conditions faced by firms in actual markets. For these and other reasons, critics such as Hunt and Arnett (2001) are skeptical of the use of price theory in antitrust law.

The basic tool used for competitive analysis in strategic management is Porter’s (1980) Five Forces, which remedy many of the deficiencies found in the Chicago School model. According to Porter, five interrelated forces dictate the level of competition in an industry: threat of new entrants, threat of substitute products, bargaining power of suppliers, bargaining power of buyers, and rivalry among existing firms.

Chicago's model for competition is almost always illustrated as in Figure 2, and the Five Forces are typically illustrated as in Figure 3 (Porter 1980, p. 4; Saloner, Shepard, and Podolny 2001, p. 126). Although a full exposition of the Five Forces model is beyond the scope of this article, Porter’s model provides a method for gauging the level of competition. The scope of the Five Forces may not be new to antitrust law. For example, it could be argued that the merger guidelines used by the Federal Trade Commission and the Department of Justice incorporate many, if not all, of these factors. Still, examining the same factors from different perspectives— including business managers— may
yield new insights. However, the implications of the Five Forces model almost certainly goes beyond a fresh perspective. For example, Porter’s model suggests that antitrust law may have focused too much on intraindustry rivalry and not enough on vertical restraints. The Five Forces are interrelated, and the first four emphasize intraindustry rivalry. Chicago-influenced antitrust law doctrine assumes that vertical restraints stimulate intraindustry rivalry by lowering marginal costs (Continental T.V. Inc. v. GTE Sylvania Inc. (1977)). However, the Five Forces model suggests weakening the bargaining power of suppliers so that buyers can reduce intraindustry rivalry. At the very least, the Five Forces model cautions against an assumption that exclusive dealing agreements, resale price maintenance agreements, and territorial restrictions result from a manufacturer’s quest to increase competition by lowering marginal costs.

**Conclusion**

This overview demonstrates the need to go forward with additional research to determine the full policy implications of strategic management teaching and scholarship. Early in his legal career, Justice Oliver Wendell Holmes (1881, p. 1) said that the “life of the law is not logic, it has been experience.” If antitrust law is to take this admonition seriously, it must reduce its reliance on the abstract logic of price theory and seek out new tools from disciplines that study and explain the actual experiences of businesses. Marketing and strategic management are two such disciplines.

**References**


