

Power Incorporated

BOOK REVIEWED:

Edward S. Herman, *Corporate Control, Corporate Power*. A Twentieth Century Fund Study. New York: Cambridge University Press, 1981.

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It is now some fifty years since Adolf Berle and Gardiner Means announced the "splitting of the property atom" in *The Modern Corporation and Private Property*. In that famous first statement of "managerialism," they argued that the development of the large scale public issue corporation, which already dominated national economic life, had radically altered the traditional imperatives of private wealth and power. The massive diffusion of stock ownership characteristic of such firms made owners more numerous, but less important. Their very number and attendant problems of organization tended to produce a vacuum of leadership in the giant firm which was filled by inside management.

The result was profound. "In the corporate system," Berle and Means said, "the 'owner' of industrial wealth is left with a mere symbol of ownership while the power, the responsibility and the substance which have been an integral part of ownership in the past are being transferred to a separate group in whose hands lies control."¹

The idea that ownership and control were separated within the modern firm was not original with Berle and Means. Thorstein Veblen's *The Theory of Business Enterprise* had already noted that "management is separated from the ownership of property more and more widely as the size of corporation finance widens," and the declining power of the ordinary shareholder had been a major obsession of Veblen's concluding work on *Absentee Ownership*. In "The Decline of Laissez-Faire," no less a personality than John Maynard Keynes had pointed to business's peculiar tendency to "socialize" itself through managerial control. As firm managers turned their attention from profit maximization to insuring "the general stability and reputation of the institution," Keynes observed, "the battle of Socialism against unlimited private profit is being won in detail hour by hour."

¹ Adolf A. Berle, Jr., and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932), p. 68.

Despite their precursors, it is Berle and Means who are commonly credited with the separation thesis. It was they who tied it to a detailed study of America's two hundred largest nonfinancial corporations, and publicized it repeatedly as the central feature of modern business organization. At the time, it was important too that Berle and Means made strong claims about how the revolution in corporate governance would profoundly alter the political system as a whole.

Within Berle and Means's analysis, the absolute separation of ownership and control of the large firm left the role of newly powerful managers wholly indeterminate. They could serve as trustees for enfeebled ownership interests. They could serve themselves, plundering the corporate vaults from within. Or they could serve the public. For reasons never given in *The Modern Corporation*, Berle and Means thought the third path of managerial freedom the most likely one. The decorous leaders spawned by the managerial revolution would transform capitalism from within:

It is conceivable,—indeed it seems almost essential if the corporate system is to survive,—that the control of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity.²

Despite its immense appeal, after another half-century of private cupidity, this bald assertion of system transformation and corporate largess commands only limited support. But the other central components of the managerialist thesis—the separation of ownership and control and the discretionary power of corporate managers—have gained widening, indeed near total acceptance. Apart from solemn pronouncements on the vitality of “corporate democracy” in an age of limited shareholder power, mainstream discussions of corporate control have focused on the degree to which managers have strayed from traditional ownership objectives. Managerially controlled firms are regularly assailed in the literature for seeking for relatively safe markups in the oligopolistic market (“the best of all monopoly profits is a quiet life”). Corporate managers are attacked for their “expense preference” (the excessive deployment of corporate resources to their own maintenance and comfort) and apparent interest in maximizing growth her than profits. These discussions proceed from the shared assumptions of the managerialist premise, and consist in a technically more sophisticated elaboration of the second alternative model of management behavior posed by Berle

² Ibid., p. 356.

and Means. Outside the mainstream, managerialism has been periodically attacked from the left and the right,³ for ignoring the operational primacy of ownership within the capitalist system. But these criticisms have been successfully deflected, or ignored. As a theory of corporate structure and control, managerialism has triumphed. It remains for Edward Herman, in his superb *Corporate Control, Corporate Power*, to declare the triumph meaningless.

Herman's reappraisal of the "managerial revolution" is avowedly ambitious. He wishes not only to demolish a set of specific understandings about the internal operation of the firm, but to provide a view of the workings of corporate power as a whole. The reasons for this are straightforwardly political: the shape of the corporate system directly affects the shape and capacities of government. We live in an age of oligopolistic competition and vastly increased aggregate concentrations of private wealth and power. Far from Adam Smith's "obvious and simple system of natural liberty," it is a universe in which the size and operation of corporate giants, the deeply corrosive progression of global capitalism, the diminished capacities of independent political organization and government, all pose obvious challenges to the possibilities of political freedom. Through a long, dense argument, Herman explores the structure of power within the American political system by focusing on the control and power of that system's only viable actor, the giant corporation.

Herman's discussion of corporate control centers on the notion of "strategic position," which he defines as "a role and status in an organization—usually associated with high executive office, a directorship, and high official committee position in the bureaucratic structure—that enable their possessors to participate in the making of key decisions." Much later he observes that "The more basic

³ But for different reasons. For the left, the valorization of managerial discretion deflects attention from the enduring strength of the ruling class and undermines the political significance of the concept of capitalist rule. For the right, managerial discretion threatens claims about the efficiency of the "free market." On the latter, a neat defensive tactic, widely practiced by economists, has been to claim the existence of an auxiliary efficient "market for corporate control," whose workings dictate that managers not responsive to ownership interests will be disciplined by stockholder acceptance of takeover bids by other, better-managed (i.e., more profitable) firms. But there is no compelling evidence that this auxiliary market generates efficient outcomes either. Cash-rich corporate giants commonly gobble up smaller firms that are better managed and more profitable. And depending on firm history, the threat of takeover may induce growth maximization rather than profit maximization as the best defense, or focus the attention of managers so single-mindedly on short-term ownership interests in profit-taking and stock price that they neglect the long-range planning necessary to insure future strength and competitiveness.

question of who has power over the key decisions, as a practical matter, revolves ultimately on determining who has the power to name and displace the top executives of the corporation." Thus in asking who controls the modern corporation, what is being asked is whether managers name and displace themselves, or whether that power resides elsewhere. This narrow question is posed against a set of background considerations aimed at clarifying the meaning of "control" itself. The most important of these is a distinction Herman draws between "literal control," or the power to make key corporate decisions, and the "power to constrain," or the ability to set outer limits on the range of those decisions. The terms are not mutually exclusive, however, since the negative exercise of constraining power often fades into affirmative demands for participation in the making of major decisions. Nor is literal control necessarily more important than constraining power.

There are . . . important constraints on managers that arise out of the profit, risk-taking, and growth expectations of board members, large owners, financial community, and working members of the organization itself—expectations that may be formalized into rules and plans, and internalized in managerial objectives and understandings. It may be argued that if the system of constraints forces managers to choose policies within a narrow range of profit opportunities compatible with stockholders or creditor interests, the constraints may be as or more important than the specific discretionary choices of managers in determining corporate objectives and actions.

Indeed, it is a major argument of the study that management control, while clearly the dominant form of governance within the large firm, permits managerial discretion in corporate decision making only within very tightly defined boundaries.

Within the formal governance structure of the firm, the major competitor to management prerogative is the board of directors, which is formally responsible for the articulation of firm policy and the selection of officers to implement it. Such a conception of the board's role is consistent with managerial control if, as is often the case, the top officers determine who will get on the board. In addition to serving themselves as "inside directors," corporation officers commonly preselect the nominees for other slots, or at least "sign off" on potential nominees. More importantly, insiders' block voting and superior access to the internal apparatus of the corporation, along with the enormous "information gap" separating outside directors (i.e., directors not employed by the firm or one of its subsidiaries) and inside management, insure a largely nominal role even for those outside directors who wish to preserve some independence from the management team. Finally, as Herman notes, the degree of "outsideness" of the boards of large

corporations is commonly overestimated. While some 56 percent of the directors of the largest one hundred industrial corporations are "outsiders" in the broad sense offered above, more than half of them are former employees, relatives of key insiders, representatives of firms doing business with the corporation, or individuals sharing other board directorships with insiders. Whatever the hoopla about corporate boards' new "openness" to outsider influence, or the myriad liberal reform proposals to change the nature of corporate behavior by appointment of an occasional "independent," there appears to be no change in the passive role of boards vis-à-vis management, nor much prospect for change in the near term.

Outside the interaction between officers and the board, the major limitations on managerial control in the past have come from owners themselves, or from banks and other financial institutions. Here too the external controls on management are in decline. From examination of his basic sample of the two hundred largest (measured by asset size) nonfinancial corporations in America, Herman finds a substantial increase in management control of the large firm during the last fifty years, continuing the trend noted by Berle and Means, and a correlate erosion of ownership and financial control positions. By Herman's count, managerial control accounts for 82.5 percent of the number and 85.4 percent of the assets of the top two hundred nonfinancials, and 78 percent of the number and 80 percent of the assets of the one hundred largest industrial firms. Data from 1900-1901 indicate management control of only 23.8 percent of the number of large firms surveyed. This percentage rose to 40.5 percent by 1929. The trend toward management control of larger firms is clear. Elsewhere, ownership control by number dropped from 45 to 42 percent during the 1900-1929 period, dropping further to 16 percent of the number and 13.2 percent of the assets of the nonfinancials by the mid-1970s. In the industrial sector, ownership figures are 21 percent by number and 19.3 percent by assets. Financial control has declined from 31.3 percent by number in the 1900-1901 sample, to 11.8 percent in 1929, to 0.5 percent in the mid-1970s.

How can this be explained?

Ownership decline can be attributed to a number of factors. Within Herman's sample, the backward and forward integration and diversified growth strategies characteristic of larger firms has contributed to the stability of dominant corporate actors. Increasingly, the large-scale corporate universe is a closed one, in which new owner-entrepreneurs play an insignificant role or are quickly absorbed by older established firms. Within established firms, sustained growth vastly expands capitalization requirements, which are met through the issuance of new stock to public securities markets. The expansion of stockholdings tends to diminish the relative size of original owner/family holdings, while leading to an immense diffusion of ownership shares. Restrictions on foundation owner-

on increased market concentration (as opposed to aggregate concentration) of corporate power remain largely inconclusive, they suggest at least a nominal increase during the past fifty years. More important, perhaps, has been the increased organizational capacity of business, evident in the continued growth of interlocking directorships, joint ventures, trade and business organization, government advisory committees and other less formal modes of communication and coordination. Herman's detailed discussion of these issues cannot be done justice here.⁵ But its abiding theme—the independence of corporations from structures of public accountability, the elusiveness of defining concerted firm behavior, and the vast power of corporations to stalemate or undermine “anti-business” legislation—is suggested in the following acid paragraph:

It is difficult to assess the significance of specific linkage such as interlocking directorates, because there are so many modes of communication—formal and informal, direct and indirect—that it is hard to say whether any one particular mode has unique importance. The law prohibits a direct interlock between Du Pont and Union Carbide, but it does not prohibit common membership of officers and directors of the two companies on other boards or organizations; two directors of Du Pont are on company boards on which directors of Union Carbide also serve. Furthermore, Irving Shapiro of Du Pont and F. Perry Wilson of Union Carbide were both members of the executive committee of the Business Roundtable, and Shapiro and William Sneath of Carbide were policy committee members of the Business Roundtable in the late 1970s. And the law does not prohibit the executives of Du Pont and Union Carbide from playing golf or calling one another on the telephone to talk about the weather. Only a few selected vehicles of communication between competitors are prohibited; otherwise, interfirm communications are subject only to rules on *what* may be communicated via the large number of available channels. Obviously, policing the subject matter of intercompany communication at times of innocent merriment or joint efforts in the social interest (e.g., lobbying against a department of consumer affairs, or serving on an advisory body to a government department) is not easy.

⁵ To give one example, Herman devotes a few pages to considering joint ventures between major companies, noting that, despite the antitrust questions they raise, they have proliferated in mineral-extraction industries. He then traces major joint ventures during the early and mid-1970s among the twenty largest U.S. oil companies, displaying the results in a matrix table indicating more than 2,700 such ventures during a period of a few years and the realization of more than 90 percent of the possible combinations among firms.

This is not, of course, to underestimate the powerful centrifugal tendencies of intercapitalist competition either at home, where the marginal increase in market concentration ratios has been accompanied and contradicted by a breakdown of market barriers and increase in market size, or abroad, where the big multinationals compete vigorously in an increasingly integrated global economy. It is merely to state the irrelevance of the mechanism of public power to the operations of the giant private firm.

The changes in who exercises control within the large corporation, of course, are interesting only to the degree that they tell us something about the actual conduct of business activity. This is particularly the case with managerial versus owner control. Berle and Means and a variety of subsequent managerialists argued that the detachment of ownership and control of the large corporations left management behavior indeterminate or at least underdetermined by the traditional owner goals of profit maximization. Berle and Means, as noted before, argued that managers were "a purely neutral technocracy." Other, less heady observers have worried that managers, conceived as relatively unconstrained economic actors, will engage in behavior that maximizes their own return, rather than that of the owners. These worries are misplaced. In addition to their own considerable ownership interests, managers are constrained by the rationalization of the internal structure of firms that has taken place during the twentieth century—principally, the shift from functional organization (acquisitions, sales, finance, etc.) of the firm to organization along product division lines (each division assuming all basic handling for its product). This shift, described in detail in Alfred Chandler's *The Visible Hand*, has both increased the efficiency of corporate operation and facilitated the application of standardized performance measures to its constituent parts. Instead of comparing apples and oranges (e.g., the efficiency of sales personnel and production managers), officers within the firm can compare the relative profitability of different product lines (e.g., tomatoes and toasters). Equally, it has effectively forced top management within the firm to formalize criteria for allocating capital among divisions. As Herman notes, "The existence of this internal capital market produces a bias *toward* rate-of-return consideration and away from growth in sales or market share *per se*, because the latter do not provide a basis for deciding between interdivisional claims on scarce corporate capital."

The changes in the internal structure of the firm, undertaken in pursuit of a more strategically competitive corporate structure, thus tend to produce their own pressures for the application of profitability and rate of return criteria to the internal performance of the firm. More generally, traditional ownership interests retain a "brooding omnipresence effect," deeply inculcated in the com-

munity within which managers move and seek employment, and by which their performance will be judged. "With a formalization of corporate objectives, the continued power and ideological dominance of ownership must prevail, as it defies the only generally acceptable criteria of performance within the business community. . . . The pursuit of subgoals may persist, but on an ad hoc basis by secretly pursuing real objectives (such as sales, expense preference) different from those explicitly proclaimed and bureaucratically imposed within a complex organization."

Finally, Herman does not see, as many do, an emphasis within large manager controlled firms on growth rather than profits. Corporate goals remain defined in terms of profitable growth, as they have been for the past century. What needs to be explained about the relationship of forms of control to corporate strategy is the degree to which a shift from predominantly ownership to predominantly managerial control affects that strategy, and how a shift in control form affects the motivational base of key corporate actors. This has not been done in the suggestive but ultimately simpleminded literature on "satisficing," "expense preference," and relative aggressiveness of owner- versus manager-controlled firms. In the modern corporate environment, growth and profits are mutually dependent. It is impossible to separate one from another to establish a clear motivational chain.

In his own survey of seventy-two large firms during the 1967-1976 period, Herman found that there was no significant relationship between earnings rate or growth and form of control. Thus, while owners play a less significant role in controlling the modern larger corporation, the corporation continues doing what it has always done. It seeks profit.

This should not be surprising, given the weakness of the case that has been made for a transformation of corporate objectives—a case that has rested on the comparison of an unswervingly profit-oriented entrepreneurial corporation which never existed, to a vision of a managerial corporation that is equally removed from reality by different oversimplifying assumptions. In fact, organizational changes, continued technical progress and competitive pressures, and the "brooding omnipresence" of ownership interest, operating through both market and nonmarket forces, have led to an internalization of profitable growth criteria in corporate psyches and in the rules of large managerial corporations. There are expense preference tendencies and other substantial deviations from profitability criteria in their operations, but such deviations existed, and still exist, under owner control.

Thus the managerial revolution, while a significant shift in the operating structure of private power, changes not at all that power's basic application.

We are left at the end with a set of fairly straightforward propositions about corporate control and corporate power: (1) that the absolute and relative importance of giant corporations has increased during this century; (2) that corporations have remained largely autonomous of external controls; (3) that the system of internal control of the large firm has shifted from predominantly owner or banker control forms to managerial control, but this control is exercised within a sharply constrained arena of discretion; (4) that the rationalization of corporate structure has led to greater uniformity in structure, organization, and goal preference among the larger firms, and that that goal is profitable growth; (5) that the widely predicted "satisficing" and "expense preference" behavior of managers has not materialized, or at least is not directly associated with a shift in the form of control. Needless to say, the neutral technocracy, the long awaited "countervailing power," the structuring of enterprise by criteria other than private cupidity, have also not appeared.

Prospects for a change in this system are dim. The new sense of "corporate responsibility" to communities or workers has not blossomed. Feeble efforts to change corporate behavior by tinkering with the proxy machinery, adding new directors, or boycotting the consumption of select products, have all had mixed or no success. Within government, powerful and ubiquitous business organization at all levels undermines the effectiveness of those rare state attempts to pose limits to corporate autonomy, while unceasing attacks on government waste and ineptitude drain democratic process of moral authority. The notoriously "feudal" character of American government, extolled by Madison as a check on the emergence of a centralized and capable state, the absence of nonbusiness-dominated political institutions, the vast challenge to national authority posed by the international character of business enterprise all lead to contradictory or ineffective government action. In Herman's figure, state-corporate relations now approximate "a blindfolded man leading a herd of untamed buffaloes."

This grim picture becomes even darker upon contemplation of the near-term development of the American economy as a whole. Herman projects an "optimistic" low-growth scenario of wage/price policy guidelines, business/government partnership, and an increased role for government as employer of last resort. The main planks of the program closely resemble the reform proposals now being promoted by the investment bankers populating the left wing of the Democratic Party. If enacted, they would bring the United States into closer approximation to the states of Western Europe and Japan. He can imagine "less benign political arrangements" issuing from any of a number of possible shocks to the political and economic systems, however, including military flare-ups, nuclear war, critical material supply disruption, trade wars, international liquidity crises, or domestic social unrest. "In a revised 'stages of growth' model," says Herman, "instead of Third World political economies becoming like us, un-

der conditions of slower growth, severe factionalism, and major systemic shock, we may become more like them.”

In sum:

We may be approaching full circle in the West, from the distant era when decentralized economic power was strategic to the emergence of personal freedom . . . to the present stage of evolution where economic freedom has produced an environment dominated by vast, impersonal organizations that pride themselves on their rootlessness (the “international” corporations) and that respond only to material incentives. These corporations have helped create enormous wealth, but in the process they have broken down traditional community links and brought forth new problems whose solutions require protective and control mechanisms—private and governmental, local, national, and international—that do not now exist. Governments have grown large and potent along with large firms, but they continue to lose the power of initiative in a world of increasingly rapid change, international mobility of resources, and internal political conflict and stalemates. As both governments and large firms continue to expand, a qualitative change in social relationships, in the distribution of power, and in the capacity of societies to respond to crises is taking place. The hope for the future must be that a series of survivable small shocks or minor catastrophes will occur, leading to the emergence of new ideologies, values and institutional arrangements that will strengthen the powers of small groups and nations to protect themselves and to cope with the lack of international authority. The autonomy and power of the business system, the weakness of government, and the resultant immobility of the whole are such, however, that a bleaker forecast is plausible.

Indeed it is.

There are problems with this book. It is curious that in a discussion of the effect of the corporate order on government, so little attention has been given to conflicts *within* the business community at levels of aggregation greater than those between individual firms. Conflicts between national and international capital, and multinational and domestically centered producers, or among and between industrial sectors, critically structure the initiatives of private power. For no clear reason, they are largely ignored in Herman’s account. More grievously, the state, too, is effectively ignored, and with it, the specificity of capitalist democracy. Apart from a few welcome references to the pro-business philanderings of the national press, the means by which consent to corporate domina-

tion is secured go unexplored, as do common arguments about the power of workers to constrain capital through the exercise of the franchise. One can agree with Herman that the costs and effectiveness of government "regulation" of business have been exaggerated or misunderstood entirely, but still wonder about the mediating role the state plays in the relation of capital and labor. Put crudely, there has been an increase in the social wage. How can this be explained without reference to political structures? Without a theory of capitalist democracy more sophisticated than the one implicit here, there can be no hope of articulating any strategy for change.

These criticisms in no way vitiate Herman's enormous achievement, however. He has provided a powerfully convincing analysis of corporate control, a huge assemblage of data, and a discriminating vocabulary for talking about strategic interdependence between autonomous corporate actors in the highly fluid setting of political decay, economic reversal, and sharply heightened international competition. What Herman has to say about the structure of corporate power cannot be ignored. The decline of external controls on the firm points to the difficulties of coordinating even a modest strategy of triage in the nation's declining cities and regions. In the face of declining trade union power, mass business reorganization renders talk of a new political accord between labor and business merely facile. Elsewhere, liberal policy analysts have recently discovered that political decisions within the American system require "equity judgments," and innumerable plans for the "revitalization" of this country's productive capacity are now making the rounds. Relying for their success on a detachment of economic decision making from the last enfeebled structures of popular discourse and debate, their generally antidemocratic thrust has been remarked often enough. But their more elemental failing is a universal silence on the most basic facts of American public life—that it is dominated by business to a degree unrivaled by any other advanced industrial state, that no mass political structure exists that can compel the giant firms, that unless its holdings are seized, capital can move, divest, and strike, that any true movement of democratic renewal proceeds in the face of an almost incalculably great and hostile private power. In addition to clearing away the debris left by decades of misguided discussion of corporate governance and control, Herman demonstrates again the daily application of these simple truths of the American political system. Drastically constraining the possibilities of democratic action, they furnish nonetheless its necessary agenda.