Conclusion

Advances in information and communication technologies and in economic theory have greatly expanded the domain of financial markets since 1980. The number of countries with stock exchanges has doubled, and the range of traded securities has expanded from traditional stocks and bonds to bundles of insurance contracts on the terminally ill and synthetic instruments that can only be valued using the latest information technology. As ICTs get cheaper and more powerful, the range of things that can be securitized—turned into securities tied to future cash flows—expands accordingly. We are in the midst of a financial revolution on a scale comparable to the Second Industrial Revolution at the end of the nineteenth century.

Although ICTs are essential for enabling low-cost valuation and trading of financial instruments, institutions are perhaps even more critical. Corporate governance—in particular, the set of institutions that grew up to orient corporations with dispersed ownership toward share price, without requiring direct intervention by bankers or large shareholders—is a *sine qua non* for market-based economies, and a potential American export. The functionalist theory of corporate governance was a Copernican revolution in thinking about the American corporation, describing an alternative account for the so-called managerialist corporation and highlighting devices that orient the corporation's elites toward shareholder value. It provided a practical and moral case for "shareholder value capitalism" that was remarkably influential in the 1990s, up through the burst of the market bubble in 2000. As this chapter has emphasized, and the next documents in more detail, the functionalist theory was more an "as-if" account than an apt description of the facts on the ground. But regardless of its status as a scientific theory, its influence on thinking about financial markets and their institutional surround is indisputable.

3

From Institution to Nexus: How the Corporation Got, Then Lost, its Soul

The corporation today is a paradox. On the one hand, it is impossible to ignore the rising power of multinational corporations in a globalized economy. Exxon Mobil's 2007 revenues of $373 billion matched the GDP of Saudi Arabia, the world's twenty-fourth largest economy. Wal-Mart has more employees than Slovenia has citizens. Blackwater Corporation has a larger reserve army than Australia. The individuals that run such corporations wield more influence over people's lives than many heads of state. In some respects, corporations transcend or even replace the governments that chartered them: states are stuck with more-or-less agreed land borders, but corporations are mobile, able to choose among physical and legal jurisdictions, and are thus effectively placeless and stateless. Moreover, corporations can fulfill many of the functions of states: they can have extensive social welfare benefit programs for employees, internal courts for disputes among their employee-citizens, foreign policies for dealing with nations where they do business, air forces for transporting executives, and offices of social responsibility to coordinate their good works. The distance between the imagined community of the nation and of many corporations is not so great. Indeed, some American multinationals look more like European welfare states than does the US government. The prophecy at the end of Berle and Means's 1932 book—that the corporation might one day supersede the state as the dominant form of social organization in the world—seems to have come true.

Yet as economic and legal theorists remind us, corporations are mere legal fictions, convenient devices that happen to have useful properties for raising financing. Anyone with a credit card and Internet access can create a corporation in moments (to incorporate in Liberia, visit www.liscr.com). A business firm is simply a nexus of contracts among free individuals—a dense spot in a web of connections among suppliers of labor, capital, materials, and buyers of their outputs. To describe a corporation as an actor that encompasses its "members," or to imagine that it has boundaries analogous to national borders, is to reify something that is simply a useful fiction. And to imagine that a network of contractual relations has either "power" or "social responsibilities" is to further the mistake. Thus, with a little sophistry, economic theorists reduce the corporation from a leviathan to a paper tiger.

The paradox of the contemporary corporation is that both of these portrayals are correct. Corporations are mere legal fictions with "no body to kick, no soul to damn," as Baron Thurlow put it. They are also social facts, given deference and responsibility in the law and in social practice. They may not *have* a body, but their very name comes from the Latin word for body, *corpus*. And corporations may not have a soul, but their participants—and sometimes the law—expect them to act as if they do.

The history of the Hershey Foods Corporation illustrates the strain between our views of the corporation as a social institution and as a financial entity. Milton Hershey founded his chocolate company at the turn of the twentieth century in Derry Church, which was quickly renamed Hershey, Pennsylvania. In addition to the usual institutions of a company town—recreational facilities, parks, churches—Hershey founded the Hershey Industrial School for orphans, and after the death of his wife, he endowed the school with stock in the company that ultimately evolved into a 77% controlling stake. Over the subsequent decades, Hershey grew to become the nation's largest candy-maker. The links between the company, the town, and the school grew dense, as their shared name indicates. The CEO of the company in the 1970s, for

instance, had grown up in the orphanage, and half of the town's residents worked for Hershey.

In July 2002, the board of the Milton Hershey School Trust that oversees the School's endowment announced plans to sell its controlling stake in the company—in effect, putting the company up for sale. The economic rationale for the decision was indisputable: the most basic rule of portfolio management is to diversify, yet half of the Trust's assets were invested in the stock of a single company, leaving the School dependent on Hershey to a degree that was downright reckless. (Consider the implications of a food safety scare for Hershey's share price, and thus the School's endowment.) Moreover, potential buyers such as Nestle or Cadbury were certain to offer a substantial premium, giving the Trust an immediate windfall; indeed, the day the sale was announced, Hershey's stock price soared from $62.50 to $78.30, even before any bidder had appeared. Who could oppose selling some financial instruments in order to fund the education of underprivileged children more generously?

As it happens, virtually everyone in the community—employees, the union, residents, alumni of the school, and Pennsylvania politicians—was shocked at the trustees' actions and responded quickly to prevent the sale. Residents feared that the company's acquisition would result in closed plants and lost jobs for the town of Hershey. Mike Fisher, Pennsylvania's Republican attorney general (and candidate for governor), filed a motion in the Dauphin County Orphans' Court to prevent the sale due to the "irreparable harm" it would cause to local business and the social fabric of the town. (The Orphans' Court had jurisdiction over the Trust.) Nonetheless, Swiss-based Nestle and UK-based Cadbury offered to buy the company in late August, and Chicago-based Wrigley made an even larger bid a few weeks later, which seven of the trustees voted to accept. Fisher's effort to prevent the sale was successful, however, and the majority of the Trust's board was pressured to resign, to be replaced by a newly constituted board which vowed to retain its controlling interest in Hershey permanently. One study attributed a $2.7 billion loss in shareholder wealth to the forgone sale of the company.[1]

This was not the first time the state of Pennsylvania had intervened to prevent changes in control of local companies. In 1990 the state legislature overwhelmingly approved a so-called "other constituency" law stating that the board of directors of a Pennsylvania corporation "may, in considering the best interests of the corporation, consider to the extent they deem appropriate ... [t]he effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located," and moreover that the board "shall not be required, in considering the best interests of the corporation or the effects of any action, to regard any corporate interest or the interest of any particular group affected by such action as a dominant or controlling interest or factor." The law was passed during a hostile contest for Armstrong World Industries, a local company threatened with an unwanted takeover by Canadian raiders, with the intention of allowing the boards of Pennsylvania corporations to refuse such outside bids if they might harm their communities. The law responded explicitly to the widely held notion that corporations exist for the primary benefit of their shareholders: in Pennsylvania, they had other obligations (at least if the board agreed). But like most large US corporations, Hershey was incorporated in Delaware, not Pennsylvania—the "other constituency" law did not apply to Hershey. Yet the state—in the form of the Orphans' Court, no less—demonstrated that it could prevent a company's dominant owner from voluntarily selling out, even with the cooperation of the company's board. In its social context, Hershey was no more a "nexus of contracts" than a family, or a church.

In this chapter I describe the rise and fall of the corporation as a social institution over the course of the twentieth century. There have been three main eras of the American corporation during this time. The first was the era of *finance capitalism*, which arose out of the turn of the century merger wave, in which bankers maintained an ongoing influence on the management of the largest corporations. From the

public's perspective, many of these new giants were little more than cartels created and controlled by Wall Street financiers. To combat this perception and avoid the potential political fallout stemming from the public's mistrust of the new "soulless corporations," the managers of many firms, like Milton Hershey, created programs of welfare capitalism to demonstrate their caring relations with their employees and communities. Other corporations, such as AT&T, engaged in public relations campaigns to portray themselves as benign entities, committed to serving the public at large.

The second was the era of *managerial capitalism*, lasting from the 1920s until the 1980s, in which financially independent corporations run by professional managers evolved into social institutions. The dispersion of corporate ownership after the initial period of finance capitalism—partly through conscious strategies on the part of their managers to broaden share ownership—allowed management, freed from direct shareholder oversight, to run their companies more along the lines of their PR. Prior efforts to give the corporation a soul were evidently successful, as policymakers and citizens began to expect corporations to live up to their self-portrayal as "soulful" social institutions. By the 1950s the soulful corporation came to dominance, and its reign coincided with rising wages and increased demands to enact social policies around equal employment opportunity, safe products, and environmental protection.

A third era of *shareholder capitalism* was ushered in by the takeover wave of the 1980s and the shift to post-industrialism, and it continues through today. In relatively short order, the social institution owned by dispersed widows and orphans was reduced to a mere contractual nexus, driven by signals on financial markets, and the widows and orphans increasingly relied on a handful of mutual fund companies to manage their shareholdings. As post-industrial corporations replaced large manufacturers as the central actors of American capitalism, the "social institution" view became difficult to sustain. The corporation has increasingly become the financially oriented nexus described by its theorists.

In this chapter I briefly describe the evolution of the corporate form prior to the twentieth century and then lay out the three eras of corporate capitalism during that century. Two predominant conceptions of the place of the corporation in society have vied for dominance over this period, one which sees the corporation as simply a legal device for financing business activity, and one which sees it as a social institution with broader obligations. The social institution view came to dominance with the rise of large-scale firms, particularly manufacturers, whose dispersed ownership gave their managers autonomy from shareholders. These corporations took on many of the functions performed by welfare states elsewhere in the world, providing stable incomes, health care coverage, and retirement security. But the bust-up takeovers of the 1980s and the advent of the shareholder value movement changed the dominant conception of the corporation, which increasingly came to look like a mere network guided by a share price-oriented system of corporate governance. The bubble of the 1990s, and the corporate scandals of the 2000s, revealed that there is large gap between the theory of shareholder capitalism as an arm's-length meritocracy, as described in the previous chapter, and how the system operates in practice.

The corporation in the law

Efforts to portray the corporation as a mere contractual device are swimming against a strong tide in history. Organizations, including corporations, have long been susceptible to "institutionalization"—being valued in themselves rather than simply as tools for accomplishing particular ends.[2] We seem naturally prone to perceiving collective actors as entities analogous to persons, with institutional personalities, and organizations have reinforced this tendency with their practices. The guilds of medieval and Renaissance times were initial predecessors of the business corporation in Europe and the US, and they were organized very much along the analogy of a body (*corps*). After years of apprenticeship, members joined a guild by swearing a religious oath of loyalty that signified a lifetime commitment, lasting until one's colleagues lowered one's body into the ground. The commitment worked

both ways: masters (members) of the guild were typically entitled to guild-sponsored funerals, support for their widows, and aid in cases of sickness or disability. And the analogy of guilds with bodies was thorough:

> All bodies were composed of a variety of organs and members, which were hierarchically arranged and were placed under the command of the head. Each body was distinct from every other, with its own will, its own interests, its own internal order, and its own esprit de corps. Each body was made of a single internally differentiated but interconnected substance, and harm inflicted on any member was felt by the whole.

Moreover, guilds typically were treated by the law as a single (collective) person, and their members had no separate standing as individuals under the law.[3]

The organization of the first joint-stock companies in England built on some aspects of the guilds while adding features useful for finance. "Early companies, including the East India Company, were considered to be a kind of brotherhood. Shareholders were also members and as such had to take an oath upon entry into the company. They could be fined if absent from company meetings or if they engaged in improper conduct."[4] In the early years of the United States, creating a corporation required a separate act of the state legislature, and corporations were expected to serve a public purpose (such as building a bridge, road, or canal). Connecticut enacted a general incorporation statute in 1837, allowing the creation of corporations for any legitimate business purpose, and other states followed, making incorporation more common. Over time, corporations evolved the familiar features that distinguished them from their "members": limited liability, separate legal personality, and indefinite life. Corporations no longer *contained* their members; shareholders became anonymous, and employees could come and go at will. The most significant joint-stock corporations in the second half of the nineteenth century were the railroads, which were largely owned by foreign investors and were responsible for fleshing out many of the legal features of the modern corporation. Corporations came to be treated as artificial persons under the law, with individual rights under the US constitution. However, large-scale manufacturing corporations that brought hundreds of employees together under one roof remained rare until late in the century. It was their emergence, as palpable collectives situated in particular places, which prompted a re-thinking of the corporation as a social institution.[5]

The rise of the large US industrial enterprise at the turn of the century produced divergent responses: was it a collective entity with responsibilities, or a mere nexus? On the one hand, the populist backlash against the new giants prompted corporate managers to engage in campaigns to cultivate a positive public image, often emphasizing their enlightened employee relations. Henry Ford's institution of a $5 per day wage (more or less) in 1914 might count here. Yet there was a limit, enforced by the courts: in the famous 1919 *Dodge Bros. v. Ford Motor Co.* case, the Michigan Supreme Court ruled:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself... it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others.

The corporation's overseers, in other words, still acted as contractually bound agents of the firm's profit-oriented owners, not as stewards responsible to a broader set of constituents.

Legal theorists have a sophisticated view of this tension and the process by which it gets resolved. Corporations are, of course, creatures of the law. In the US they are chartered by the fifty states, and thus what a corporation is, and to whom it is responsible, varies over time by jurisdiction. Moreover, jurisdiction itself is a choice: businesses can incorporate in any state they like, independent of the location of their operations (if any). A Texas-based company incorporated in Pennsylvania may have obligations to its community, while a neighboring company

incorporated in Delaware may not. But the law is, in part, a residue of broader social processes. Fears of deindustrialization led to popular support of the Pennsylvania law making corporate boards responsible to "stakeholders," in spite of strong resistance by the financial community. Conversely, dependence of the state budget on out-of-state incorporation fees led Delaware to avoid such a stance. Thus, pragmatic legal thinkers do not seek to resolve what a corporation "really" is, but to apply a theory of the corporation that best serves society's interests, or that best predicts how judges might rule.[6] One theory is that shareholders own the corporation, and it should therefore be run for shareholder value—the view articulated in the *Dodge Bros. v. Ford* decision. As Delaware's top jurist noted, however, this view "is not premised on the conclusion that shareholders do 'own' the corporation in any ultimate sense, only on the view that it could be better for all of us if we act as if they do."[7] Thus, if it turns out that we would be better off imagining the corporation as a social institution, with obligations to its community, this can be arranged too—for instance, in Hershey, Pennsylvania.

If the corporation is a legal fiction, then the pragmatic question is what theory or genre of legal fiction works best under various circumstances. The historical question is what accounts for the prevalence of different views at different times and in different places. In particular, it is worth considering how the corporation came to be established as a social institution during the early decades of the twentieth century in the US, with the rise of large-scale industry, and how this view waned as the shareholder value view has come to predominate the post-industrial economy in the later decades of the century.

From legal fiction to social institution: how the corporation got its soul

The familiar US industrial corporation arose fairly abruptly around the turn of the twentieth century. Railroads had grown large prior to this time, of course, as had Rockefeller's Standard Oil, and there were a few substantial manufacturers such as Carnegie Steel—organized as a partnership dominated by Andrew Carnegie. But the large-scale, publicly traded manufacturer emerged over a relatively brief period through a series of Wall Street-financed mergers that turned dozens of local and regional producers into national oligopolies or monopolies. Edison's electric company was merged into General Electric, Carnegie's steel partnership was combined with suppliers and competitors into US Steel, and regional farm equipment manufacturers were rolled into International Harvester. In industry after industry, by 1903 the public corporation had become dominant in manufacturing. The governance of these firms reflected their origins: bankers, particularly those that had been responsible for their creation, continued to serve on the boards of dozens of corporations through the First World War. Banks, railroads, and industrial corporations were interconnected through ownership ties and shared corporate directors into identifiable "communities of interest"—the Rockefeller group, the Gould group, the Vanderbilt group, and of course the Morgan group.[8]

This was *finance capitalism*, a new kind of economic system in the US. Almost immediately it attracted a substantial political backlash among those that feared concentrated economic control and its political concomitants. Faceless monopolies were bad enough, but faceless monopolies controlled by a small handful of bankers in New York were worse still. Louis Brandeis published a series of articles on this question in *Harper's Weekly*, based on evidence uncovered in the 1912 Pujo Committee hearings in Congress. The articles (re-published in 1914 as *Other People's Money: And How the Bankers Use It*) documented a "money trust" in which a small handful of bankers—J. P. Morgan in particular—used their positions of economic power to "control the business of the country and 'divide the spoils.'" The vision of an economy controlled by financial oligarchs is a recurrent theme in American culture, but in this case the description was not far wrong. J. P. Morgan's associates, for instance, served on six dozen corporate boards, and executives of other banks also sat on the boards of hundreds of corporations. By most accounts, they were not without influence. Brandeis claimed that "When once a banker has entered the Board—whatever may have been the occasion—his grip proves tenacious and his influence usually supreme; for he controls the

supply of new money." This situation was relatively temporary: firms became skilled at shepherding their retained earnings rather than relying on bank loans, and as business historian Alfred Chandler notes, the bankers had little industry knowledge and thus not much practical value to add to board meetings. Overt bank control thus declined as the scale of enterprise increased in subsequent decades.[9]

It was not just bank control of industry that alarmed the public, however, but the very size of the new corporations. Andrew Carnegie might serve as a public face for the steel company that bore his name, but many of the largest corporations were assembled through consolidating geographically fragmented industries into oligopolies. To the extent that General Electric or US Steel had founders, it was J. P. Morgan and his Wall Street colleagues who had stitched them together. These new entities were patently artificial, like the trusts that had been their predecessors, and equally untrustworthy due to their anticompetitive possibilities.

Corporate managers pursued two avenues to quell these concerns and to give their organizations a soul. The first avenue was *welfare capitalism*, a set of corporate practices that evolved from the turn of the century through the 1920s to provide an array of employee benefits on and off the job: pensions, paid vacations, health insurance, and housing assistance, among other things. Welfare capitalism was a distinctly American approach to dealing with the social problems associated with industrial society. The US had the smallest welfare state and lowest unionization rate of any industrialized nation at the turn of the century. Thus, in the US corporations managed the social risks that were seen as the responsibility of governments in Europe.[10] In some cases, welfare capitalism extended beyond financial benefits to include health and recreation programs, domestic education to teach middle-class virtues, and corporate social workers to help with problems at home. The intention was to inculcate a work ethic, to bind employees to their companies, and, of course, to forestall unionization and prevent government intervention. The result was to give the corporations that employed these tactics a personality and tangibility as an institution. In the case of Dayton's

National Cash Register, for instance, "NCR was never just a factory, rather [it was] a living organization. The company's real existence lay in the hearts and minds of its employees . . . a cohesion of values, myths, heroes and symbols." NCR was, in short, an imagined community, a miniature nation-state.[11]

In *Creating the Corporate Soul*, historian Roland Marchand documents campaigns by public relations professionals in the early part of the twentieth century to give massive new corporations such as US Steel, GM, International Harvester, and AT&T an aura of "institutionality." Advertisements in national magazines included renderings of picturesque factories to convey solidity and a connection to place; folksy notes from company founders or presidents; and touching images of the many individuals whose lives were improved by the company. Institutional advertising campaigns sought to portray corporations as benevolent entities driven by a higher social purpose then mere profit—in spite of the contrary view of the Michigan Supreme Court.

AT&T's thirty-year campaign was the most remarkable and, arguably, the most effective at giving the large corporation its soul in the eyes of the public. At the turn of the twentieth century, AT&T had a reputation as a ruthless monopolist relying on litigation and intimidation to crush its rivals. Poor service, arrogance, and predatory pricing had marked the company as a "bad trust," and the threat of antitrust action—or even public ownership—was always there. Independent locally based competitors portrayed AT&T as an unnatural monopoly headquartered back East, and the corporation had little public goodwill in reserve. Thus, in 1908 AT&T began an institutional advertising campaign to give itself a soul. The purpose of the advertisements was not to ring up more sales, but to convince the public of AT&T's institutional beneficence. According to this campaign, the phone company's size was not a threat, but a positive feature, promising "One Policy, One System, Universal Service." Images of brave linemen working through bad weather, and gracious operators connecting families from coast to coast, emphasized the human face of the corporation. Even the company's owners were not New York bankers but regular working people. Shareholders were

portrayed in advertisements as a vast "investment democracy" comprising a demographic cross-section of America, with special emphasis on widows and orphans. AT&T was not a soulless monopoly, but "Ma Bell," bringing families together by phone and sending out dividend checks to the hundreds of thousands of ordinary working men (or their survivors) who owned its shares. AT&T had become a reliable and trusted member of the family. Not a bad accomplishment for a corporation representing "the largest aggregation of capital and resources that had ever been controlled by a single private company in the history of business."[12]

Efforts to create a personality and a soul for the corporation were evidently successful. After Standard Oil was split up in 1911, attempts to rein in corporations based on size and "soullessness" subsided, and the companies kept getting bigger. A second wave of mergers in the 1920s led to a great increase in the concentration of assets held by the largest tier of corporations. And by the 1920s control by financiers had waned, as the largest corporations sought to broaden their stock ownership along the lines of AT&T. The stock market boom of the 1920s vastly increased public participation in the market—the number of shareholders in the US quadrupled from 2.4 million to 10 million between 1924 and 1930—and thus by the end of the decade ownership had become widely dispersed in dozens of the largest corporations. As Berle and Means summarized these two trends, control of assets was *centripetal*, becoming ever more concentrated in a handful of companies, while ownership was *centrifugal*, becoming ever more dispersed. AT&T, for instance, had 454,000 employees in 1930 and 567,000 shareholders—none, as the company proudly pointed out, owning as much as 1% of the shares. The result of these two processes was that the bulk of the nation's industrial assets were controlled by professional managers with little ownership themselves and little accountability to the company's shareholders.[13]

This was the birth of *managerial capitalism*, the second era of the American corporation. In their 1932 book *The Modern Corporation and Private Property*, Berle and Means provided an astute assessment of the new "corporate system" and speculated on what the future would bring. A mere two hundred organizations had come to control half of the nation's non-financial corporate assets, and 44% of these firms were under management control—a proportion expected to grow into the future. The implications were profound:

> The economic power in the hands of the few persons who control a giant corporation is a tremendous force which can harm or benefit a multitude of individuals, affect whole districts, shift the currents of trade, bring ruin to one community and prosperity to another. The organizations which they control have passed far beyond the realm of private enterprise–they have become more nearly social institutions.[14]

And how would the few hundred men that controlled half of American industry use their power, if their shareholders were too dispersed to demand accountability? That was the critical question for the future. As Berle and Means concluded their analysis:

> The modern corporation may be regarded not simply as one form of social organization but potentially (if not yet actually) as the dominant institution of the modern world... The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state... The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant form of social organization."[15]

Managerialist dominance in the postwar period

Two decades after Berle and Means published their book, a consensus had begun to form among mid-century social theorists around the nature of this new economic organism. Gains by organized labor during the 1930s had promoted the spread of rationalized employment practices among large manufacturers, and the expansion of personnel offices and standardized benefits during the labor shortages of the Second World War had raised the bar for large-scale employers—which were

increasingly prevalent. According to contemporary commentators, the new production and employment practices of large firms were not just different in degree, but in kind.

Thirty-five years after Brandeis outlined the characteristics of J. P. Morgan's finance capitalism in the pages of *Harper's*, Peter Drucker used the same forum to publish his analysis of the new managerial-industrial society. The stunning productivity of America's manufacturers during the War had demonstrated beyond doubt the superiority of the principles of mass production, from the fabrication of planes by the thousands to the D-Day invasion itself. The central institution of this new order was the managerialist enterprise: "the representative, the decisive, industrial unit is the large, mass-production plant, managed by professionals without ownership-stake, employing thousands of people, and organized on entirely different technological, social, and economic principles" than the small family-owned factories that had predominated in the early period of industrialization. Drucker asserted that the principles of mass production had spread broadly, from manufacturing to agriculture to clerical work, and even to scientific and medical research. Society had been reorganized along the lines of the automotive assembly line. And the corporations that embodied these principles also left their stamp on the psyches of that interacted with them, as workers, customers, and neighbors. Through its pervasive influence on daily economic activity, the industrial corporation "determines the individual's view of his society," including perceptions of prosperity and social mobility, even for those that did not work there. "The big enterprise is the true symbol of our social order... *In the industrial enterprise the structure which actually underlies all our society can be seen*" (emphasis added).[16]

Finance had become largely irrelevant to this new system:

> The mass-production revolution has completed the destruction of the power of the land-owning aristocracy of the *ancien regime* which began two hundred years ago. But it has also dethroned the ruling groups of bourgeois society: the merchant, the banker, the capitalist. Symbolic of this change is the slow but steady decay of the great merchant oligarchies:

the "City" in London, "Wall Street" in New York," "State Street" in Boston. Where only twenty years ago the bright graduate of the Harvard Business School aimed at a job with a New York Stock Exchange house, he now seeks employment with a steel, oil, or automobile company.[17]

Shareholders had completed the descent into irrelevance described by Berle and Means:

> In non-socialist countries today the owner—that is, the shareholder—has largely abandoned control. A growing number of our large enterprises are run on the model which Owen D. Young proposed twenty years ago, when he was head of the General Electric Company: the stockholders are confined to a maximum return equivalent to a risk premium. The remaining profit stays in the enterprise, is paid out in higher wages, or is passed on to the consumer in the form of lower prices."[18]

If it was not run primarily for the profit of its shareholders, then what did this new organism want, and how did it accomplish its ends? Economist Carl Kaysen asserted in 1957 that the soul of the corporation, so much in doubt at the turn of the century, had been found by its managers: "No longer the agent of proprietorship seeking to maximize return on investment, management sees itself as responsible to stockholders, employees, customers, the general public, and, perhaps most important, the firm itself as an institution." The cynically motivated good works of the early corporations had evolved into *noblesse oblige* on the part of the contemporary corporation: "Its responsibilities to the general public are widespread: leadership in local charitable enterprises, concern with factory architecture and landscaping, provision of support for higher education, and even research in pure science, to name a few." And the employment practices used by welfare capitalists to evade unionization had become standard in both unionized and non-unionized firms: "The whole labor force of the modern corporation is, insofar as possible, turned into a corps of lifetime employees, with great emphasis on stability of employment." Through its enveloping labor practices, "membership in the modern corporation becomes the single strongest social

force shaping its career members."[19] Corporations had become the new guilds, creating lifetime attachments to their members through devices that extended from health care to retirement pensions that rewarded those that spent a career with the company. The Organization Man had been born.

Now that they were established as the central institutions of American society, corporations came under increased systematic scrutiny from social scientists of various kinds. A specific sub-discipline arose to study them—organization theory—with its own central texts. The idea of a theory of organizations was something new. As Peter Drucker pointed out in "The New Society of Organizations," the word "organization" in this sense was unknown to the *Concise Oxford Dictionary* as late as 1950, yet by the end of that decade organizations were seen as the building blocks of modern industrial society. In their 1958 book that announced the new discipline of organization theory, James March and Herbert Simon stated that the organization was "a sociological unit comparable in significance to the individual organism in biology," ubiquitous and enveloping in modern life, yet something about which surprisingly little was known systematically.[20] If members of organizations expected to spend their lives there, moving up the hierarchy (or not), then it was appropriate to understand why organizations had the structures that they did, and with what effect on members. Economic theories of the firm provided little insight here—firms were essentially a black box—so theorists worked with the materials available: the managerialist industrial firm. Remarkably, financial considerations had become so distant that the word "profit" did not appear in the index; the theory was presumed to apply to all types of organizations, whether large corporations, non-profits, or universities. Organizational members (and presumably firms) did not maximize, they "satisficed"—seeking alternatives that were above threshold, rather than the best possible.

Economists in the early 1960s began to theorize these new "satisficing" entities. If firms did not maximize profits for their shareholders, then it was necessary to understand how the motivations of those that ran them translated into corporate policies. The simplest answer was that firms sought growth: bigger firms paid better and provided greater prestige, and the more levels of hierarchy there were, the more opportunities there were for advancement. High-level executives rarely switched employers in the 1960s, and salaries were much more correlated with firm size than profit, particularly for those at the top. As a result, executives had strong incentives to pursue organizational growth to best serve their own self-interest. Profits could not be ignored completely, of course: if a company's share price were low enough, and the company were small enough, it might be taken over by outside raiders, so management had to pay at least some attention to share price. But according to Robin Marris, an early theorist of takeovers, "the giants who produce the bulk of the output would remain relatively immune" from takeover in any world imaginable to economists of the mid-1960s, giving further incentives to get big.[21] Big firms did not face takeovers, and they rarely failed. The best working assumption, then, was that managerial motivations were aligned with making the organization grow large—even at the expense of profitability.

What had happened to social class in all of this? Sociologist Ralf Dahrendorf argued that the separation of ownership and control described by Berle and Means had meant the end of capitalism as we knew it, and referred to the new corporate-industrial system as "post-capitalist." The US was still an industrial society, defined by "mechanized commodity production in factories and enterprises." But capitalism required the "union of private ownership and factual control." By this definition, the US was no longer a true capitalist system: the managers were now in charge, not the owners. To be sure, the class conflicts endemic to capitalism had not disappeared; they had simply been transferred to conflicts within the enterprise itself. Executives were the new upper class, and workers the new proletariat. With ownership of the means of production rendered moot, conflicts now revolved around the exercise of authority at work. Position within a bureaucracy defined one's social class in post-capitalist industrial society, not the ownership of property. The social organization of production within firms had become the primary basis of class struggle. Moreover, this struggle did

not transfer outside of the enterprise: one's position in a corporate hierarchy had as little to do with broader political interests as the sports team one rooted for. The managerial class was therefore not a ruling class in any political sense—at least according to Dahrendorf.[22]

Not everyone agreed with this assessment, of course. In his 1956 book *The Power Elite*, C. Wright Mills argued that a new ruling class had emerged out of the confluence of political, economic, and military elites stemming from mobilization for the Second World War. Mills described how the large national corporation had expanded during and after the War to insinuate itself into the formerly isolated power structures of the smaller cities, creating for the first time a national power elite centered around a few dozen corporations. Owners and executives of these corporations—the "corporate rich"—were more-or-less intermingled as a class, through devices such as intermarriage and shared directorships on corporate boards. The financial world had been banished to irrelevance: "Not 'Wall Street financiers' or bankers, but large owners and executives in their self-financing corporations hold the keys of economic power." These "self-financing corporations" may have severed their ties to high finance, but they were not disconnected from political power. The connections among top executives in the corporate, military, and political worlds created a set of overlapping cliques among elite decision-makers, many of whom moved among these worlds and thus knit them closer together. "As an elite, it is not organized, although its members often seem to know one another, seem quite naturally to work together, and share many organizations in common. There is nothing conspiratorial about it, although its decisions are often publicly unknown and its mode of operation manipulative rather than explicit." But it was, unmistakably, a ruling class, with top corporate executives at the center.[23]

Conglomerate growth and decline

And yet the corporate elite did not have complete control over the rules of its own game, as the corporate quest for growth collided with antitrust policy in the 1950s and 1960s. One of the outcomes of the Second World

War was a greater concentration of corporate assets among the largest firms. This generated concern in Congress about the anticompetitive implications of having three or four oligopolists dominating most substantial industries, and thus led to the Celler–Kefauver ("anti-merger") Act of 1950. Celler–Kefauver amended the Clayton Act of 1914 to prevent anticompetitive mergers in which firms bought competitors or important suppliers. This obviously limited pathways to corporate growth, to the frustration of those that ran the firms. If acquiring competitors or suppliers was out of the question, then firms that wanted to grow via acquisition—the quickest way to get big—had to turn to targets outside their industry. New financial tools, and the development of the multi-divisional organizational structure, created a means to buy and manage these targets much as investors bought equities for their portfolio. The result was a merger boom during the 1960s that created a new kind of company: the diversified conglomerate. ITT, originally known as "International Telephone & Telegraph," completed hundreds of acquisitions in dozens of industries during the reign of CEO Harold Geneen in the 1960s, including Sheraton Hotels, various auto parts manufacturers, the makers of Wonder Bread, a chain of vocational schools, insurance companies, and Avis Rent-a-Car. At the end of a decade of acquisitions ITT had grown to be the fifth largest corporate employer in the US. By the 1970s, the notion of treating the corporation as a diversified portfolio of businesses had become widely accepted among managers and the consultants that advised them, and the trend toward diversification continued through the end of the decade to encompass most large manufacturers.[24]

In a society organized around large corporations, in which the middle class aspired to a career moving up the ladder of a Fortune 500 firm, policymakers began to treat corporations not simply as economic entities but as levers of public policy. The largest employers—AT&T, General Motors, Ford, General Electric, Sears—had been in the vanguard of progressive employment practices for decades, and their practices were widely emulated by other firms (while being decried as "industrial feudalism" by some critics). Internal promotion ladders,

employer-sponsored pensions, and health insurance coverage came to be standard practice among corporate employers. Thus, the management methods and structures of a relative handful of firms had leverage over a wide swath of business practice.[25] In the early 1970s the Nixon Administration presided over a series of policy changes that held corporations accountable in areas from workplace safety to employment discrimination to environmental impact. The Environmental Protection Agency (EPA) was created in 1970 to protect the natural environment, for instance, by regulating toxic outputs in manufacturing and auto emissions. The Occupational Safety and Health Administration (OSHA) was established in 1971 to protect employees from dangers on the job. The Equal Employment Opportunity Commission gained litigation authority in 1972 and promptly set up task forces to investigate discriminatory employment practices at four of the six largest US employers—GM, Ford, GE, and Sears—which led to the creation of affirmative action programs at corporate employers. If "membership in the modern corporation [was] the single strongest social force shaping its career members," as Kaysen had claimed, then there was a public interest in assuring that they did it fairly.[26]

In spite of its reputation for enforcing a stifling conformity, a career in a bureaucracy had much to recommend it. As Richard Sennett points out, the corporation could be a cultivator of virtue, teaching self-discipline and delayed gratification for its long-term members. A corporate career allowed a stable life narrative, long-term social relations, and a site to develop one's talents. The corporation provided a form of identity and a connection to past and future, like a community. As long as it kept growing, the company provided more rungs to climb on the ladder. And at the end of one's career, one could look forward to retiring with a company pension and health care coverage.[27]

Yet just at the point when the corporate system had achieved its dominance, and it appeared that a handful of ever-expanding conglomerates would end up controlling the bulk of the American economy—under the watchful guidance of Federal policy—the system began to fall apart. In retrospect, the oil crisis of 1973 signalled the end of the long postwar economic boom in the US, and with it the growth that had underwritten the promises of the corporate system. Firms continued to grow through acquisitions in diverse industries, but organic growth was stunted. Moreover, the core of the American economy had always been its large-scale integrated manufacturers, perhaps best represented by the big three Detroit automakers. But American manufacturing was in long-term relative decline, not least in employment. Much of this was attributable to competitive pressures: oligopoly at a national level did not guarantee global competitiveness, and American automakers, as the most prominent examples, began a long slide in market share.

Perhaps a more fundamental trend than growth in international trade was growth in productivity, which implied by simple mathematics that more work could be done with less labor. Manufacturing was bound to follow agriculture in having bountiful outputs produced from minimal labor inputs. Daniel Bell identified the emerging situation as "post-industrialism," in which the majority of the workforce is engaged in services of various sorts rather than agriculture and manufacturing. This had important implications for workers' attachments to their employers and colleagues. American-style mass production had been marked by large-scale workplaces: Ford's Rouge Plant housed 75,000 Ford employees in a single vast, integrated facility, and many workers spent their entire careers there. By the early 1970s, however, most Americans worked in services. Although service industries can be organized through large-scale employers (e.g. chain stores), the norm for services was relatively small-scale establishments. Wal-Mart, for instance, employed 1.42 million Americans in 2008 and operated 4,141 stores in the US, implying a maximum of fewer than 350 employees per workplace. Further, the tenures of employees were much lower on average in services—according to the January 2004 Current Population Survey, the median employee in retail was 38 years old and had been with their employer for 3 years, compared to 44 and 8 for transportation manufacturing. Hierarchies with growing employment can provide employment security and advancement, but there is a limit on how

high one can rise in a chain store, on how long one was likely to stay there.

The challenges to manufacturers were particularly acute for conglomerates. Their rationale had always been a bit suspect: why did one need a costly corporate office to oversee the business units that were doing the real work? How does a bakery benefit from sharing a corporate parent with a rental car company, or a car parts maker? Hierarchical levels above the "portfolio" of divisions were, in some sense, pure overhead. Thus, the shares of conglomerates typically traded at a discount relative to what a group of separate free-standing firms operating in the same industries would get. According to the stock market, the whole was worth less than the sum of the parts, with the obvious implication that their shareholders would be better off if the conglomerates were split into free-standing companies operating in their own industries. Fortunately for their managers, Robin Marris had been right: given their size, large conglomerates faced little threat of takeover, at least in the 1970s. But this situation would not last for long.

Reagan's takeover wave and the end of managerialism

A central goal of the Reagan Administration in the early 1980s was economic revitalization, drawing on a new set of theories about how that might be achieved. One of the most important elements was the "market for corporate control," a phrase coined by Henry Manne in his influential 1965 article, discussed briefly in the previous chapter. Manne was one of the leading lights of the "law and economics" movement, a group of scholars centered on the University of Chicago that sought to analyze law and regulation using the tools of economics. From an economic point of view, the idea of managerialism was intolerable: firms that failed to maximize profits, by using their resources to pay employees more than necessary or charging customers less than they could, distorted the operations of markets and allocated resources inefficiently. Moreover, not everybody believed that unfettered managerial dominance was as widespread as it seemed. Following Marris, Manne had argued that poor management was reflected in a company's share price, and that if the price were low enough there were incentives for outsiders to buy the company and rehabilitate it, to be rewarded through the increased value of the firm.

Manne made the critical point that control of a company was an asset that could be bought by outsiders—that managerial control was contestable, even if ownership was dispersed. This was often an attractive option for outsiders, as taking over poorly run firms "is one of the most important 'get-rich-quick' opportunities in our economy today."[28] Mergers and takeovers benefit shareholders as well, because they usually gain a premium over the company's market price. Takeovers may even rescue poorly run firms from declining into bankruptcy. But because those best able to recognize and address under-performance were competitors in the same industry, antitrust concerns often prevented value-enhancing mergers. Thus, Manne implied that mergers in the same industry were not always anticompetitive, and that antitrust should be reformed to allow welfare-enhancing takeovers. As a corollary, efforts to make takeovers more difficult, such as the Williams Act (passed three years later) and state corporate laws like Pennsylvania's, should be given critical scrutiny in light of the efficiency-enhancing benefits of an active market for corporate control: "Only the take-over scheme provides some assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling shareholders."[29]

Subsequent academic economists went further still in their critique of managerialism. Among the most influential was a 1976 article by Michael Jensen and William Meckling, which revived the view of the corporation as a nexus-of-contracts, but made the financial market orientation more central. The critique had two main parts. First, it didn't seem reasonable to believe that shareholders would routinely invest in underperforming firms when there were better alternatives. "How does it happen that millions of individuals are willing to turn over a significant fraction of their wealth to organizations run by managers who have so little interest in their welfare? ... Why, if non-manager-owned shares have such a serious deficiency, have they not long since been driven out by fixed

claims?"[30] Berle and Means seemed to imagine that, as ownership grew dispersed, hapless shareholders came to find themselves disempowered, with management in control. But investors are fairly sophisticated about where they put their money—or else they do not hang onto their capital for very long—and therefore the people that run corporations need to make a compelling case to sceptical investors that they are going to get their money back, and more. Thus, managers seeking outside investment typically include a set of safeguards to demonstrate their commitment to shareholders, and are rewarded with a higher valuation, which gives them an advantage over their competitors. Those that fail to show sufficient devotion to shareholders are likely to be taken over, per Manne, and to pay a higher cost of capital. Through this invisible hand, corporations spontaneously come to be structured to serve shareholder interests.

A second point was about the ontological status of the corporation. Those that viewed the corporation as a social institution were deluding themselves.

> Contractual relations are the essence of the firm. . . . most organizations are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals . . . Viewed in this way, it makes little or no sense to try to distinguish those things that are "inside" the firm (or any other organization) from those things that are "outside" of it. There is in a very real sense only a multitude of complex relationships (i.e. contracts) between the legal fiction (the firm) and the owners of labor, material and capital inputs and the consumers of output . . . We seldom fall into the trap of characterizing the wheat or stock market as an individual, but we often make this error by thinking about organizations as if they were persons with motivations and intentions.[31]

Manne had made clear the benefits of an unrestricted takeover market, arguing that the divine right of management could and often should be challenged from the outside. Jensen and Meckling had undermined the idea that there was any essential unity or integrity to the corporation, that there was an "inside" or an "outside." In combination, these arguments provided a rationale for the 1980s takeover wave, which essentially ended the reign of the conglomerate. If there was no compelling financial reason for keeping conglomerates together, then why not bypass their managers and break them back up?

The strategy of making acquisitions in unrelated industries had spread from being an aberration among a few peculiar firms to the dominant approach among large American manufacturers during the 1970s. By 1980, the median Fortune 500 firm operated in three distinct industry categories, and many were in dozens. Beatrice, originally a packaged-foods manufacturer culpable for La Choy Chinese foods and several other brands, came to include within its corporate boundaries Airstream travel trailers, Culligan plumbing equipment, Harman Kardon stereo equipment, Samsonite luggage, and many others. It was far from alone in its rococo approach to industrial diversification, as business schools and consulting firms spread the portfolio method of strategy broadly throughout the corporate sector. But such firms were chronically undervalued by the stock market, worth more as a set of parts than as a whole. All that was needed was a catalyst to bring about a wholesale re-shuffling of the industrial deck.[32]

The Reagan Administration provided such a catalyst. In 1982, the Justice Department's Antitrust Division issued a new set of merger guidelines that greatly reduced the effective barriers to intra-industry mergers. Since firms in the same industry are typically the most enthusiastic acquirers, this created a set of potential buyers for the parts of conglomerates. During the same year, the Supreme Court ruled in the *Edgar v. MITE* decision that the Illinois law regulating tender offers for domestic (i.e. Illinois-incorporated) corporations was unconstitutional under the Commerce Clause, and thus struck down similar state anti-takeover laws across the country. And the Administration had staffed the Justice Department, the Securities and Exchange Commission, the Office of Management and Budget, and the Council of Economic Advisors with those sympathetic to the views of Manne and other law-and-economics theorists. Thus, the regulatory climate was ripe for Manne's dream of an active market for corporate control to come true. And with the aid

of innovations for financing takeovers, it did, in the form of the largest takeover wave in US history up to that point.

The 1980s merger movement is aptly characterized as a bust-up takeover wave. Between 1980 and 1990, 28% of the Fortune 500 largest manufacturers received tender offers, that is, offers by outsiders to buy control directly from shareholders—most of them hostile, and most successful. By the end of the decade, through bust-up takeovers and mergers, one-third of the largest corporations in the US had disappeared as independent entities. Conglomerates were particularly hard-hit. Given the so-called "conglomerate discount," an entrepreneur with access to bridge financing could make a killing by making a premium-priced tender offer for a diversified firm and immediately selling off its component parts to buyers in related industries. One financial firm's valuation model, used to calculate the degree to which a conglomerate was undervalued by the stock market, was whimsically titled "chop shop": like cars that are stolen and dismantled for parts, conglomerates could also be disassembled for profit.[33]

At the time, the bust-up takeover wave was something of a shock to corporate America. When one-third of the largest companies disappear in a brief period, it is clear that a moment of reckoning has arrived. There were several consequences of the takeover wave. First, companies became far more industrially focused. Figure 3.1 shows the average level of industrial diversification of the largest American manufacturers from 1980 to 2005. Firms became substantially more focused during the 1980s, and the trend continued through the subsequent decade and a half. By 1995, the median large manufacturer operated in a single broad industry category—not three, as in the early 1980s—and there has been no large-scale return to conglomeration, even as the threat of unwanted takeover subsided. The manufacturing conglomerate has been almost completely de-legitimated in the US, hanging on only in a few idiosyncratic cases (notably GE and United Technologies).[34]

Second, it became holy writ among management that the ultimate purpose of the corporation was "to create shareholder value." The phrase recurred in the mission statements of hundreds of American

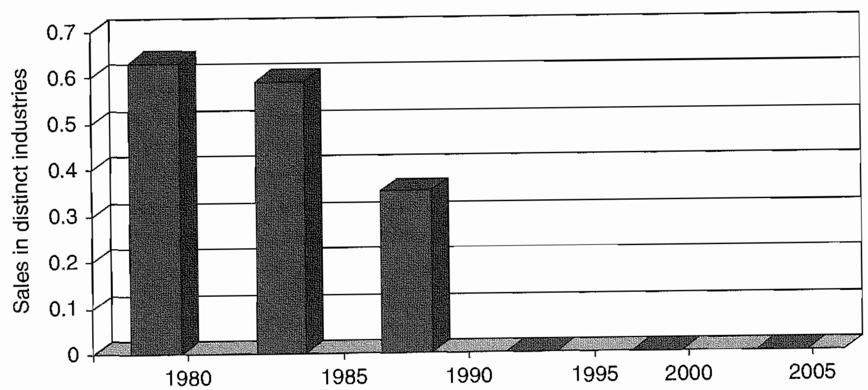

Figure 3.1 Declining median diversification across industries among the 500 largest (Fortune 500) US manufacturers, 1980–2005 (see n. 34)

corporations: "We exist to create value for our share owners on a long-term basis by building a business that enhances The Coca-Cola Company's trademarks;" "Sara Lee Corporation's mission is to build leadership brands in consumer packaged goods markets around the world. Our primary purpose is to create long-term stockholder value." This, in turn, became the stated rationale for restructurings aimed at achieving corporate focus. When Ford spun off its large finance unit in 1997, the company's CEO explained it in terms of shareholder value: "We believe the market value of the The Associates is neither fully nor consistently reflected in Ford's stock price. Because the market views Ford as an automotive company, it has not fully recognized or rewarded us for our diversification in nonautomotive financial services businesses." Similarly, when Sara Lee announced plans to divest most of its manufacturing facilities to focus more on brand management, like Nike, its CEO stated: "Wall Street can wipe you out. They are the rule-setters. They do have their fads, but to a large extent there is an evolution in how they judge companies, and they have decided to give premiums to companies that harbor the most profits for the least assets. I can't argue with that."[35]

Perhaps the most compelling reason for executives' new-found religious devotion to shareholder value was the massive shift in compensation practices that occurred during the 1980s and 1990s. It was not just

how much CEOs were paid that changed, but in what currency: stock options and other share-price-based compensation became like milk for growing children, where too much was never enough. Stock options are warrants to buy shares at a set price—in principle, the price of the stock on the day they were granted (although subsequent experience shows that many boards illicitly backdated the options to the point that the stock had achieved its lowest recent level). As a form of compensation, options were touted by corporate governance critics as a means to more effectively align the interests of managers and shareholders: the value of the options depends on how much the share price increases from the time of the grant, giving the options-holders reason to ensure that the share price goes up. During the 1990s, the average value of options grants to corporate CEOs increased by ten times, tying their pecuniary interests ever more tightly to share price. Few doubt that the ubiquitous use of stock options had the effect of focusing executive attention on the company's share price above all else. This was not entirely benign, of course: Federal Reserve Chairman Alan Greenspan argued that large grants "perversely created incentives to artificially inflate reported earnings in order to keep stock prices high and rising... The incentives they created overcame the good judgment of too many corporate managers."[36] We return to this theme later in the chapter.

Finally, the prevalence of bust-up takeovers undermined the notion that organizational boundaries were somehow sovereign. Instead, it became clear that the boundaries were a provisional device. There was no essential unity or integrity to a particular corporation. It was, evidently, simply a nexus-of-contracts, just as the financial economists had stated. What had sounded like a radical provocation in the 1970s—that stock markets provided the best measure of a corporation, and that the boundaries were ephemeral—became the common sense of corporate America by the 1990s.

"Shareholder value" and the employment relation

The bust-up takeover wave, and the pervasive spread of executive compensation tied to share price, drove home the message that corporations existed to create shareholder value—or at least that they had better act as if they did. The result was a wholesale re-shuffling of the industrial deck. Consider some examples. Westinghouse Electric Company was founded in 1886 in Pittsburgh to build electric generating equipment and for decades was the major competitor of the General Electric Company, formed in 1891. Over the course of the twentieth century its businesses grew to include household appliances, radios, broadcasting equipment, locomotives, nuclear power facilities, office furniture, and financial services, among others, and by the early 1980s it employed nearly 150,000 workers. It was a stalwart of the Pittsburgh business community for decades, and in 1942 endowed a national science prize that generations of high school students competed to win. As with other conglomerates, however, its depressed stock valuation weighed on the company in the 1980s, and in 1993 the company recruited Michael Jordan, a former McKinsey consultant and Pepsi executive, to lead a turnaround. This included the divestment of various business units, the 1995 acquisition of CBS, and the 1996 acquisition of Infinity Broadcasting. By 1997 Westinghouse was primarily a media company, a transition that was ratified by disposing of its remaining industrial businesses, changing its name to CBS, and moving its corporate headquarters to New York City, at which point it employed 29,000 people. Two years later CBS was acquired by media giant Viacom; seven years after that it was spun off again as CBS.[37]

ITT, the prototype conglomerate once thought powerful enough to help topple the democratically elected government of Chile in 1973, went through multiple rounds of restructuring in the 1980s and split the remaining businesses into five separate companies in 1994. Its residual stub—primarily in the hotel and casino business—was ultimately acquired in 1997 by Starwood Lodging. And AT&T—the largest private employer in the US in the early 1980s, with 850,000 workers—was broken up into a long-distance company and seven Baby Bells in 1984; acquired and divested computer equipment-maker NCR in 1991 and 1996; became the nation's largest cable television provider by buying two cable companies in 1999 and 2000 (which it then sold off in 2002 to re-focus on

its core competence); acquired a cellular phone company in 1994 that it spun off in 2001; and after a long slide in sales and employment (to below 50,000), ended up being acquired itself by SBC, one of its former Baby Bells, in 2005—which promptly changed its name to AT&T. Location, industry, identity, and employment, which had been relatively fixed during the corporate-industrial era, had become labile in the shareholder-value, post-industrial period.

The changing relation between firms and workers was reflected in the composition of the largest corporate employers. Table 3.1 shows the ten largest employers in the US in 1960, 1980, 2000, and 2007, the latest year for which data were available at the time of this writing.[38] Whereas seven of the top ten were manufacturers or oil firms in 1960, and six were in 1980, none was by 2007. (IBM and GE both derived most of their revenues from services by the late 1990s.) Employment became less concentrated among large firms over this period. The top ten firms in 1960 collectively employed the equivalent of 5% of the US nonfarm labor force in 1960, which declined slightly to 4.6% in 1980 and to below 3% in 2000. This also overstates the level of employment concentration, as the

Table 3.1. *Ten largest US-based corporate employers, 1960–2007*

1960	1980	2000	2007
GM	AT&T	Wal-Mart	Wal-Mart
AT&T	GM	GM	UPS
Ford	Ford	McDonald's	McDonald's
GE	GE	UPS	IBM
US Steel	Sears	Ford	Citigroup
Sears	IBM	Sears	Target
A&P	ITT	IBM	Sears Hldgs
Exxon	Kmart	GE	GE
Bethlehem Stl	Mobil	Kroger	Kroger
ITT	GTE	JC Penney	SBC/AT&T

largest firms outside the retail, restaurant, and telecom sectors employed many or most of their workers outside the US. Thus, of the dozen largest corporate employers of Americans in 2007, nine were in retail or food service: Wal-Mart, UPS, McDonald's, Target, Kroger, AT&T, Sears Holdings, Home Depot, Verizon, Walgreen, Lowe's, and Safeway. Put slightly more dramatically, Wal-Mart employed more Americans than the twelve largest manufacturers combined.[39]

Moreover, the duration of the bond between firms and employees was very different among these firms. According to the January 2004 Current Population Survey, the median employee in transportation equipment manufacturing (GM, Ford) had been with their employer for eight years; those in primary metals (US Steel) had median tenures of seven years; electrical equipment and appliance manufacturing employees (GE) had ten years' tenure; and workers in petroleum manufacturing (Exxon), eleven years. Large manufacturers, in short, maintained very long-term attachments with their typical employees. In contrast, the median employee in the food services industry (McDonald's) had been with their employer for 1.5 years, while those in retail (Wal-Mart, Sears, Target, Home Depot) logged three years on average. Service providers—with the notable exception of state and local governments—maintain substantially shorter tenures among their employees, and dramatically so in the case of retail and restaurants. They also provided lower wages, stingier benefits, and shorter career ladders—although of course this is much less true for some firms (e.g. IBM) than others (Wal-Mart).

In short, the largest employers in 1980 provided the prospect of long-term employment, health care coverage, and adequate retirement pensions—the hallmarks of the managerialist industrial firm. The largest employers in 2007 offered a polyester uniform that would last longer than the job itself. Moreover, even the vanguard employers of the post-war era began an aggressive program to renounce their former welfare-capitalist ways. "Neutron Jack" Welch, the widely admired CEO of GE, made it clear that employment at his company was not a lifelong commitment when he cut 100,000 jobs between 1981 and 1985. In a 2001 discussion with Harvard Business School students, he explained the new

social contract that he had helped usher in: "If there's one thing you'll learn—and dot-coms have learned it in the last year—is no one can guarantee lifetime employment... You can give lifetime *employability* by training people, by making them adaptable, making them mobile to go other places to do other things. But you can't guarantee lifetime employment."[40] Not if you exist to create shareholder value, which GE emphatically did under Welch. Recall that Welch's predecessor Owen Young regarded shareholders as fixed claimants, with any "excess" profits returning to the firm itself and its employees and customers. Welch clearly regarded the shareholder as king—the residual claimant, entitled to a pot of earnings that increased by 15% every year.

The concept that the corporation exists to create shareholder value, and that it is nothing but a nexus of contracts, had clear implications for employees: they were all temps, whether they realized it or not. The economists Armen Alchian and Harold Demsetz stated it bluntly in a highly influential 1972 article that may have stood as the clearest academic rationale for the new employment relation. There is nothing magical about the relationship between a firm and an employee that distinguishes it from a customer's relation to a grocer, they argued: "I have no contract to continue to purchase from the grocer and neither the employer nor the employee is bound by any contractual obligations to continue their relationship. Long-term contracts between employer and employee are not the essence of the organization we call a firm."[41] Workers were free agents all along, even if they didn't recognize it. After the bust-ups of the 1980s, the idea that the corporation was nothing but a nexus, and that it had no special connection with its employees, became increasingly true. Firms became adept at retaining contractors rather than hiring permanent employees; outsourcing tasks outside their "core competence;" and engaging in more-or-less temporary alliances rather than vertical integration. The conglomerate had rendered dubious the idea that the corporation had an organic unity: parts came and went through acquisitions and divestitures, and to find a "core" or "essence" to an ITT was a fool's errand. The network organization took the next logical step: the corporation was not attached to particular parts, or even to particular members. It was, "in a very real sense," simply a nexus of contracts that existed to create shareholder value.

If employees could not expect to spend a career at GE, or any other company, then firms should no longer be held responsible for their well-being after they left. Thus, IBM froze the level of benefits offered through its defined benefit pension plan in 2006 so that additional years of service would not result in additional retirement payouts. GM and Sears quickly followed suit, and GM capped its retiree health care coverage so that increases would be borne by the retirees and their families, not the company. These were all part of a general trend to phase out corporate obligations to retirees and to move workers to portable personal accounts such as 401(k)s, which did not bind them to a particular firm. American companies would no longer be in the business of providing long-term benefits to employees, as they had done for half a century or more. As Boston College's Alicia Munnell put it, "Our employer-based social-welfare system is collapsing." Meanwhile, the former welfare capitalist firms had found themselves burdened by obligations that were assumed by governments in other advanced industrial nations, putting them at a competitive disadvantage. GM's CEO noted that the company's health-care and retirement plans were designed in the 1950s, when GM ruled the world's auto market. But "We're now subject to global competition. We're running against people who do not have these costs, because they are funded by the government."[42] When the heads of America's largest manufacturers speak longingly of socialism, we are clearly in a different world. The irony, of course, is that the firms themselves had created this system in part to forestall the "socialistic" government programs that now benefited their global competitors.

The practices previously described as corporate feudalism—long-term attachments between employees and firms, promotion ladders, social welfare benefits, and *noblesse oblige* on the part of corporate management—are now the stuff of nostalgia. The late 1990s saw a brief period of enthusiasm for the free-agent contract worker, liberated from the shackles of corporate servitude by their 401(k).[43] But this enthusiasm died down considerably with the burst of the "new economy" stock

market bubble in 2000. Within a few months, the job title "Independent consultant" had become a synonym for "unemployed," and corporate co-dependence had regained its appeal. The transition from feudalism to market capitalism had been accompanied by decades of wrenching social upheaval, and it was not unreasonable to expect the same for the end of corporate feudalism, particularly given the limited social welfare institutions in the US—a theme we take up in Chapter 6. In contrast to Europe, investor-citizens in an ownership society could no longer rely on a social safety net from their employer or their government. They were free agents whether they liked it or not.

Shareholder value and corporate form

The new consensus around shareholder value made clear what the purpose of the corporation was, and this consensus had a decisive hand in shaping the transition of the American manufacturing economy. Financial considerations—market valuation—would drive choices about the boundaries and strategy of the firm. Firms should focus on doing one thing well, and that one thing was often determined by the stock market. Thus, if the stock market undervalues a combined car-and-finance company, then the solution is to split them into separate parts. Corporate executives were quite explicit about this: when ITT announced a plan to split into three separate companies in 1997 (following its prior five-way split a few years earlier), its CEO stated "We just think that having these three companies acting and operating and being evaluated in their own business environments will provide investors, analysts and those who deploy debt a simpler, more clear way to evaluate us." Had the split occurred, the remaining entity known as the ITT Corporation would have been primarily in the business of publishing phone directories in Europe.

By the same token, many valuation-driven changes led firms to shed physical assets, such as manufacturing facilities, in favor of "intellectual capital" (broadly construed). When Sara Lee "de-verticalized" in the late 1990s by selling off its manufacturing base to please Wall Street, the rationale was clear. "Slaughtering hogs and running knitting machines are businesses of yesterday," as the CEO put it, while shareholder-oriented corporations are in the business of ideas—in this case, designing and advertising bras and hot dogs to be manufactured and distributed by outside vendors. The new corporate model was that of the ironically titled "original equipment manufacturer" (OEM), in which the tasks of making and delivering physical goods are done by contractors. A Hewlett-Packard vice president explained why the company no longer needed to make its own PCs and instead contracted with generic "board stuffers," who assembled and distributed computers for HP and several of its rivals: "We own all of the intellectual property; we farm out all of the direct labor. We don't need to screw the motherboard into the metal box and attach the ribbon cable." Said another executive: "The consumer doesn't care if all the computers [bearing different brands] were made on the same production line. The only thing that matters is who will stand behind it." OEMs were, in effect, service businesses. They need never touch the physical products bearing their names. With the rise of offshore contract manufacturing, hundreds of American companies had reached the same conclusion.[44]

If the post-industrial corporation was a mere nexus, enmeshing various forms of intellectual capital (such as the trademarked slogan "Gentlemen prefer Hanes" for Sara Lee), how was it to be evaluated? The folk wisdom among corporate executives was that the stock market yields a higher valuation for intangible assets than tangible ones—advertising tag lines are more valuable than production lines. But it was also evident that companies were valued for their social capital, particularly when their intellectual capital was hard to parse. Biotechnology companies routinely took years to come up with a product, and years more to get it through the process of testing and evaluation by the government before it could come to market. How much is a revenue-free biotech firm like ImClone worth?

As a nexus of contracts, the corporation is also a network of affiliations, and this provides clues to a potency that is otherwise hard to assess. Thus, a sign that ImClone was likely to produce a blockbuster product was the fact that John Mendelsohn, the head of the prestigious

M. D. Anderson Cancer Center, served on its board. Another was that discriminating investors, such as pharmaceutical company Bristol Myers Squibb, had invested in it. The nodes in a corporation's nexus—its law firm, accounting firm, investment bank, alliance partners, investors, directors, top executives, major customers, and so on—implicitly provide their imprimatur for the firm. And while it is a cliché that one is known by the company one keeps, this cliché can have financial consequences: "At the height of his wealth and success, the financier Baron de Rothschild was petitioned for a loan by an acquaintance. Reputedly, the great man replied, 'I won't give you a loan myself; but I will walk arm-in-arm with you across the floor of the Stock Exchange, and you soon shall have willing lenders to spare.' "[45] Being seen in the company of Wilson Sonsini, Kleiner Perkins, Goldman Sachs, or Stanford University can boost your stock, and these ties are particularly important for new companies seeking to go public. Thus, savvy entrepreneurs may put more time into configuring the right constellation of affiliates to impress external evaluators than they do running the business itself. For a weightless post-industrial firm driven by stock market valuation, the network *is* the business. Pragmatically, if the right affiliations bring a higher valuation, then the entrepreneur has done her job, and the problem is solved.

There is a certain Potemkin Village aspect to this valuation-by-networks model.[46] Yet to the extent that corporations are attuned to the stock market, their leaders are prone to fine-tuning the appearance yielded by their networks. Corporate boards, for instance, routinely select members for their affiliations, as adding a former cabinet officer or CEO who serves on several other boards brings luster to any group. Research shows that companies seek to recruit such "star" directors when they face high levels of investor scrutiny, as indicated by receiving anti-management shareholder proposals, having a large financial analyst following, or being owned primarily by institutional investors rather than individuals. Well-connected directors have no discernible impact on profitability—directors rarely have the kind of direct managerial control necessary to influence operating performance—but they do significantly increase the esteem in which the company is held by outside analysts and executives, as measured by *Fortune Magazine*'s annual survey.[47] Thus, calculated choices of affiliates do seem to work in placating the investment community.

American cronyism[48]

By the late 1990s, the question of the purpose of the corporation had evidently been resolved once and for all in the United States. Corporations existed to create shareholder value. Moreover, the problem of managerialism—that non-owning professional managers might behave in ways contrary to shareholder value creation—had also been resolved, as the typical CEO derived the vast majority of his or her compensation from stock options and other forms of share ownership. But providing the right motivation was not sufficient to remove the corporation from its broader social context. "Create shareholder value" turned out to be insufficient guidance for running a company.

In the American system, share price is like a global positioning system for those managing corporations. Yet share price provides a peculiar measure of value because it is based on expectations about the future, rooted in present-day information. Prior performance is rewarded only in as far as it provides information about what future performance will be. Moreover, market value depends in large part on what other participants think market value *should* be. Managing for shareholder value therefore contains an essential perceptual component of anticipating how the market will react to the announcement of news about the company. It is a form of rhetoric where the audience to be persuaded is not a particular individual (say, a bank loan officer) but the market.

This does not mean that rampant dissembling is a sustainable approach to management, or that deception goes unpunished: outside monitors have incentives to uncover falsehoods and can make money by betting against firms that commit them. But research on corporate governance suggests that many managers systematically behave as if impression management were a core part of their task. For example, share buybacks—that is, a company's repurchase of its own shares, which reduces the number outstanding and signals that management believes

its shares to be underpriced—are typically greeted by increases in share price. Yet savvy corporate managers in the 1990s found that it was possible to increase value merely by announcing a buyback program without subsequently following through. Descriptions of executive compensation plans crafted to convey allegiance to shareholder value boosted share prices more than the same plans described in more generic terms. And releases of so-called pro forma earnings announcements, giving more positive impressions than certified earnings figures, became rampant in the late 1990s. Corporate managers took seriously the rhetorical injunction to know one's audience. The most visible members of this audience are large institutional investors, the financial media, and financial analysts working at brokerage houses.[49]

The blueprint for the American system of corporate governance revolves around arm's-length relationships that prevent personal ties from influencing the operations of the various markets that comprise the system. Yet inevitably, social ties are widespread and influential. Studies of corporate boards find that shared directors—individuals serving on two or more boards—have been pervasive among American firms since the early part of the twentieth century, when Louis Brandeis warned about the undue influence of J. P. Morgan and other New York bankers. Among the 1,000 largest US companies in 2001, the average company that shared a director could reach every other company in under four steps. Conseco, considered one of the worst-governed companies, could reach Colgate Palmolive, one of the best, through this path: Conseco director David Harkins served on the Fisher Scientific board with Michael Dingman, who served on the Ford board with Robert Rubin, who served on the Citigroup board with Reuben Mark, then-CEO of Colgate Palmolive. An airborne flu virus that infected the Enron board in January 2001 could have made its way to 650 Fortune 1000 companies by May through monthly board meetings.

The significance of the small "diameter" of this network was foreshadowed by C. Wright Mills in *The Power Elite.* Mills argued that those in powerful positions often seem to know each other or to have acquaintances in common through their connections to the same organizations, and that they turned to each other for guidance on shared problems. As a result, responses to issues of corporate governance, or practices that are perceived to create shareholder value, spread rapidly among companies through shared directors. Dozens of studies in recent years document that shared directors act as conduits for the spread of practices, information, and norms, which accounts for some of the surprising conformity among corporate managers in their approaches to corporate governance. The adoption of takeover defenses, the creation of investor relations offices, and the adoption of compensation practices all have been shown to spread through a contagion process among boards via shared directors. Shared directors also created a means for collective political action; for instance, the legislatures of states with densely-connected corporate elites were more likely to adopt anti-takeover legislation in the 1980s than were legislatures in disconnected states.[50]

Moreover, to the extent that there is a "culture of the boardroom," it is evidently one that protects its own, as Mills might have anticipated. Thus, when Dr. Mendelsohn of the M. D. Anderson Cancer Center came under fire for serving on the boards of two companies implicated in investor fraud—Enron and ImClone—he found understanding and forgiveness among his director colleagues. Charles Miller, Chairman of the University of Texas Systems Board of Regents, which oversees the Center, had himself served on a dozen corporate and non-profit boards. As he put it: "We could all see, 'There but for the grace of God go I.' " The president of Rice University echoed: "All of us at one time or another have been up to our elbows in alligators." Unlike the Amish, corporate directors evidently do not practice shunning.[51]

Directors' understandings of how best to create shareholder value were not an immaculate conception. Jack Grubman, the former star telecommunications analyst at Citigroup's Salomon Smith Barney unit, attended board meetings to advise the directors of a half-dozen telecom firms that he followed and touted to clients, including WorldCom (subsequently the largest bankrupt in American history), Global Crossing (also bankrupt), McLeodUSA (ditto), and others. The easy relationship between Grubman and the telecom sector he policed worked both ways.

Salomon preferentially allocated shares of firms about to make an initial public offering (IPO) to the personal accounts of telecom executives such as Bernie Ebbers, acquisitive CEO of WorldCom. IPO shares typically shoot up in value on the first day of trading and generally provide an immediate payoff—what one investment banker called "free money." Ebbers made $11 million from his IPO shares. Ebbers's firm in turn sent tens of millions of dollars in fees to Salomon for investment banking services (although Salomon insisted there was no quid pro quo). Moreover, the value of an IPO firm depends in part on its affiliations, as we have seen: an announcement of a contract or alliance with WorldCom during the late 1990s, for instance, would generally enhance the expected profitability of a telecom firm about to do an IPO, and thus the value of its shares. The incentives created through the web of connections among directors, executives, analysts, and investment bankers would seem to favor the Potemkin Village approach to "creating shareholder value."[52] In the next chapter, I describe more fully the conflicts of interest created by the new financial conglomerates.

Far from being a system of impersonal transactions based purely on merit, then, the American system of corporate governance turns out to be thick with social connections among the most important decision makers. Corporate directors and the executives they oversee, financial analysts, investment bankers, and state legislators responsible for creating corporate law, are connected by more or less dense ties that belie the schematic portrayal of an anonymous meritocracy policed by independent analysts, auditors, and legislators. But while the financial incentives for promulgating corporate Potemkin Villages may produce speculative bubbles, as we saw during the late 1990s, such excesses will ultimately give way.

Conclusion

The transition to post-industrialism, coupled with the dominance of the shareholder value ideology, has meant the twilight of the corporation as a social entity in the US. It could have been otherwise. So-called corporate feudalism lives on elsewhere in the world, and even some private companies in the US, such as SAS Institute, continue to provide the kind of "company town" welfare capitalist benefits that characterized some early twentieth-century US corporations.[53] But for large-scale employers, it is hard to imagine this system coming back. Notions of corporate social responsibility are built on an attachment to a particular place. But shareholder value-oriented multinationals are, in the memorable phrasing of Martin Wolf, "rootless cosmopolitans" with only vestigial ties to nationality or employment.[54] Hershey may still reside in Pennsylvania, but its competitors in the consumer packaged goods industry, like Sara Lee, are effectively placeless.

The subsequent history of Hershey reveals that even companies explicitly seeking to balance commitments to shareholders and community may have a difficult time. In October 2007, five years after the Milton Hershey School Trust had launched its abortive attempt to sell the company, the reconstituted board of the Trust released an unusual public statement saying, in part, "the Trust is not satisfied with the Company's results. The Company has been underperforming both the market and its own stated expectations" and the Trust had accordingly lost "more than $1 billion in market value during this period of unsatisfactory performance." This came on the heels of an announcement the CEO would be stepping down; the Trust, in the meantime, had opened (unsuccessful) discussions with Cadbury about the renewed possibility of a merger—subject to the constraint that the Trust would retain voting control of the company. A month later, the Trust fired six Hershey directors, and two more resigned, leaving just the incoming CEO and a representative of the Trust. By mid-2008 Hershey faced new competition as its former suitor Wrigley merged with its arch-rival Mars. Analysts urged the company to consider a sale to maintain its global competitiveness, but the Chairman of the Trust repeatedly vowed that Hershey would remain independent, evidently regardless of the economic consequences: "Simply put: We will not sell the Hershey Co." By mid-2008, Hershey's shares had slid back to where they were six years before, and the Trust was seemingly no closer to a workable strategy to diversify its holdings on behalf of the orphans.[55]

Corporations in the US have been transformed by information and communication technologies and the shift to a shareholder value orientation. But the finance industry has seen an even greater shift, as the basic model of financial intermediation has undergone a fundamental transformation. In the next chapter, we examine how the growth of financial markets has changed the nature of financial intermediation and its most important institutions, as banks rooted in particular places have been replaced by placeless financial markets.