Managing by the Numbers

Absentee Ownership and the Decline of American Industry

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Preface

In many ways, this book is the product of a fortuitous intersection of two different approaches to contemporary American business. Since the mid-1970s, two members of our group, Christopher Meek and Warner Woodworth, have been studying troubled industries and helping managers, workers, and local government officials in their efforts to prevent plant closures and reverse the effects of industrial decline. As interventionists, we were not always successful. But we invariably found, at the heart of the problems we studied and tried to solve, the same two interrelated developments, both having to do with corporate ownership and control.

Throughout this book we refer to these developments as *absentee ownership* and *professional management.* By the first term we mean the ownership of companies by shareholders scattered around the nation and the world, or the ownership of individual plants and businesses by other, larger companies themselves owned by such shareholders. The second term refers to the kind of generic manager whose roots are in an MBA program instead of in the factory or on the shop floor of a specific business; the kind of manager who goes "by the numbers," treating workers and businesses alike as little more than financial assets.

Our third coauthor, Gibb Dyer, arrived, although from a different vantage point, at similar conclusions about the impact of absentee ownership and professional management on American industry. Where Meek and Woodworth came at the problem from the back end—that is, from the point of crisis and deterioration—Dyer started at the front end, by tracking successful family-owned companies from their genesis onward. In these historical studies, Dyer repeatedly found that once successful family-owned businesses faltered, losing the loyalty of employees as well as their technological and marketing competitiveness when they began to be influenced by absentee interests and the values and financial techniques of professional managers. In his consulting work with troubled family companies, Dyer, like Meek and Woodworth, found himself advising management to revive the traditions of family ownership, as well as cautioning founders anticipating retirement to consider alternatives to going public.

Our own critique of professional managers and their training stems in large part from our experience as consultants to executives in businesses ranging from small, family owned enterprises to Fortune 500 corporations. We also have taken as well as taught many MBA courses ourselves in programs at the University of Michigan, MIT, Boston College, the University of New Hampshire, and today at Brigham Young University. Thus, the observations we make and the criticisms we express are not merely reckless "shots made from the hip." They have been derived and developed from our several collective years of experience with business students in the classroom, and with professional managers in the "real" business world.

In our work in America's companies and industrial communities, we were amazed at how frequently we heard the same story—the story of a company, once vital and innovative, that lost its competitive edge after the withdrawal of the founding entrepreneurs and the shift to absentee ownership. Middle managers and workers across the country sadly—and sometimes bitterly—told us a similar tale of how professional managers had drained the profits from their companies, once the economic backbone of their communities. More often than not we found that the answer to our efforts to revive troubled companies was not a program of innovation and change but instead a return to the company's historical and cultural roots.

It was not until late 1984 and early 1985 that we realized that our seemingly different and independent work was coming to the same focal point. As we shared our research findings and consulting experiences at departmental meetings, it became clear that the three of us were essentially looking at the same issues from different angles and coming up with similar conclusions. A panel presentation at the 1985 Academy of Management meetings in San Diego further clarified the overlaps of our research when panel commentator Davis Dyer, then of the *Harvard Business Review*, suggested that we expand on our ideas into a book.

It has been fun writing this book, because we realized from the start that it would be controversial and that reactions to it would probably be mixed and emotional. Some readers, perhaps, will be angry with everything we say—and we look forward to their comments and criticism. Other readers will find themselves cheering our analysis of the problem, but they will not agree with our recommended solutions. And at least some readers, we hope, will give serious thought to our analysis of the impact of absentee ownership and professional management on American business, and will consider how our recommendations may be used in their situations. In any case, we look forward to the debate this book may generate.

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CHAPTER 1

Changing Patterns of Ownership and Management

Many people see symptoms of malaise afflicting American business, but few agree on the nature and causes of the disease. The popular press daily covers farm foreclosures, bank failures, or industrial plant closings and layoffs. The business community worries aloud about the inability of American firms to compete in a global economy. We are all aware of the problems afflicting our steel industry, of the labor–management conflict in the airline industry, and of the gradual replacement of manufacturing jobs with low-paying service sector employment.

At the same time, academics attempt more sophisticated interpretations of today's troubled business climate. A number of critics suggest that macroeconomic forces are the real cause of America's industrial problems. Some economists, for example, argue that the current crisis stems from inadequate monetary policy. Others call for protective tariffs to halt the decline of American factories and the loss of American jobs. Still others advocate a national industrial policy to curb economic decline and confront future industrial challenges.[1]

At a different level of analysis, other experts suggest our problems are essentially microeconomic, internal to the functioning of the corporation. In one well-known book, for example, William Ouchi reviewed the strengths of Japanese management and articulated the values of a "Theory Z" approach to working by consensus. Peters and Waterman's best-selling *In Search of Excellence* proclaims organizational culture to be the key factor in America's best-run companies. Organizational behaviorists stress the need to improve communications and redesign boring, rigid jobs. Students of industrial relations voicc the need for systems of work that generate a high level of employee commitment.[2] Others argue that industry has failed to adapt to the larger technical, social, and economic environment and that a renewal process is essential to future survival.[3]

INDUSTRIAL METAMORPHOSIS: AN HISTORIC SHIFT

All these comments and commentators provide useful insights into our contemporary industrial dilemma. But they ignore the impact of an important historic shift that has occurred in the nature and structure of business organizations. Our research attempts to fill this gap by examining some of the neglected dimensions of industrial evolution and by suggesting promising new directions to be pursued.

Drawing on original historical data collected while studying family-owned businesses, communities, and large corporations, we intend to critique simplistic assumptions that long-term viability will result from "staying close to the customer" or managing "by walking around." When analyzing corporate performance, our data suggest management style and corporate policy cannot be separated from ownership structure and the distribution of power. The "values" and "symbols" that make up what recent commentators call "corporate culture" do not exist outside of a larger social context, nor do they operate independently of ownership, control, and wealth.

Thus, we emphasize two underlying issues as essential explanatory factors in understanding current problems—absentee ownership and professional management. The emergence of today's global marketplace with its diverse and complex transactions has been accompanied by a corresponding increase in the size and complexity of business organizations. Firms which once focused their energies on a specialized segment of the market now have grown to encompass many different products, services, and businesses. What were once closely held or family-owned firms, centered in a particular community and location, have been transformed into publicly traded, multidivisional, conglomerate structures, owning a multitude of enterprises and controlling a bewildering array of economic activity.

As a result of these changes, distant, or "absentee," ownership has come to be the dominant form of ownership, and with this shift in ownership structure a professional managerial class has arisen, trained in the nation's leading business schools, and supposedly qualified to manage any and all businesses. This industrial trend toward distant ownership and professional management has frequently been hailed as progress, but our empirical research has documented its many unanticipated and difficult organizational and industrial problems. The shift to ever-larger structures, absentee ownership and control, and "professional" managers without roots in specific businesses has had serious consequences on many different levels of business and society.

Evolution of American Corporations

Today's business realities can be seen in the context of two hundred years of American corporate history. That history can be divided into four distinct phases:

Phase I (1800s)
Phase II (1917–1930s)
Phase III (1940s–early 1970s)
Phase IV (mid-1970s–1980s)

Each phase is characterized by a particular kind of interaction between organizations and society. In the first half of Phase I, that is, until the mid-nineteenth century, the dominant model for conducting business was the small-scale craft system. This system was made up of local entrepreneurs who established small shops in their own community, contracting with skilled craftspeople to produce a particular product. Trust, mutual respect, and reciprocal reward systems gave technology a human face.

Late in the century, the factory system, mass production, and the assembly line were the products of an industrial revolution. The modern corporation brought new speed and control of production through work simplification and the systematic de-skilling of laborers. Dark, dingy, and unsafe working conditions producing defective and even dangerous products gave rise to legislative reforms in a variety of industries including food processing, meat packing, mining, and drugs. The excesses of the "robber barons" increased public suspicion of big business, leading to the Federal Trade Commission and antitrust legislation. The struggle between private interests and the public good continued well into the twentieth century.

Phase II was the period of the First World War. The common cause of Allied victory led to a temporary reconciliation of private and public interests. A spirit of cooperation among labor, management, and government led to the formation of the War Industries Board and new positive expectations for the future. After the war ended, however, unmet expectations spelled the end of this new-found trust and led to a growing disillusionment with corporate power. The Great Depression of the thirties only accelerated this trend. The increasing threat of corporate power finally provoked government intervention. Roosevelt and the New Deal won benefit programs for the poor and social security systems for the general population. Society affirmed labor's right to organize through unionization, and created the Securities and Exchange Commission to oversee the stock trading. Congress passed a wide variety of consumer legislation to protect consumers and regulate industrial mismanagement.

The end of World War II ushered in Phase III, a period of tremendous success and affluence in American society. Driven forward by the growth of industry, the United States quickly attained the highest Gross National Product, per-capita income, and standard of living in the world. A growing, mostly white, middle class generally agreed that "What's good for General Motors is good for America." Such statements were not even an expression of corporate arrogance: They were a reflection of social fact.

Soon enough, however, a re-emerging public consciousness began again to question corporate America's role in creating or exacerbating problems such as racism, pollution, and the militarization of our economy. Another body of regulatory laws put industry up against the wall. Ralph Nader attacked GM's Corvair as "unsafe at any speed" and launched a populist campaign for consumer protection. The civil rights movement and the Vietnam antiwar effort shook up boardrooms across the country and led to widespread changes in organizational and private life. The Environmental Protection Agency and a host of other government mechanisms changed forever the way we do business in America.

The present phase IV is a situation similar to Phase I, in that we find ourselves now in the middle of a growing struggle between business and society. Since 1975 or so, American business has been turned on its head. A new and unfamiliar global economics has strangled traditional markets where U.S. firms used to make billions in profit. Once, no matter what American managers did, the wave of the economy simply carried them forward. Now we have lost, and continue to lose, entire industries to international competition. A massive foreign trade imbalance has made Americans nervous and European and Third World investors happy.

Meanwhile, many U.S. plants are idle. Excess capacity and declining productivity are blamed for widespread plant closings and massive layoffs. Gigantic mergers absorb more of our business and financial resources while the federal deficit *quadruples.* Ours has become an era of union busting, general decline for the labor movement, and concession bargaining.

The current crisis, argue the doomsayers, will culminate with the demise of corporate America as we now know it, and a stagnant economy like Britain's will replace the boom years of the past. More optimistic futurists like Naisbitt argue that a millennium of technology and service sector success is just around the corner. Such arguments, however, conveniently ignore the low-paying, dead-end reality of most service sector work, as well as the recent tendency for the computer information industry to follow high-tech manufacturing jobs to the Third World.

Whatever our immediate future holds, it is clear that the notorious corporate incidents of the recent past—Three Mile Island, Johns Manville and asbestosis, the Ford Pinto, Union Carbide in Bhopal, the Bendix-Martin Marietta battle, E. F. Hutton, Ivan Boesky and other scandals in the financial community—have taken their toll. A new backlash against corporate America is manifest in the blocking of proposed mergers, in new tax laws, in limitations on the use of Chapter 11 bankruptcy to abrogate labor contracts, and the recent passage of trade and plant-closing legislation in the U.S. Senate. All are signs of growing concern about the role and power of the corporation in American life.

A central thesis of this book is that much of the current crisis facing, indeed engulfing, American industry is rooted in deeply shifting patterns of corporate ownership and management. We sense that a very different, absentee type of ownership structure has created a correspondingly different professional manager. As companies no longer focus their efforts on a particular community, location, or market, so managers no longer feel the need for experience in or allegiance to a particular business. Combined, these two interrelated changes in the nature and practice of American business are profoundly related to the erosion of our industrial infrastructure.

ABSENTEE OWNERSHIP

As we have seen, over a century ago, business was primarily a system of small, craft-based, family-owned enterprises, held together by personal relationships and driven by entrepreneurial skills. The common condition was that owners directly managed and controlled the firm. Often the family held all corporate stock, sat on the board of directors and appointed other board seats as well. By law the board had a fiduciary responsibility to the stockholders, and a basic theoretical goal of maximizing profit.

This rather simple arrangement of ownership and management has been rent asunder by recent historical developments. The emerging American economy is one dominated by absentee-owned companies, enterprises whose real owners are scattered across the nation. Today's megacorporations are enormous, bureaucratic, impersonal systems operated by executives who, all too often, have only their own career and financial interests at heart. These professional managers have been allowed to pursue their own agenda, with all the economic power of a major corporation at their disposal.

This massive change in corporate control has never been fully investigated. Early in this century Thorstein Veblen pointed to a "red line of cleavage" between what he called "absentee owners" and the general population, and warned of a widening split between "haves" and "have-nots" that could eventually result in social and political chaos.[4] Veblen was perhaps the first to observe that there was a difference both in "material interest" and in "sentiment" between owners who operate as local residents, or community-based entrepreneurs with a stewardship over their business, and purely absentee owners who feel no personal allegiance to a distant industrial plant or the community that surrounds it.

Much of the subsequent research on absentee ownership has also focused on the impact of changing patterns of ownership upon community social structure and decision making.[5] Some researchers have also pointed to the significance of the shift in corporate ownership patterns. The notion of managerial control of American business was first proposed by A. A. Berle and Gardiner C. Means who, half a century ago, argued persuasively that the shift toward large-scale corporations was already in full swing.[6] Even at this early date, two hundred big firms dominated the economy, and the founders, families, and entrepreneurs who originally had owned American business were being supplanted by professional managers. Berle and Means found that 44 percent of major companies were subject to managerial control, while an additional 21 percent were controlled by some sort of legal device. Thus, a total of 65 percent of the firms they surveyed were administered by nonowners.

Berle and Means documented the trend, but they had little to say about its implications for markets, for profits, for employees, and for society as a whole. Since their time, this trend has accelerated. A decade ago, Alfred Chandler argued that managers, not merely the market, controlled the economy. As Chandler saw it, Adam Smith's "invisible hand" of the economy really belonged to senior executives who directed the affairs of Wall Street with tight fists.[7] Our own research supports Chandler's view. As we see it today, huge corporations and their managers have become, in effect, the absentee landlords of our society. Corporate power, ownership, and the American economy alike is in the hands of today's managerial elite.

Thus, our investigations have centered on the ways in which this shift toward absentee ownership and professional management directly affects business itself. We suspect that owners who live thousands of miles away from the businesses they control might well be detached and unfeeling about the community where that business happens to be located. We hypothesize that even managers who may be temporarily based in a local community, but who are really seeking a future career elsewhere, may lack a real sense of personal stewardship over the businesses and plants placed in their trust. Is there evidence to support such a view? We think there is.

Likewise we want to explore whether the corporate culture of an absentee-owned company differs markedly from that of the locally owned company. Do workers feel greater alienation from management, and experience less secure, more stressful, working conditions under absentee control? Are there significant organizational changes when a locally based entrepreneur sells out his or her business to a much larger company that has diverse holdings all across the nation or even the world? What effect does this kind of merger or acquisition have on corporate performance, on profits, on morale, and on the company's ability to compete in the world marketplace? We will be trying to answer these and other similar questions in the rest of this book.

Throughout, when using the term "absentee ownership," we will mean not merely geographical distance, but also a psychological and social distancing of the owners and executive managers from the rest of the organization, and a managerial perspective in which subsidiary operations are seen as little more than financial assets. Absentee ownership also includes what we call a kind of technical distance, an inability to understand and appreciate the fine but often significant points of product design, manufacture, and distribution. We will look in more detail at the various forms of "distance" that can arise between management and employees in Chapter 5.

MEGA-MERGERS

Business mergers are not a new phenomenon. At the turn of the century, acquisitions occurred at such a frenzied pace that by 1902 a full third of all manufacturing firms had been consolidated. Out of those mergers came AT&T, Standard Oil, General Electric, Alcoa Aluminum, U.S. Steel, United Fruit, and International Harvester. These large corporations were run by men who were also owners, founders, partners, or members of a key family of stockholders. For example: Swift and Armour of meat packing; Rockefeller of Standard Oil; McCormick's Harvester; Vanderbilt's railroad empire; Carnegie, Morgan, and Schwab of steel.

The situation is vastly different today with ownership diluted, stockholders scattered across the nation, and top executives operating out of some remote office building in a distant state. Those early "industrial giants" seem like dwarfs in today's industrial world. When Andrew Carnegie and J. P. Morgan joined forces to produce the nation's first billion dollar corporation in 1901, it looked like a veritable Goliath. But against the mergers of the 1980s, these early deals pale by comparison. Recently Chevron merged with Gulf for a $13.4

billion price; Texaco acquired Getty Oil for $10.1 billion; Du Pont picked up Conoco for $7.4 billion; U.S. Steel snatched Marathon Oil for $6.5 billion; GE is completing a $6.3 billion acquisition of RCA; Philip Morris took over General Foods for $5.6 billion; Santa Fe became the owner of Southern Pacific for $5.2 billion; and General Motors is finalizing a $5.0 billion marriage with Hughes Aircraft.

The way to climb the Fortune 500 list is no longer a matter of growing from the ground up through excelling in a particular line of business. Rather, today you buy your way up, and everybody is doing it. Nabisco, Texas Air, ABC, Carnation, Bendix, the list goes on. High tech, low tech, energy, medical care—they're all wheeling and dealing, getting bought, fighting off a takeover, or being sold.

The mix of business deals varies. They include mergers, such as the marriage between GE and RCA, and attempted takeovers such as GAF's $4.1 billion fight for Union Carbide, a firm ten times the size of GAF. The list includes friendly marriages such as General Foods and Philip Morris as well as hostile, nasty battles like the fierce takeover attempt of Walt Disney Productions by Saul Steinberg which cost Disney $325 million to block. And although most deals are domestic, some like Crown Zellerbach's acquisition by Sir James Goldsmith are foreign.

The popular mythology is that such merger activity is a "healthy remaking of the economy." In truth, many firms are "borrowing up to their eyeballs," as one executive put it.

The fact is, since the 1960s the wave of merger activity has set record after record. The underlying logic seems to be that, if small is beautiful, then large is luscious, and gargantuan is gorgeous. A direct connection is claimed between massiveness and efficiency.

So the wave has grown, in spite of annual predictions that it would crest each year. In 1975 the first multi-billion-dollar corporate merger occurred. In the 1980s, there have been over sixty such mergers with thirty-six in 1985 alone. In fact, in 1985, 3,284 mergers and acquisitions were completed, amounting to an 18-percent increase over 1984. This was a record eleven per day, involving $179.6 billion in transactions.