EDWARD S. HERMAN

CORPORATE CONTROL, CORPORATE POWER

A TWENTIETH CENTURY FUND STUDY

Who
controls the giant
American corporation?

Family founders, bankers, institutional investors, or managers – who guides these central institutions of the American economy? And how is the power of the corporation used today? For growth and profit? Or with concern for society at large?

Edward Herman reveals that the shift of control from owners to managers has not altered the corporation's drive toward greater size and higher profits, nor has it enhanced its social responsibility. He shows that despite government regulation and other outside influences, there has been no taming of the corporation.

Corporate Control, Corporate Power

A Twentieth Century Fund Study

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Foreword

The giant corporation, which is one of the most publicized features of modern capitalism, has been a source of criticism as well as praise since the nineteenth century. Now, in the latter part of the twentieth century, its power and influence remain the subject of controversy. The Trustees of the Twentieth Century Fund, who have long been interested in the relations between big business and big government, were receptive to Edward S. Herman's proposal for a fresh inquiry into the accountability and control of the nation's large corporations. Its receptivity, admittedly, was heightened by the fact that the late Adolf A. Berle, who with Gardiner C. Means wrote the landmark study on the managerial revolution – the shift of control from owners to managers – over 50 years ago, was the longtime chairman of the Fund and had frequently voiced the hope for a reappraisal of corporate power.

Herman's study reassesses Berle and Means in light of the vast changes that have taken place over the post-World War II decades. During this period, corporations have grown immensely in size and in reach, a growth accompanied by an increase in government regulation and other efforts to make corporate management more responsible to society at large. The movement to tame the corporation has intensified in recent years, aroused by illegal corporate activity, as well as by heightened awareness of corporate power and its role, intentional and unintentional, in our society. As a consequence, higher standards of corporate behavior have been enacted. But the debate has continued, with corporations and their supporters claiming that regulation is now excessively rigid and their critics charging that corporations have managed to evade their alleged obligations to society.

In this study, Herman traces the changing structure of the corporation, analyzing its responsiveness to outside controls. He has found that the power of government to restrict or limit corporate action is exaggerated and the influence that financial insti-

tutions once held over corporate decision making has declined. He also argues that corporations have remained faithful to their basic objective, which is to maximize profits, and that they continue to be relatively impervious to the demands that they have a responsibility for the public welfare.

These findings may add fresh fuel to the debate, not tamp it down. But it must be pointed out that Herman has amassed a wealth of evidence in support of his position. In all the studies sponsored by the Fund, our authors have complete freedom in expressing their views so long as they are substantiated. Herman, a careful and thoughtful scholar, has met this test. Although his findings may provoke controversy, he has provided valuable new material that must be taken into account in assessing the place of the large corporation in our society.

The Fund is grateful to Edward S. Herman for his comprehensive study. I hope that it will stir debate on a higher plane, which in itself is a significant contribution.

M. J. Rossant, Director
The Twentieth Century Fund
October 1980

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Preface

The 1960s and 1970s witnessed a great increase in political and social activism in the United States, sparked in part by new or greatly intensified concerns over environmental pollution, urban decay, and other maladjustments that were attributed partly to government ineptitude, partly to corporate irresponsibility. For some, government ineptitude was seen as a *product* of corporate irresponsibility. Interest in these issues was given special impetus by the Watergate and foreign bribery scandals of the mid-1970s and the Love Canal and Three Mile Island episodes of the latter part of the decade. This period was also one of increased academic interest in the limitations of market processes (market failure), the growing demand for and importance of so-called public goods, and the need for and limits of "corporate responsibility." There was a parallel surge during these years in government activities and programs designed to provide individual and group income security, as well as to protect against the various perceived forms of market failure.

This expansion of government activity was not well received by the business community in the United States. And although the growth of government helped to cope with some social problems (income and medical insecurity, environmental degradation), others were not only unresolved but were even exacerbated. Inflation worsened, productivity growth continued to decline, unemployment rose, and fragmentation and social divisiveness became increasingly evident. We are now in the midst of a period in which "Big Government" is blamed and castigated for numerous social ills, waste, and ineffectiveness; but at the same time, government is being asked to deal with many of these identical problems. The attacks on government further the process of fragmentation and weaken its authority and power to act – especially efficiently and rationally.

The efficiency, rationality, power, and ends of government are

greatly affected by the specific character of the corporate order and larger society within which government functions. In the United States, Japan, and Sweden, the degrees of accommodation, coordination, and conflict between the private corporate world and that of government are significantly different. These variations are of enormous importance, as government in every industrialized state is not only large but has also been assigned (or has assumed) significant responsibilities. Effective management can provide stability and alleviate social distress, whereas government ineptitude, corruption, or fanaticism can inflict serious damage, and in extreme cases even pose a threat to community survival (e.g., Nazi Germany).

This book is about the corporate order in the United States and some of its special characteristics that affect its relationships with government, its capacity for reform, its responsiveness to external pressures, and its likely short- and medium-term evolution. These matters are addressed from the vantage point of how they are affected by the control of the large corporation; the interests and objectives of those who control it; and the constraints and linkages, internal and external to the firm, that help shape those objectives. In a sense, this book is a reappraisal of the postulate of a "managerial revolution," with a more explicit concern than appears in much of the earlier writing on this subject with the forces that shape and limit managerial discretion.

On some questions central to this work – the evolution and present status of control of the large corporation; the changing ownership position of individuals, families, and financial institutions; the role of financial institutions in corporate control; and the structure of ties among companies – significant fresh data are presented in Chapters 3, 4, and 6. The focus on corporate control allows detailed treatment of many controversial issues – the alleged attrition of the profit motive as a consequence of managerial control, the resurgence of the control power of the banks, government encroachment on corporate decision making, and the extent to which intercorporate ties and interest groupings (e.g., interlocking directors and joint ventures) have compromised corporate autonomy and unified the business community. Analysis of these issues sets the stage for an appraisal of the concept of corporate responsibility and various proposals for making the large firm more responsive to changing community priorities.

This book is a product of the author's long interest in the centralizing tendencies and effects of corporate and financial power,

and in the broader question of the possibilities and limits of reform and social change. Although my own concern with and study of these issues go further back, the Patman Report of 1968, which described in dramatic fashion the extensive stock ownership by bank trust departments, was a landmark in provoking controversy and research (including my own) on the issue of the centralization of corporate control and the role played by banks and other financial institutions in this process. Based on this interest, I prepared a research study, also sponsored by the Twentieth Century Fund, on commercial bank trust departments. From this study, which was concerned in part with the control powers of banks arising out of stock ownership, came the present, broader inquiry into the control of large firms.

The author wishes to acknowledge his indebtedness to Josh Markel, Adam Finnerty, and Michael Marchino, who served as research assistants during the preparation of this work and contributed much useful advice on both technical details and the broader issues considered here. Donald Goldstein provided invaluable assistance in the analysis of director characteristics (Chapter 2) and interlocks and other ties among large firms (Chapter 6). Many helpful comments were made by Joel Dirlam and Vic Reinemer, who read the original manuscript. Thanks are owing the Twentieth Century Fund for financial assistance and to its Director, M. J. Rossant, for his patience and encouragement. Editing by Pamela Gilfond greatly improved the readability of this book, and many valuable substantive comments were made by Masha Sinnreich, also at the Twentieth Century Fund.

Edward S. Herman

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Corporate Control: Background and Issues

The large corporation and its impact

A central feature of economic development during the past century has been the rise of the large corporation, both nationally and internationally, to a strategically important position. Large firms have grown enormously in absolute size, and those economic sectors dominated by large firms, such as manufacturing and utilities, have increased at the expense of other economic sectors, particularly agriculture (see Table 6.1). In the late 1970s more than 60 percent of the assets of all nonfinancial corporations in the United States were owned by companies with $250 million or greater in assets, and in the important manufacturing sector, the 200 largest firms controlled 60 percent of all assets in 1977, up from 45 percent in 1945.[1]

Whether concentration and market power have increased since 1900 is still subject to debate; the changes in output composition, the increased geographic scope of markets, the higher rate of product innovation, the greater importance of advertising, and other complexities make comparisons difficult. Still, authorities on these matters agree that concentration had already attained quite high levels 75 to 80 years ago and that significant market control prevailed in many industries following the great merger movement around the turn of the century (if not before).[2] Thus whatever the *trend* of market control since 1900, its level was substantial then and is substantial in 1980. The long-established norm of market structure and behavior has been that of *oligopoly,* that is, the constrained rivalry of a few interdependent sellers who compete mainly by means of product differentiation.[3]

An economy dominated by oligopoly is one in which the market still operates, but under conditions far removed from Adam Smith's "obvious and simple system of natural liberty." The range of variations found in oligopolistic industries in degree of

competition and in the adequacy of market results is wide.[4] Under some circumstances, where they are subject to competitive challenges,[5] internal pressures,[6] or a favorable cultural milieu, large oligopolistic firms may skillfully adapt and develop products, techniques, and social policies according to market changes and community demands. In other contexts, oligopolists may be technologically lethargic, quick to resort to restrictive practices and seek protection when subject to competitive threats, and socially and politically regressive. These differences are conspicuous among nations, but extremes of oligopoly can be found among large corporations within a given country – witness the dynamism of the computer and semiconductor businesses in the United States, on the one hand, and the lethargy of the automobile–steel–rubber tire businesses, on the other.

Lethargy is partly a function of the maturity and size of an industry, as well as of the age, size, and bureaucratic character of the dominant individual firms. Old and very large firms may lose their flexibility as a result of bureaucraticization, technological vested interests, and habituation to limited competition and protectionism.[7] They may be able to get away with this – at least for a while – if their market power is great and entry barriers are substantial. They may even have enough economic and political clout, given their networks of related supplier–customer interests, to be able to command social resources that enlarge and protect such vested interests, to the long-run detriment of society at large. In the United States this point has been raised with respect to both the automobile industry[8] and the "weapons culture."[9]

Another urgent issue in this age of rapid technological change is the proliferation of what economists call "externalities," "spillover," or "neighborhood" effects. These are unintended impacts of production or consumption on others, effects that are excluded from the cost and revenue calculations of the originating sources; that is, they are not "internalized" and taken into account through market processes. Their importance has increased with growing numbers of people, greater economic interdependence, and an outpouring of chemicals and industrial products of uncertain environmental effect – on consumers using products containing, say, nitrites; workers absorbing new chemicals in the workplace; the general public affected by waste residues interacting with one another in the environment. Where these external effects produce deleterious results, the externalities are properly regarded as negative outputs and associated final products are underpriced and

produced to excess.[10] When external effects would be positive (e.g., public education, or mass inoculation by law to combat a serious contagious disease), privately produced outputs tend to be too small and overpriced. In the case of outputs designated "public goods," external benefits are spread over many people – perhaps the entire population. Prices cannot be readily assigned or charged to such goods,[11] like national defense and national parks, which private enterprise does not provide in economically efficient quantities. Such goods have been increasing in importance in the total spectrum of goods demanded by the public.[12]

Problems such as negative externalities and a deficiency of public goods output are hardly attributable to the rise of the large corporation, although insofar as the large corporation has accelerated modern industrialization, has assumed industrial leadership, and wields political power, at the very least it shares responsibility as a causal agent. The large corporation may also contribute more directly to negative externalities as a result of its size, geographic dispersion, and mobility, which give it greater freedom to select technologies and business strategies that add to its internal efficiency but that may involve an unfavorable tradeoff between costs and benefits to society.[13] Nonetheless, it is clear that the problems of externalities and public goods deficiencies would not be resolved by a return to a world of small-scale enterprise. Their resolution will depend, however, on an efficient political response to the new demands that are not being met by market forces alone.

Problems that *are* directly associated with size and market control might be solved by a return to a world of smaller enterprise (although this is by no means certain),[14] but size and market power are almost surely irreversible developments – society is not going to return to a small, perhaps mythically beautiful, world, barring a revolution in values and power hard to envisage emerging out of present structures and trends, or an international catastrophe that would bring a regression to mere survival. Thus room for policy maneuver may be painfully narrow. It is partly for this reason that the bulk of social commentary addressed to the large firm, its impact and reform, operates within the very limited framework of what appears to be practically possible. There are utopians at the extremes, urging massive decentralization to quasi-laissez-faire, on the one hand, and broad-scale nationalization of the commanding heights of private enterprise, on the other. But most reformers call for marginal changes that recognize current

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