The Debate on Corporate Governance:
An Historical Analysis of Berle and Means Contributions

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ABSTRACT

What is corporate governance? It is the relationship among various participants in determining the direction and performance of corporations. The primary participants are (i) the shareholders, (ii) the management, and (iii) the board of directors. Since the New Deal era, 1933-1940, the theory of management control has sparked tremendous debate concerning the governance of America's large corporations. It is the argument of this paper that an historical interpretation of The Modern Corporation and Private Property, within the context of other works by Adolf Berle and Gardiner Means, could raise profound insights in terms of a paradigm shift concerning the governance of big corporations in contemporary economy.

INTRODUCTION

The heritage that The Modern Corporation and Private Property left behind is twofold: a thesis concerning with the split between ownership and control, and the complex logic of corporate capitalism—both are theoretical premises that deal with the changing nature of capitalism through the medium of "the big business" and professional management. In combination they pose an intriguing question: who has corporate control?

There are three possible theoretical solutions dealing with the question of corporate control. First, the theory of family control suggests that the large corporations are controlled by the members of upper-class families with large stockholdings in those corporations. Second, the theory of financial control presumes that the large corporations are controlled by large financial institutions through the combination of stockholdings and debtholdings. Third, the theory of management control maintains that the large corporations are controlled by the professional managers. Both the theory of family control and the theory of financial control treat the question of corporate control within the Marxist paradigm of "monopoly capitalism," which at best is satisfactory for the conditions of late 19th century. But the theory of management control has become one of the most, if not the most, influential interpretations of the nature of 20th century capitalism, yet there is no agreement about the implications of that theory (Ayala, 1989: 99). Needless to say, The Modern Corporation and Private Property has been the first systematic effort toward shedding light on the theory of management control.

Indeed, the theory of management control has sparked tremendous debates concerning the governance of America's large corporations. In the 1990s, we are faced with a renewed sense of enthusiasm toward the corporate governance debate. Unfortunately, most participants in the debate of the last few years have focused on "the agency theory," stating that the corporation should be run in the interest of shareholders, thanks to the contributions of Michael Jensen, Eugene Fama, Oliver Williamson, William Meckling, Armen Alchain, and Harold Demsetz (Blair, 1995: 13). By ignoring the contributions of management control theory, the current debate on corporate governance only reduces an important debate into a one-sided discourse which is fast becoming an outright dogma, albeit in the name of corporate democracy (Pound, 1995: 98).

At the same time, the current battle for corporate control represents an assault on professional management from all sides. The tight hold professional managers have on the corporation is slipping and thereby the balance of power within the firm is beginning to be shaken, challenging the very nature of the corporation. In this respect, politics has replaced hostile takeovers and LBOs as the defining tool for corporate governance challenges (Pound, 1992: 83). Since the debate over corporate governance has long centered on power, a rethinking of the theory of managerial revolution seems to be of interest to both management researchers and practitioners. Traditionally, the theory of managerial revolution points toward a historical shift in the structure of modern capitalism. Replacing America's business elite, associated with 19th century capitalism, the managerial revolution theory proclaims that since the New Deal era, 1933-1940, we are faced with the rise of corporate managers as the new elite in the contemporary economy due to the separation of ownership from control (Parsons, 1957: 132).

Nevertheless, the theory of management control is also mistakenly associated with the political domination of our contemporary social system by an emerging class of technocrats. Particularly, since the publication of James Burnham's The Managerial Revolution in 1941, an erroneous attitude with regard to the theory of management control has resulted in the managerial ideology discourse. Or, as a recent commentary has put it, Burnham recorded one of the most important trends in twentieth century American history; the gradual shift of national power away from a traditional elite in business and government and toward a new managerial class (Scott and Hart, 1991: 39).

Predating Burnham's idea, the publication of Adolf Berle and Gardiner Means' The Modern Corporation and Private Property in 1932, represents a very different understanding of the theory of managerial revolution. Although the implications of Berle and Means's theory are subject to much debate, still the following issues can be summarized. First, the theory of managerial revolution has undermined a philosophy of natural rights which was held dearly by Adam Smith and laissez-faire capitalists. Secondly, the theory of managerial revolution not only has called into question the assumption of profit-maximization but also rejoices in the disappearance of competition in favor of industry planning. Third, when the theory of managerial revolution is effectively devised, classical and neoclassical economics will be found to have little to contribute to management (Mason, 1958: 2).

This essay attempts to examine the contributions of Berle and Means in order to explore the implications of the theory of management control. It is the argument of this paper that an interpretation of The Modern Corporation and Private Property, within the context of other works by Berle and Means, could raise profound insights in terms of a paradigm shift concerning the governance of big corporations in contemporary economy.

The New Deal's Economic "Bible"

However, the theory of managerial revolution has taken a different path through The Modern Corporation and Private Property (Berle and Means, 1932, Reprint 1991). When Adolf Berle and Gardiner Means published their landmark study in November 1932, they immediately stirred a new trend concerning the changed concept of the corporation in business history and its impacts on contemporary capitalism. An insightful commentary by Charles Beard in the New York Herald Tribune's February 19th book review section, proclaimed the book as "the most important work bearing on American statecraft between the publication of the immortal Federalist and the opening of the year 1933" (Stigler and Friedland, 1983: 241).

The book came out right after the great crash of 1929 and the disastrous decline of the market in the next four years. Given the state of the economy, a number of important and powerful people, both in business and government, were more alert and sensitive to the book's findings than if it had appeared before the crash of 1929, to the extent that Time magazine labeled it as "the economic Bible of the Roosevelt administration" (Hessen, 1983: 279). In addition, this book has also been linked to a series of regulations, such as the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935, insofar as the brand of economic intervention implied by Berle and Means became one strand of the Roosevelt Revolution (Kuttner, 1993: 36). However, in dealing with this monumental work, some business researchers contend that we are faced with one of the enduring classics that many argue for or against, but few actually read or understand (Weidenbaum & Jensen, 1992: 101).

Be that as it may, the major problem in most interpretations of The Modern Corporation and Private Property is due to the very way that the book had been compiled. One of the major points of this joint study was that the modern large corporation was no longer a mere legal device for carrying on private business, but a social institution giving rise to a substantially new form of property tenure. The other major point was in noting the appearance of a situation in which any status of ownership tended to become more or less formal in terms of control of the business policy of the firm while redefining the governance of business corporations. Plainly, The Modern Corporation and Private Property seems to consist of two separate books.

Perhaps, such a unique composition is due to the way this research project was originally put together. After Berle had joined Columbia Law School on November 1, 1927, under the auspices of the University's Council for Research in the Social Sciences and financed by the Social Science Research Council of America, he began conducting his research project in order to show the changes in property rights brought about through the rise of the modern corporation. Needing a statistical and economic research associate, he asked Gardiner Means to join the project. The theory being that a lawyer and an economist working hand in hand might secure a more fertile result than alone. Still the project remained under the tight control of Berle, as he noted in the "preface" of the first edition (Berle and Means, 1932: lii).

While Berle's interest focused on the fiduciary theory of the corporation in connection with the changed concept of property, Means viewed the project as a search toward the nature of the modern corporation and around the separation of ownership and control (Lee, 1990: 679). It is due to such a profound difference that any reading of The Modern Corporation and Private Property on its own, usually results in common misunderstandings insofar as the purpose of the book is concerned. Instead, this paper suggests an interpretation of the book within the totality of other works by Berle and Means as the path to a proper understanding of its contributions.

The New Deal's Corporate Revolution

The significance of Berle's debate with Dodd is in revealing a major theoretical inconsistency within the pages of The Modern Corporation and Private Property. A careful examination shows, if Berle's original view concerning the concept of trusteeship had been consistent with the theoretical premises proposed by the book, then he should not have any disagreement with Dodd's position. For Dodd's views on corporate management's responsibilities toward the entire community seems to be minimally consistent with Means's conclusion concerning the theoretical implications of the book, as was indicated in his note for a 1968 edition (Berle and Means, 1932, Reprint 1991: xlvii).

Highlighted by an important question, whether management should be treated as trustee for the stockholders or trustee for a larger constituency, the debate revealed an important discourse concerning the New Deal's corporate revolution as put forward by Gardiner C. Means. Unlike Berle and Dodd, Means rejected the principle of trusteeship and regarded management as neither a trustee for the stockholders nor as a trustee for the public. Instead, a shift in the locus of the debate was suggested.

As a huge collective, the modern corporate enterprise combines the labor of tens or hundreds of thousands of workers and the capital of tens or hundreds of thousands of investors in a great engine of production serving millions of consumers. Reaffirming that management should run the corporation as a self-governing entity, Means added that only by economic performance based on the logic of collective enterprise will the public interest be served (Means, 1962a: 277). This was an important issue because when the two men began their acquaintanceship in 1927, Berle's interest in the project was based on a belief concerning the split between ownership and management. Convinced that such a distinction lacked economic significance, Means held that the fundamental point of the project was in the separation of ownership and control due to its theoretical implications for the question of corporate governance (Eichner, 1980: 57).

Due to the significance of such a thesis, numerous attacks on The Modern Corporation and Private Property since its first edition, have primarily focused on the statistical work in the book (Crum, 1934: 83). Most notably, the critics claim that the book was written at a time when it was difficult to obtain access to the necessary documentation (Chevalier, 1969: 174). Asserting that many of the book's stock ownership and control findings are of a questionable nature (Burch, 1972: 107), the opponents argue that the separation of ownership and control may well be one of those rather critical, widely accepted, pseudofacts (Zeitlin, 1974: 1099).

Nevertheless, the problem involving most of these critics is that they reject the book in the name of data inaccuracy while another group of researchers such as Robert Larner (1966), Edward Herman (1981), Alfred Chandler (1990), and Neil Fligstein and Peter Brantley (1992), consistently have confirmed the separation of ownership and control thesis inasmuch as management control is positively associated with the size of the corporation. In this respect, the old incredulity toward The Modern Corporation and Private Property leads to the historical context within which Means's theory was shaped.

The New Deal era, 1933-1940, was the historical juncture within which Means's theory was shaped, a period during which a "managed capitalist order" culminated into revolutionary changes concerning government-business relations and the role of the corporation in a democratic society. Insofar as the rise of an organizational type of capitalism is linked to the Great Depression (Kirkendall, 1964: 146), the New Deal has been considered more as the product of corporate capitalism rather than the shaper of it (Hawley, 1975: 51).

Means believed that the New Deal primarily represented "a revolution in point of view" concerning the structure of American economy. The revolution which Roosevelt made was to turn away from the doctrine of laissez-faire and look directly at the potentials of American big-business economy. In doing so, the New Deal did not reject the theory and practice of free enterprise, rather it turned down the classical economic theory as the basis for operating a capitalist system. The significance of such a revolution were twofold: first, it was recognized that the modern economy was not an economy of small enterprise but that its dominant characteristic was big enterprise; second, it was recognized that the pricing process was significantly different from that assumed in classical theory (Means, 1962b: 24-26). In the modern huge corporation, business enterprise has come to be primarily a problem of administration and management, while the aspect of trading has been reduced to a minimum (Means, 1933: 11).

In this respect, technology has been a driving force determining the shape of such a transformation along two steps. First, co-ordination of economic activity through administration rather than market trading as the essential feature of the factory system during the 19th century. Second, the development of the corporation as a form of business organization carrying further the process started by the factory system and resulting in the corporate revolution during the 20th century (Ware and Means, 1936: 12-13).

To explain this, Means turned to the Great Depression. In doing so, the main problem seemed to be in discovering why, in the short three year period from 1929 to 1933, a tremendous unused capacity to produce existed side by side with dire want and distress from the lack of the very things which could have been produced. Why did this "poverty in the midst of plenty" develop and why did it continue? (Means, 1935a: 73). But, to explore the major causes of the Great Depression a reexamination of the structure of American economy was necessary. Conducting an empirical study, Means concluded that a significant distribution of stock ownership took place from 1916 to 1921, increasing both the number of stockholders and the proportion of corporate industry owned by persons of moderate means. While the number of stockholders continued to increase, the United States gradually became "a nation of stockholders" (Means, 1930: 591).

Comparing the result of the great dispersion of stock ownership in America to the legacy of the French Revolution for landholding, Means then turned to the changed meaning of ownership. The ownership of industrial wealth and the control over that wealth are coming to lay less and less in the same hands. Amid such a revolutionary change, ownership of wealth without appreciable control, and control of wealth without appreciable ownership, appeared to be the logical outcome. The increasing diffusion of stock ownership in the largest American corporations was also responsible for the development of a new condition in terms of control. Formerly assumed to be merely a function of ownership, control now appeared to be a clearly distinguishable factor (Means, 1931b: 96).

As revolutionary as that which occurred during the industrial revolution, the separation of ownership and control involved a change in the organization of large enterprises. Since the giant corporation has come to be commonplace in American economic life, a society in which production is governed by blind economic forces fades away in favor of one in which production is carried out under the ultimate control of management. That, in turn, changed the meaning of capital from tangible goods to that of an organization built in the past and available to function in the future (Means, 1931a: 37). Presenting a challenge to the classical economic theory, this new revolution demanded a shift of emphasis from analysis in terms of competition to analysis in terms of control. Indeed, it is impossible to understand the structure of American economy without grasping the concept of control. A relatively new economic concept, this term embrace five major types: 1) control through almost complete ownership; 2) majority control; 3) control without majority ownership; 4) minority control; and 5) management control. Of these, it was the last type which attracted Means the most because the management of a large corporation may be able to exercise a significant degree of control over the use which is made of resources without itself owning any significant volume of assets (Means, 1962c: 120).

At the same time, the concept of control is similar to what the political scientists call power because the most essential element of the new economy is the element of power. Nevertheless, the term control is most suitable for business administration because "power" is solely a term of position whereas "control" is a term of both position and action since the verb "to control" corresponds to the phrase "to exercise power." The close association between control and policy refers to a power relationship that exists among individuals and groups in an enterprise, and emphasizes the ability to influence the firm’s policies (Means, 1939a: 111).

In this manner, the concept of control includes both market control and nonmarket control. Market control only partly dominates the firm’s policies, and in such a case, an understanding of the concept of control would be covered by an analysis of markets. Still, the major policies developed in large administrative organizations, such as an army or a big business corporation, usually are subject to a very considerable measure of nonmarket control. In general, nonmarket control could be exercised through establishing a climate of opinion within which policies are developed (Means, 1939b: 154).

To illustrate the concept of nonmarket control, the controversial administered-prices thesis was proposed. By an administered price Means meant one which is set by administrative action and held constant for a period of time. Since most industrial prices are administered prices and not classical market prices, the administered-price thesis held that a large body of industrial prices did not behave in the fashion that classical economic theory would lead one to believe (Means, 1972: 292).

The Debate on Corporate Governance

The theory of management control, as put forward by the works of Berle and Means, represents the state of the art thinking in terms of the enduring logic of big business and its impacts on the corporate governance debate. Still, some contend that a current reading of The Modern Corporation and Private Property reveals that much of the book, as well as the managerial revolution theory itself, has become a period piece in American business history (Weidenbaum and Jensen, 1991: ix).

Whether the theory of management control represents another piece within the waves of historical relativism or a manifestation of the updated evolution of the modern corporation, seems to be subject to much debate. While the advocates of the agency theory claim that "the present day revolt of shareholders" in the United States signifies that "the de facto" separation of ownership and control is coming to an end (Useem, 1990: 701), still many assertions made by the managerial revolution theory have been confirmed thanks to the current research on Japanese big corporations (Tsurumi, 1991; Johnson, 1995; Yoshimori, 1995).

In this paper, however, we have focused on the theory of management control within the context of historical transformations taking place during the New Deal era. In doing so, the contributions of Berle and Means raise intriguing insights in regard to the role of the modern corporation in a democratic society. A different version of the managerial revolution theory, the works of Berle and Means could facilitate a rethinking of the corporate governance debate. Focusing on the centrality of power through the separation of ownership from control thesis, Berle and Means shed light on a philosophy of governance for the modern corporation which shared the spirit of the New Deal era.

Since corporate governance arrangements influence the efficient use of society's resources and the ability of firms to create new wealth, the theory of management control, as put forward by Adolf Berle and Gardiner Means, still seems to be full of promise for management researchers and practitioners. Indeed, the provocative and frame-breaking paradigm shift discussed by the authors of The Modern Corporation and Private Property could enable us to unlearn a misleading discourse which is fast becoming accepted wisdom on the corporate governance debate. What is apparent throughout all this process, David Vogel added, is that corporations have increasingly assumed public or quasi-public functions (Vogel, 1975, PP. 30-31).

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