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052135207X - Regulating Big Business: Antitrust in Great Britain and America, 1880-1990

Tony Freyer

Excerpt

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## *Introduction*

Late in the nineteenth century a new form of capitalism emerged in Great Britain and the United States. Before the revolutions in modern communication and transportation, the owners of firms personally managed the processes of production, distribution, transportation, and communication. Generally, these business enterprises were family run and comparatively modest or small in size. By the end of the century, however, technological innovation and mass markets fostered the development of large-scale corporate structures, engendering the separation between owners and operators. In this new form of capitalist enterprise managers were increasingly the principal decisionmakers. Accordingly, an economic order controlled by small-scale, family firms gradually gave way to one dominated by giant corporations and managerial capitalism. In both nations this economic transformation spawned social and political tensions, compelling the public and policymakers to decide upon the appropriate response to big business.

A primary focus of public discourse was antitrust. Before World War I the British considered but rejected antitrust; in America, however, it became a fundamental political and cultural value. During the 1920s, as Britain's corporate economy gradually caught up with the United States in its reliance upon managerial centralization, the demand for government intervention grew. Large and small business groups, labor, economic experts, and publicists debated the appropriate policy. Eventually, supporters of governmentally supervised cartelization and monopoly won.

During World War II, however, a new consensus emerged in Britain. Based upon the use of administrative investigation, publicity, and ultimately the selective prohibition of certain trade restraints British policymakers hoped to foster full employment and economic efficiency. As a result, throughout the post-war era, despite

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differences in the mode of enforcement, the theory, practice, and outcome of each nation's antitrust policy gradually if unevenly converged. Generally, British and American officials consistently condemned cartels, while maintaining a more ambiguous policy toward corporate concentration and merger. Near the end of the century, these policies encouraged each nation's corporate big business to adopt flexible management structures, facilitating adjustment to increasingly uncertain economic conditions.

In a comparative context this study explores the development of big business and the antitrust response. It attempts to show that government policies influenced the point at which managerial capitalism prevailed first in America and then Britain. The study also suggests that the search for these policies reflected the adjustment of the business order to changing economic conditions before and after managerial capitalism triumphed. Examined on one level is the relation between public policy and four distinct merger waves which over a century shaped the structure of each nation's corporate economy. At another level the study considers the relative importance of private interests and pressure groups working through the political process and the courts. On still another level the role of economic experts and economic thought is examined. Despite failures and inadequacies, antitrust often facilitated the development of flexible management organization which enabled giant corporations to more effectively adapt to changing economic conditions. After managerial capitalism prevailed, moreover, antitrust increased the opportunity of smaller firms by limiting restrictive practices.

World War I was a turning point in the development of big business. Until the late nineteenth century family firms and relatively small-scale enterprise dominated the British and American economy. During the 1880s the businessmen of both nations first developed new forms of large corporate enterprise, but it was the great turn-of-the-century merger wave which established the foundations of a new economic order. Nevertheless, in Britain the family firms accommodated large-scale corporations and, to a relatively greater extent, retained control. In America, however, small business lost that control to corporate managers. By World War I British businessmen thus adopted legal and market innovations to preserve their independence. In America, by contrast, giant corporations operated by professional managers prevailed. At the same time, loose

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restrictive structures increasingly were the norm in pre-war Britain, while American managers established ever tighter centralized control through corporate merger.

In both nations, the problems of meeting increased cost through more effective organization were similar. A significant difference, however, was the law. The British courts permitted restrictive agreements but generally would not enforce them, encouraging corporate owners and merchants to establish mutually advantageous cooperative arrangements through negotiation and compromise. Many American businessmen entered into similar sorts of loose restrictive contracts. Yet, by the 1890s, state and federal law made loose restrictive trade practices not only unenforceable but also subject to legal prosecution. As soon as any of the parties felt the agreement was no longer useful they could sue, charging that it was a restraint of trade. In other cases, individuals who had sold their enterprise to a competitor who then possessed a monopoly could sue to break the agreement if they decided to reenter the business. In either instance, the availability of a legal cause of action facilitated conflict rather than compromise.

Changes in government policies coincided with the start of the first merger wave. Before the turn of the century American state laws and the Supreme Court's interpretation of the Sherman Antitrust Act outlawed cartels while, ironically, encouraging various forms of mergers. Basically, there were three individual merger structures: the common law trust, the asset acquisition, and the holding company. While American courts rarely condemned the merger itself, they often struck down the restrictive covenants related to the merger. Particularly in the case of asset acquisitions, American judges almost always found the basic acquisition to be legal, but often overturned attendant covenants not to compete as violations of the common law of trade restraints. Eventually, federal authorities and the Supreme Court encouraged these ambivalent results by applying a new rule of reason. British law, by contrast, permitted most cartel practices and mergers. The courts even modestly altered the traditional restraint of trade rules affecting contracts by adopting a more flexible rule of reasonableness, ultimately enabling British firms to enforce restrictive agreements. The different legal rules governing loose and tight business structures facilitated the persistence of British family enterprise on the one hand and the triumph of American managerial capitalism on the other.

After World War I both nations' business enterprises increasingly used mergers and cartels to ameliorate the problem of enforcement. During the 1920s each country experienced a second major merger wave, with the result that the British corporate economy began more closely to approximate that of the United States. Still, significant differences remained. Not until after World War II did the depth of managerial centralization within British big corporations approach their American counterparts. Throughout the same period, the extent of peacetime cartelization was greater in Britain except during America's short-lived National Recovery Administration. During World War II each nation's government controlled the economy. Yet the return of peace paved the way for the merger wave of the 1960s, and Britain closed the gap in managerial organization. Accordingly, the multidivisional corporate structure characterized each nation's corporate economy. Convergence continued in the 1980s merger wave when conglomerates increasingly prevailed though, in each nation, these mergers were often entered into primarily to dismantle less profitable firms.

The connection between governmental policy and mergers also continued after World War I. In America the Supreme Court restricted the scope of the new Clayton and Federal Trade Commission Acts and applied the rule of reason to distinguish "good" from "bad" corporate giants. At the same time federal judges continued to outlaw overt cartel practices. By contrast, Britain's first brief experiment with antitrust under the Profiteering Acts ended in 1921. Thereafter British courts increasingly *enforced* restrictive agreements, while the government began promoting cartels and sanctioned changes in company law which fostered holding companies. The different mix of policies helped to explain the uneven development of corporate management and cartelization in each nation during the second merger wave.

After World War II Britain created permanent antitrust institutions, reversing the policy of the inter-war years. The Monopolies Act of 1948 and the Restrictive Trade Practices Act of 1956 established new enforcement policies which influenced the third and fourth merger waves. The same pattern was evident as a result of the enforcement of antitrust in post-war America. Thus, in both nations, a firm anti-cartel policy coincided with a fluctuating but generally more lenient mergers policy to encourage similar corporate structures.

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The strength of business self-regulation influenced the development of managerial capitalism. From the 1880s on, business groups, publicists, and experts used the idea of self-regulation or “self-government” to describe privately negotiated and enforced cooperative agreements within comparatively loose organizational structures. The idea embraced a wide range of practices, including weak informal gentlemen’s agreements, stronger trade associations, various forms of retail price maintenance, and quite sophisticated cartels. But, regardless of the form, the agreeing parties sought to restrict if not eliminate altogether competition. The use of these agreements did not end business conflict. Rather, depending upon the effectiveness of private enforcement, self-regulation maintained cooperation through ongoing negotiation or intimidation. Cooperative agreements, nonetheless, could be attractive to independent, generally smaller firms because it enabled owners to retain control. Preserving this independence, however, reduced the incentive to establish greater managerial centralization through corporate consolidation.

Creating the organizational efficiencies inherent in managerially centralized, big corporations required making what Alfred Chandler called a “three-pronged investment.” First was “an investment in production facilities large enough to exploit a technology’s potential economies of scale or scope.” The second prong was “an investment in a national and international marketing and distributing network, so that the volume of sales might keep pace with the new volume of production.” Thirdly, in order “to benefit fully from these two kinds of investment the entrepreneurs also had to invest in management.” The recruitment and training of managers was essential “not only to administer the enlarged facilities and increased personnel in both production and distribution, but also to monitor and coordinate those two basic functional activities and to plan and allocate resources for future production and distribution.” According to Chandler it was this “three-pronged investment in production, distribution, and management that brought the modern industrial enterprise into being.”<sup>1</sup>

Before World War I British but not American firms generally failed in this regard. The turn-of-the-century merger wave represented the American success in making the “three-pronged investment.” This success paved the way for the long-term superior performance of American big business until the middle of the

twentieth century. Despite important exceptions such as Guinness, Lever, Dunlop, Pilkingtons, Courtaulds, Nobels, Brunner, Mond, and Metropolitan Carriage, however, British firms suffered “entrepreneurial failure.” According to Chandler, this was the “failure to make the three-pronged investment in production, distribution and management essential to exploit economies of scale and scope.” Moreover, the “time period in which that investment could have been made was short. Once first movers from other nations had entered the British market, often supplementing their marketing organizations by direct investment in production, the window of opportunity was closed.”<sup>2</sup> During the second merger wave, British companies began catching up, said Leslie Hannah, developing “managerial hierarchies as deep...[and] as well-trained and professional, as those in America.”<sup>3</sup> This process was still underway until after World War II.

Chandler and Hannah suggested that the persistence of cartelization contributed to Britain’s entrepreneurial failure. The present study explores and provides support for their suggestion.<sup>4</sup> The rise and triumph of the British system of business self-regulation coincided with the failure to make the three-pronged investment which had established the basis for American industrial dominance. The system permitted and often actively encouraged smaller firms to retain their independence within looser organizational structures. It also sanctioned horizontal trade restraints between firms in the same industry and vertical restrictive agreements between producers and distributors. In either case, the ability to maintain and ultimately enforce self-regulating cartel practices discouraged the investment in “managerial hierarchies” upon which the triumph of managerial capitalism depended. Indeed, in the United States the use of antitrust to outlaw cartels channeled investment decisions toward mergers engendering greater managerial centralization. Before World War I, however, Britain’s sanction of cartels contributed to making the first merger wave smaller.

A policy supporting both mergers and cartels promoted the rise of the British corporate economy during the 1920s. But not until Britain began attacking cartels did managerial capitalism prevail. Outlawing business self-regulation was part of the ongoing adjustment of antitrust policy and business to changing economic conditions. At no point after either America or Britain declared self-regulating restrictive agreements illegal did business stop

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resorting to them altogether. As a result, throughout the post-war era the policy of each nation's antitrust authorities converged on the need continuously to police cartel practices.

From the point that each nation instituted antitrust, the policy toward mergers and corporate concentration fluctuated. Yet, by the 1970s and 1980s, while concentration levels were higher in Britain, each nation's antitrust policy generally remained more tolerant of conglomerate and diversifying mergers than of horizontal combinations. Again, policy had converged. Unlike the case of cartels, however, officials in both countries encouraged flexible organizational structures better suited to a new post-war era of business uncertainty. Both Britain and America found it difficult to maintain competitiveness within the post-war global economy. At the same time the failure rate of mergers in both nations was high. Nevertheless, antitrust fostered a business environment in which many firms performed well, suggesting that whatever its inadequacies, antitrust often facilitated managerial effectiveness.

During the formative era of big business and antitrust the market influenced each nation's policymakers differently. The American market encompassed a vast continent in which a majority of the population did not live in major cities until 1920, fostering a clash between rural and urban market interests. In addition, the nation's federal system and constitutional tradition of judicial supremacy channeled market tensions into a wide array of political pressures suggested by the greater reliance on lawyers. In Britain, by contrast, the domestic market was not only geographically compact, but it had become predominately urban *before* large-scale corporate enterprise appeared. Also, export markets were of much greater importance to British industry than was the case in America. Moreover, Parliament was the single dominant legislative body, while the courts generally exercised self-restraint. Also, in Britain lawyers were much less important to business than accountants. As a result, compared to the United States the scope of market tensions manifested in interest-group pressures was narrower.

In both nations before World War I small and big business became distinct political interest groups. The United States differed from Britain, however, in having a majority of voters in agricultural or raw materials sectors. Small firms served these sectors. As small enterprise was threatened by the emergence of large corporations

(which were usually based in a few large northeastern and western cities) they formed political coalitions with other dispossessed groups. The thoroughly urban British market, by contrast, lacked major extractive sectors so that even if big threatened small firms there was no comparable basis for such coalitions. In any case, the compact market and export trade proved to be more amenable to the repeated negotiation of restrictive agreements British law sanctioned. Once the system of business self-regulation took hold, moreover, it facilitated a degree of cooperation between large and small business which helped to protect the latter. In America, however, both the law and the market fostered conflict between the two business groups.

The different experience of small business was part of a wider social milieu facilitating consensus or conflict. British legal rules governing restrictive trade practices, corporate consolidation, and combination generally reflected a consensus favoring Free Trade and business self-regulation. In British usage Free Trade and *laissez-faire* were very much distinguishable, applying Free Trade only to a policy of no tariffs or other barriers to international trade. Accordingly, for the British, restraint of trade and Free Trade were not inconsistent. Because of greater conflicts in values and interests the primary point of agreement found in American law was, by contrast, that despite the general belief in *laissez faire* some sort of government intervention was essential.

In order to accommodate the new phenomenon of large-scale enterprise, each country's lawmakers changed legal principles. Application of those principles, however, could not transcend the ideological, social class, political, and market relations that constituted the two nations' divergent experiences with big and small business. Increasingly, many British commentators blamed the relative decline of their nation's economy at least in part on the failure to develop centralized corporate management on a scale comparable to that of Britain's American and German competitors.

Social values also influenced the course of political conflict. The British system of class distinctions created a preference for greater economic cooperation and political consensus based on freedom of contract and Free Trade. Many British business leaders belonged to the ruling class which controlled social as well as governmental institutions. Although many political issues divided Liberals and Conservatives, shared class values sustained bipartisan opposition to

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government intervention along the lines of American antitrust. In the United States, however, voters considered the leaders of giant corporations to be the agents of corruption. Accordingly, big business threatened not only the hope of individual opportunity represented by small business but also the republican values sustaining free government itself. Despite the general belief in *laissez-faire*, therefore, the primary point of agreement was that the rise of big business required government action. Thus, in Britain, social values facilitated cooperation between large and small business, whereas in America they fostered intractable confrontation.

In each nation, a similar pattern characterized the relation of large and small business to labor. Although the business groups of neither country liked unions, British business and labor at least agreed on opposing antitrust. In America, by contrast, big business and labor resisted antitrust, while small firms used the policy to defeat unions. This victory prevented a political coalition with the influential labor constituency. Perhaps more significant in the long run, it contributed to ambiguity in antitrust laws which worked to the advantage of corporate giants.

After World War I market tensions and social values gradually changed. During the 1920s merger wave in Britain, the faith in rationalization eroded the Free Trade consensus. With the coming of the Depression, British policymakers embraced tariff protectionism and formally promoted self-regulating restrictive agreements. The growth of the corporate economy resulting from the merger movement hurt many small firms. They nonetheless lacked the sort of political allies American small business had had in the less urbanized market before 1920. In addition, many other small enterprises remained protected within the system of self-regulation, further undercutting political pressure for American-type antitrust.

During World War II, Labour joined many Conservatives in the belief that post-war full employment and economic efficiency required the development of some sort of antitrust policy. Large and small British business groups helped to shape the consensus favoring the investigation-publicity approach of the 1948 Monopolies Act. When first Labour and then the Conservatives directly attacked restrictive practices through measures which culminated in the Restrictive Trade Practices Act of 1956, however, smaller firms fought back. But, by then, small business was too divided to overcome the new consensus favoring government intervention. Throughout the

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rest of the post-war era, the antitrust policies enacted by both Labour and the Conservatives remained within that consensus. The dramatic growth in the role of British lawyers in mergers and acquisitions suggested the scale of the change.

During the seventy years following World War I, the change in America was generally less pronounced. By 1920 the dissipation of the market tensions driving small business resistance coincided with the triumph of managerial capitalism. Throughout the 1920s and 1930s segments of both large and small business cooperated in a campaign against antitrust. By the start of World War II the old antagonism revived, though throughout the remainder of the century it was episodic. Gradually, Americans' greater preoccupation with economic efficiency and consumer welfare eclipsed the moralistic concerns reflected in republican values. During the economic contraction of the 1970s and 1980s the emphasis upon efficiency dominated federal antitrust policies and court decisions. Meanwhile, the increased antitrust prosecutions of state attorney generals represented a return to the older antitrust tradition. Whether the state statutes were the harbingers of a more vigorous era of antitrust response to big business was unclear. Nonetheless, that any change would fundamentally shake the commitment to economic efficiency was doubtful.