Introduction

There is perhaps nothing in U.S. society that is both more pervasive and yet less understood than the business corporation. In popular discussion of the modern business corporation the loudest voices seem to assume an almost religious fervor. The detractors, or “corporation beaters,” see the corporation as something akin to the devil incarnate in the modern world. They see the business corporation as the new leviathan, a huge, artificially created monster, trampling all in its path – people, environment, political institutions, and so on – showing no regard for anything beyond its own insatiable appetite for money and power. On the other side of the debate we see an almost religious devotion to the corporation. It is viewed as the master creation of modern society, a vehicle by which human society has become capable of creative power never before imagined, the natural outgrowth of the marvelous market mechanism whose “invisible hand” coordination of human economic activity guarantees both the highest possible level of production and the most optimal patterns of distribution and allocation.

Unfortunately, all the impassioned pleas that we hear in the public forum about “protecting people and the environment from the giant corporations” or about “getting the government off business’s back” fail to reflect an understanding of the modern business corporation matching their passion. These pleas serve relatively little purpose. Understanding the corporation, however, is crucial for the well-being of contemporary society. No amount of corporation beating will make the large business corporation go away. Corporations have become a thoroughly established part of our social and economic environment. Unless we should move into a completely socialistic economy, in which case the government would come to assume the various roles played by corporations in our present society, the corporation will continue to be with us.

The corporation beaters, however, are little worse off than the corporation devotees. While it is clear that the corporation is with us to stay, it is also clear that it is an institution in turmoil. Whether we read in our newspapers about the balance-of-payments problem and
2 The corporation as anomaly

the noncompetitiveness of U.S. business in world markets, about corporate takeovers, junk bonds, and the savings and loan disaster; any of the large number of best-selling books written since the mid-1970s on the “crisis” in American management; or the more theoretical discussions of management theory that have emerged among management scholars, it is clear that a large number of corporations have not been operating particularly well. The economic performance of a significant number of corporations has been no better than what the critics of corporate business claim the social performance of corporations has been. Most commentators who go beyond reciting depressing statistics seem to agree that we simply don’t understand the business corporation very well.

By this I do not mean to say that we lack any theoretical framework within which to place the corporation. Rather, the problem is quite the reverse. We have a number of conflicting and contradictory theoretical frameworks within which different people and groups place the business corporation. The resulting theoretical disagreement creates confusion. Moreover, the theoretical framework for the corporation that has been most dominant in framing public policy relative to the corporation and has also been most dominant in forming the general public’s perspective on the business corporation is an economic-theoretical framework that is woefully inadequate to the task of providing a sound understanding of the managerial corporation.

Most discussion of the U.S. economic system generally, as well as most discussion of the role and obligations of business corporations within U.S. society, appears to be premised on the view that corporations are simply artificial persons and that their behavior in the market is substantially the same as that of other persons. Given the dominant economic view that individuals invariably act as maximizers of their utility, this translates into a view of the business corporation as an individual acting in the market to maximize its utility. Customarily, the utility of the business corporation is held to be money profits. This view claims to descend from the economic works of Adam Smith, written now over 200 years ago. There is a sense in which that view does descend from the economic theory of Smith. Yet despite that fact, most economic theorists prior to this century viewed the modern form of corporate business, a form in which business control is exercised by salaried executives, as either unworkable or incompatible with the working of a free market economy.

In spite of that fact the economic tradition that arose out of Smith’s work has evolved over time to include a view of the business corporation as simply another kind of economic individual, governed by
the same self-interest that it claims governs all economic individuals. That same tradition has also come to dominate our thinking and guide our policy making about economic issues in general. As a corollary, public policy makers and much of the general public have come to accept the now traditional economic view of the corporation as well.

Yet while it may seem to be plausible for economists, policymakers, and a significant part of the general public to view the business corporation as just a bigger and more powerful individual agent in the market, it is clearly not plausible for business managers and for management theorists to so view the corporation. Whatever may be said for the view that the market brings about an invisible hand coordination of economic activity apart from any conscious economic planning on the part of the larger society, the name of the game in business management is conscious coordination of the economic activity of those who make up the business enterprise. Managers and management theorists, therefore, have tended to recognize that the business corporation is an institution composed of many and varied interests, which interests it is the job of the manager to coordinate into a coherent pattern of business activity. This recognition has given rise to a number of emerging alternative theoretical approaches to the business corporation.

The result of the advocacy of such a wide variety of theoretical perspectives on the business corporation has been little short of mass confusion. Not only does this confusion infect the theoretical understanding of the business corporation as various sorts of academics attempt to understand the corporation, it also infects our collective view of the appropriate role of the business corporation in contemporary society as that role is shaped by policymakers in response to a variety of public pressures. This book is an attempt to provide some general direction toward the resolution of that confusion.

The project that I pursue in this book is primarily the development of a case study in the philosophy of science. I shall be concerned to look at the managerial business corporation as it has been treated in theory. While organizational and management theorists have had a great deal to say about corporations recently, it still remains that the dominant theoretical perspective on the business corporation is that which is developed within traditional economics. This is not surprising, because the business corporation is most immediately an economic institution. Moreover, a large part of public policy as it relates to business corporations is economic policy. Yet perhaps most importantly, the discipline of economics is simply far better established and is far broader in scope than are the disciplines of management science and
The corporation as anomaly

Organizational science. Because of the entrenchment of the economic discipline and the esteem in which economics is held by most policymakers, it is quite natural that the view of the corporation which emerges from economic theory should exercise a greater impact than the views of the corporation which come from far newer and less well established disciplines. Likewise, it is also quite natural that policymakers who accept a general theory about economic phenomena should equally accept the part of that theory that deals with the business firm.

Unfortunately, the view of the corporation that arises from traditional economic theory is woefully inadequate. Both the inadequacy of that view and the reason for its continued dominance can best be understood by examining the way in which it has developed as a part of the economic tradition. That examination thus leads me into an exercise in the history and philosophy of economic science.

The basic point I wish to make is that the development of the modern business corporation has presented a significant anomaly to traditional economic theory. As Alfred Chandler notes:

Those institutional changes which helped to create the managerial capitalism of the twentieth century were as significant and as revolutionary as those that accompanied the rise of commercial capitalism a half a millennium earlier. . . . The appearance of managerial capitalism has been, therefore, an economic phenomenon.¹

Unfortunately, the mainstream of contemporary economic theory has carried on its theoretical endeavors as if this “economic phenomenon” didn’t really constitute anything fundamentally new in the economic world. I shall argue that the way in which traditional economic theory has attempted to accommodate itself to the existence of the corporate form of business operation has been unsuccessful, and that a fairly radical revision of economic theory is required if economic theory is to be able to give a satisfactory and comprehensive explanation of economic phenomena in a world in which corporations are among the chief economic agents.

The first step in this phase of the project is to show that the development of the marginalist theory of the firm, now so widely accepted among economists, did in fact constitute a very significant, albeit generally unrecognized, change in the character of the economic tradition that has come down to us from Smith. The development of a theory of the firm was not simply a natural outgrowth of the economic doctrines presented in The Wealth of Nations. Rather, it constituted a serious attempt to accommodate the old economic theory to
Introduction

a significantly different kind of economic phenomenon. In Chapter 1 I contrast the views of earlier economic theorists (up to John Bates Clark writing in the early twentieth century) who saw the corporate form of business either as something that shouldn’t be expected to work or as something that contravened the fundamental laws of the operation of the free market, with the contemporary economic view that takes the corporation as a perfectly natural part of the economic landscape. This in itself should suggest that the firm recognized by contemporary economists as so natural a component of their later theory was viewed by earlier economists as a creature quite alien to their earlier stages of economic theory. I then go on to identify the fundamental character of the theoretical change that occurred in the transition and explain why it has not generally been recognized as a significant change.

The second step is to show that the assimilation of the managerial corporation into economic theory has not been very successful. In order to do this I need to trace out that process of assimilation. Yet that tracing itself requires a set of categories for analysis.

Because economic theory has been developed into such a highly systematic body, I shall assume that the general categories which have been developed for the analysis of the history and philosophy of science can be fruitfully applied to give us an understanding of the history of economic theory. Given this, I argue in Chapter 2 that the history of economic theory can best be understood from the perspective of Larry Laudan’s “reticulated model of scientific justification.” Most discussion of the history of economic theory thus far has been carried out, first, from the perspective of Sir Karl Popper’s evolutionary view of knowledge; later, from the perspective of Thomas Kuhn’s notion of science as a “paradigm-bound” activity; and most recently, from the perspective of Imre Lakatos’s “methodology of scientific research programmes.” I argue in Chapter 2 that each of these earlier approaches suffers from weaknesses that are remedied in Laudan’s approach. Armed with Laudan’s methodological approach, I give in Chapter 3 a thumbnail sketch of the history of economic theory since Smith, focusing on fundamental changes in the explanatory aims and methods of economic theory and on those aspects of theory that are relevant to the eventual development of the modern theory of the firm.

While the economic tradition as it has descended from Smith is often presented as more or less of a monolith or, in Kuhnian terms, a “single paradigm,” by the end of Chapter 3 it should be clear that while we can make some sense of the notion of an ongoing tradition,
The corporation as anomaly

there are clearly significant and discontinuous changes within that tradition. In Chapter 4 I examine the extent and location of agreement and disagreement within the economic tradition. I argue that the elements of agreement are far more modest than the customary presentation of economics would have us believe. In particular, I argue that the points of agreement within the tradition are limited to three: a commitment to a methodological individualism that views all economic activity as some kind of arithmetic function of the behavior of individual agents, a commitment to the view that human economic activity is generally self-interested, and a commitment to the preferability of invisible hand or unconscious coordination of economic activity. The first and last of these three points prove particularly troublesome in the attempt to understand the operation of an economy dominated by managerial-corporate coordination of business activity.

In Chapter 5 I narrow my focus to look at three major approaches to theories of the firm, noting in particular how behavioral and managerial theories differ from the dominant marginalist theory of the economic tradition. I go on in Chapter 6, then, to explore the chief points of weakness in the marginalist approach to the firm. Most significantly, I argue that the marginalist theory of the firm suffers from a very narrow explanatory scope and does so primarily because it fails to account for the collective character of the modern business corporation.

Given what emerges as the clear inferiority of the marginalist theory of the firm in the face of its major theoretical rivals, it may initially seem that such a theory could only be held on the basis of some form of collective irrationality, perhaps, as some have charged, a commitment based on political ideology rather than scientific critical objectivity. I conclude Chapter 6 by arguing that there are very good theoretical reasons for the continued dominance of the marginalist theory of the firm. In particular, the marginalist theory of the firm is a part of the broader and more comprehensive marginalist program in economics. As a result, the marginalist theory of the firm must be judged not merely as a theory of the firm, but also as a part of a comprehensive economic theory. It is on this latter ground that the dominance of the marginalist theory of the firm must be understood. While there are other theories of the firm that are both well articulated and clearly preferable to the marginalist theory, there is no general economic theory that is both well articulated and clearly preferable to the general marginalist economic theory. The marginalist theory of the firm remains dominant, then, not because it is a good theory
Introduction

of the firm, but because it is a part of a fairly serviceable and more comprehensive theory that has no well-developed and serious rival.

This explanation of that dominance should hardly be very satisfying to the advocate of the marginalist theory. Thus, the final step in this project is to argue that a fairly radical revision of economic theory is required if it is to be able to give a satisfactory and comprehensive explanation of economic phenomena in a world in which managerial corporations are among the chief economic agents. If the marginalist theory of the firm is an inadequate theory of the firm and if it is a consequence of the more comprehensive marginalist theory of economics, it would seem that the inadequacy of the theory of the firm should eventually force some modification of the more comprehensive theory of which it is a part. This is precisely what I argue in the last two chapters of this work. In Chapter 7 I identify those characteristics of the managerial corporation that most render it anomalous for marginalist economic theory. In particular I note the role that profits play in corporate decision making, the role of various “stakeholder” or constituent groups in the functioning of the corporation, and the importance of corporate organization.

In Chapter 8 I argue that the central fact about the modern business corporation that makes it an anomaly for traditional economic theory is that the corporation is a genuine collective entity that features a very conscious “visible hand” type of coordination of economic activity. Such an entity must invariably prove anomalous to an economic theory committed to a reductive individualistic mode of analysis and to the ideal of unconscious invisible hand coordination of economic activity. A recognition of the collective and consciously coordinating character of the modern business corporation must sooner or later force a modification in economic theory, and do so in the direction of a theory that can include an account of collective as well as individual action, and a fortiori provide as important a place for conscious coordination of economic activity as for unconscious coordination.

While I think it is inevitable that the presence of corporations in our society must force economic theorists to develop a sound theory of collective action, and hence provide society with a theoretical understanding of the economy that makes good sense of business corporations, it is important to note that we do not need to wait for such a revision of economic theory before moving our public thinking about the corporation away from the individualistic invisible hand model of traditional economics. As I noted earlier, there is and has been for some time an emerging body of literature, mostly coming from business schools, that takes seriously the collective, institutional character
8 The corporation as anomaly

of business corporations. Some of this literature has focused on the appropriate role of business corporations in twentieth-century U.S. society. Some has focused simply on sound principles of business management. Whichever focus has been taken, the general recognition is that corporate business cannot in the long run be viable, either socially or economically, if it does not pay serious attention to its own institutional character.

Unfortunately there is no single institutional theory of the business corporation that has gained even close to as widespread an acceptance within any community of business scholars as the marginalist theory of the firm has within the community of professional economists. This, however, surely need not constitute an insuperable barrier to developing a public understanding of the corporation that would pay serious attention to the collective and institutional character of the corporation.

A recognition of what the modern business corporation really is—a social institution, a locus of collective action in which the varied interests of a number of individuals and groups are brought together and transformed into a more or less coherent pattern of group behavior in pursuit of at least partially convergent purposes—requires a number of changes in the ways in which we think about the economic world in general and about business corporations in particular. At the theoretical level, we must develop analytical tools that will allow us to explain collective economic action as well as we can currently explain individual economic action. More practically, the corporation can no longer be regarded as a purely economic agent (on the model of economic agency given in traditional marginalist economic theory) or perhaps even a purely economic institution. Rather, it becomes necessary to regard the business corporation as a political institution as well (if indeed a clear distinction between economic and political institutions is itself ultimately tenable). It must clearly follow from this that a rethinking is required of the appropriate relationship between society in general and the business corporation. (It is not at all clear that this applies equally to individual-entrepreneurial businesses.)

Equally it follows that we have a clearer basis for addressing the social roles and responsibilities of corporate business as we come to see corporations not merely as economic agents, but also as semipublic political and social institutions. Finally, a recognition of the political dimension of corporate business must lead us as well to a rethinking of appropriate forms of corporate governance. If the corporation is a “semi-public power,” as John Bates Clark suggests, then it is surely
Introduction

plausible to suggest that its governing structure should provide for the input of a broader range of constituencies than is now the case.

The directions in which I have been pointing, of course, carry well beyond the scope of this present book. Yet it has always been a fundamental commitment of the economist that theory serves practice, or, more particularly, policy. I am firmly convinced that a more satisfactory theoretical understanding of the managerial corporation as a component of a general economy must go hand in hand with a changed view of the appropriate place of the managerial corporation in society as a whole.

My central thesis in this book is that the key to rethinking the place of the corporation both in theory and in actual practice is to understand the corporation as a locus of collective action. It is my hope that this book will provide at least a modest step toward that rethinking.
CHAPTER 1

The hidden change in economic theory

The mainstream of economic theory is very often presented to us as a largely continuous and progressive development of a unitary general approach or ‘paradigm’, to use a term about which I shall have more to say later, dating back to the work of Adam Smith. A. W. Coats, for example, has claimed that economic theory has been “dominated throughout its history by a single paradigm – the theory of economic equilibrium via the market mechanism.”1 Similarly, D. Gordon has claimed that “Smith’s postulate of the maximizing individual in a relatively free market... is our basic paradigm. Economics has never had a major revolution; its basic maximizing model has never been replaced.”2 While one does hear talk among economists of “the marginalist revolution,” “the Keynesian revolution,” “the monopolistic competition revolution,” and so on, no one, I think, would claim that these so-called revolutions have altered the foundations of the way in which people have looked at the economic world in the same manner in which the Copernican revolution altered the foundations of the way in which people looked at the arrangement of the heavens. If political metaphors are at all apt, the above-noted changes in economic theorizing would better be viewed as changes in the ruling party in a widely popular and accepted constitutional democracy.

Whatever one might wish to say about the usefulness of Thomas Kuhn’s notion of “paradigm” in the attempt to understand the history of economic thought, it is clear at least that there has been something of a common thread running through the major developments in economic theory since the work of Smith. Yet it is equally clear that economic theory has undergone significant changes during the centuries that have passed since then.

Undoubtedly the changes in economic theory wrought by Jevons, Menger, and Walras (the “marginalist revolution”); the changes wrought by John Maynard Keynes; and those by Robinson and Chamberlin (the “monopolistic competition revolution”) have given contemporary economic theory a face that Adam Smith would have recognized only in outline. Yet I want to claim that there has been another kind of change in economic theory of equal or greater mag-